

PREM 19/1454

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Confidential Filing

Public Expenditure and
Cash Limits.

ECONOMIC

POLICY

Part 1: May 1979

Part 33: October 1985

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
2-10-85							
3-10-85							
4-10-85							
15-10-85							
17-10-85							
25-10-85							
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7-11-85							
8-11-85							
14-11-85							
20-11-85							
21-11-85							
26-11-85							
ENDS							

PREM 19/1454

PART 33 ends:-

HMT internal minute 26.11.85

PART 34 begins:-

HMT to ps/chief whip 5.12.85

Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in The National Archives.

1. Autumn Statement 1985, HMSO, November 1985
[ISBN 0 10 202286 0]
2. House of Commons Hansard, 12 November 1985,
Columns 431-443 "Autumn Statement"

Signed Wayland Date 9 December 2013

PREM Records Team



FROM: MRS R LOMAX

DATE: 26 November 1985

cc PS/Chief Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr Turnbull
Miss O'Mara
Mr Pratt
Mr Cropper
Mr Lord
Mr H Davies

1. W/W
2 pa.

MR CULPIN**CHANCELLOR'S TCSC APPEARANCE: OPENING STATEMENT**

I attach a final draft of the Chancellor's opening statement for use at his appearance before the TCSC this afternoon.

2. The Chancellor has decided to drop the prepared statement on privatisation. He will speak off the cuff, so there will be no hand out for the press on this subject.

A handwritten signature in cursive script, appearing to read 'Rh.'.

MRS R LOMAX

cc: B, TC, Dilzee, SG

CHANCELLOR'S OPENING STATEMENT TO TCSC, 26 NOVEMBER

This year's Autumn Statement is the fourth in the series. It sets National Insurance rates for the next financial year, and fulfils the Treasury's statutory duty to publish an economic forecast; but its main function is of course to give the results of the annual survey of public expenditure.

This year we have provided more detail than ever before. We have given a Departmental breakdown of likely spending in the current year. And we have shown forward plans for three years ahead, instead of just one. These changes respond to suggestions made by the Committee, and I am glad to see that they have been welcomed.

I know that the Committee is less happy about another change, which is the omission of a forecast "fiscal adjustment". But I believe this is no real loss. The fiscal adjustment was simply the difference between an early and inevitably uncertain forecast, on which no decisions were based, and a conventional assumption. It added nothing to understanding or evaluation of the public expenditure plans which, as I say, are the main focus of the Autumn Statement - nor did it either represent or foreshadow any policy decision.

For the Autumn Statement is not a preview of the Budget. It cannot report decisions on tax because I have not taken them. And the decisions on expenditure - which are genuine decisions - though important in themselves, represent only one side of the public sector's accounts, and thus inevitably carry no implication for the stance of fiscal policy either next year or beyond. To describe the Statement as reflationary or deflationary is thus, even in Keynesian terms, a logical absurdity.

I shall, as always, make my decisions on fiscal and monetary policy in the Budget. And they will be decisions to sustain the conditions which have brought us the prize of relatively non-inflationary growth.

PLEASE CHECK AGAINST DELIVER.

The record speaks for itself. We have held to a prudent fiscal policy, and reduced the PSBR from $5\frac{1}{4}$ per cent of GDP to a forecast $2\frac{1}{4}$ per cent this year. We have the lowest borrowing requirement, in relation to our national income, for 14 years: lower even than in 1981-82, when my predecessor with great courage presented a very tough Budget indeed. We have maintained monetary conditions tight enough to bring inflation down from double figures to $5\frac{1}{2}$ per cent, with the firm prospect of a further substantial fall next year. We have resisted every temptation to seek short-term advantage in ways that would have undermined the long-term strength of the economy.

The Autumn Statement confirms that, even if you exclude the proceeds of privatisation, we plan to keep public expenditure broadly constant in real terms. With a growing economy, this should permit a gradual reduction in the burden of taxation. But the timing and size of any reductions are uncertain, and must depend on the judgements that I have to make at Budget-time each year.

The Autumn Statement shows expenditure under control and the economy set for a fifth successive year of relatively non-inflationary growth, and into the sixth. That is the prospect, and I shall do my best to answer your questions on it today.

PLEASE CHECK AGAINST DELIVER.

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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Kenneth Baker MP
Secretary of State
Department of the Environment
2 Marsham Street
London
SW1P 3EB

NBN.

21 November 1985

Dear Kenneth,

NEW TOWNS' RECEIPTS

~~will request if required~~

Thank you for your letter of 12 November.

I am pleased to hear that your programme of new town disposals is running well, and that you expect a modest increase of receipts above forecast. I am also grateful that you are prepared to surrender the additional receipts. May I suggest that our officials get in touch to prepare the necessary PQ announcing the cash limit change.

I am copying this letter to the Prime Minister, the Chancellor and Sir Robert Armstrong.

Yours,
JH

JOHN MacGREGOR

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ce bc

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Nicholas Edwards MP
 Secretary of State for Wales
 Welsh Office
 Gwydyr House
 Whitehall
 London
 SW1A 2ER

NBE

21 November 1985

Dear Nicholas,

**LOCAL AUTHORITY CURRENT AND CAPITAL EXPENDITURE:
 SCOTLAND AND WALES**

Thank you for your letter of 7 November. Tom King also wrote to me on the same date and I have now seen George Younger's letter of 15 November.

will report if req'd.

I am grateful to you and George Younger for your understanding of my difficulties with your requests for compensation for English overspending on local authority capital; and for your acceptance that there should be no change to baselines as a direct result of English local authority capital overspending in 1984-85. I hope that Tom King will now also accept that conclusion for his block. I agree that allocations in Wales can be set on the assumption that local authorities will use 83 per cent of the total spending power available to them, as in England.

I am sorry that there should have been a misunderstanding about what had been agreed in the past. To ensure that there is no misunderstanding in future, I should perhaps repeat what I said in my letter of 6 November: that I do not think it would be right to base provision for Wales and Scotland on levels of spending in England which exceed what we intend and provide for. The right approach cannot be to validate English overspending throughout the UK, but rather to get it under control. I have consistently aimed at that objective in my Survey discussions. While we cannot be certain about the outturn result, I believe that our decisions are consistent with my objective.

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On current expenditure, I confirm that I was generally content with the wording you proposed for use in the Public Expenditure White Paper and at the time of the Autumn Statement. I note George Younger's concern that discussions with Scottish local authorities will be more difficult because they will not be based on figures based on any claim to realism. But you and he (like colleagues in English spending departments) are free to side-step that difficulty by making it clear that no decisions have yet been taken for 1987-88 and 1988-89.

As regards the assurance I have already given you and George Younger, I confirm that the sums required to bring the Welsh and Scottish baselines for local authority current expenditure in 1987-88 and 1988-89 up to the level they would have reached under the normal operation of the formula in the 1985 Survey will be added after publication of the Public Expenditure White Paper to provide the starting point for the 1986 Survey. The exact figures can be agreed between my officials and yours (and George Younger's) but will be roughly £43 million and £45 million in Wales and £5 million and £14 million for Scotland.

As regards any further additions to the English local authority current baseline, I agree that Wales and Scotland should receive full formula consequentials of any addition which is allocated to services and GREs. However, if the 1986 English RSG settlement throws up an arrangement which is not fully covered by that, we may need to consider the question of consequentials at the time. I had already said that I would be content for you to use some of the £43 million and £45 million additions for Wales for capital rather than current, and I have no objection in principle to your doing the same for any further formula consequentials. But the figures will need to be discussed and agreed with the Treasury at the relevant time.

I am copying this letter to the Prime Minister, George Younger, Tom King, other members of E(A) and Sir Robert Armstrong.

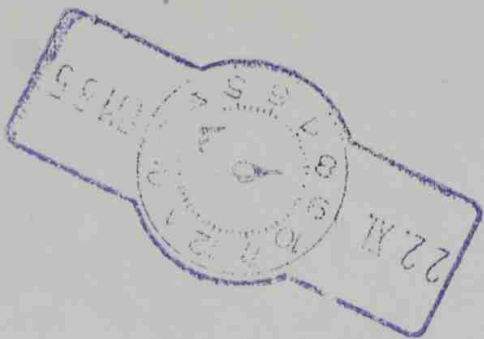
Yours ever,
JM

JOHN MacGREGOR

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Public Exp: Recon Pol

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cc BGI



pa

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon George Younger TD MP
Secretary of State for Scotland
Scottish Office
Dover House
Whitehall
London
SW1A 2AU

Ponnie Quinlan 2

This is right*. But
it will cause angst.
I suggest you should not
intervene.

m.

DRS

20 November 1985 20/11.

* and is more evidence of
a tougher approach by the
Treasury.

at flap

[Handwritten scribble]

Dear George,

**HOUSING SUPPORT GRANT INCREASE:
OFFSETTING SAVINGS**

As you will be aware from my minute of 31 October to the Prime Minister we are facing the prospect that claims on this year's Reserve will go beyond the amount available. The Prime Minister, sharing my concern, subsequently asked that colleagues take every possible measure to keep within the resources available to them and to avoid bids against the Reserve.

I approved a Winter Supplementary Estimate from your Department for Housing Support Grant. Approval was unavoidable in the circumstances of this programme, but the Supplementary Estimate involved a claim on the Reserve of £15.686 million. The increase in provision of £15.941 million for Housing Support Grant is offset by a net reduction in other public expenditure elements of the Vote of £255,000. The reduction of £3 million in provision sought for Housing Association Grant is directly offset by an increase of the same amount in expenditure funded by the NLF.

The increased expenditure on Housing Support Grant is a result of changed economic assumptions and under the so-called "Concordat" would normally be accepted as a charge on the Reserve. However, in the correspondence establishing how the Concordat would operate when the Reserve was first operated in its present form, in April 1984, the Treasury reserved the right, if the Reserve as a whole appeared to be under threat, to seek offsetting savings (in full or in part) from within the Scottish block or, failing that, from other expenditure within your control. Regrettably, that condition is, at present, satisfied.

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I should therefore be grateful if you could let me know your proposals for generating savings of £15.686 million to offset this claim on the Reserve. These might include reductions in cash limits where these are not expected to be fully spent during the course of the year. This is similar to what was done earlier this year when part of the cost of the special relief to Scottish ratepayers was met from underspending in 1984-85 that would otherwise have been carried forward to 1985-86.

I am sending a copy of this letter to the Prime Minister.

Yours,
JH

JOHN MacGREGOR



THE AUTUMN STATEMENT

1. The response of the markets to the Autumn Statement was bullish. The market is delighted with the strong performance of the economy, but also sceptical regarding:
 - a. the presentation of asset sales;
 - b. oil prices;
 - c. unit labour costs;
 - d. the dropping of £M₃.

2. Your own doubts regarding the relationship between public expenditure and asset sales are well based. Peter Middleton made an important point this morning: the danger of an adverse market response to present fiscal policy will come in the run-up to the next Budget, especially if the market feels that the Chancellor is taking a risk by the likely size of the intended tax cuts.

3. The discussion over public expenditure and asset sales within the Autumn Statement boils down to three simple points:
 - a. If there were no asset sales next year, then:
either the PSBR would be higher;
or public expenditure would be lower and taxes higher.

 - b. Even excluding asset sales, the ratios of
$$\frac{\text{PE}}{\text{GDP}} \quad \text{and} \quad \frac{\text{PSBR}}{\text{GDP}}$$
are nevertheless on a downward path, as set by the MTFS.

 - c. The reason public expenditure is enabled to increase but not get out of hand is the very buoyant recovery of the economy.

Note a
point for
public
use.

Brian Griffiths

BRIAN GRIFFITHS

PRIME MINISTER

PUBLIC EXPENDITURE

This has been a curious day and you should have a report on it.

Yesterday I was fearful that we would get an appalling press - all U-turns, rip-roaring spending, tax cuts and a snap election in 1986.

There was enough in the media reaction to your Lord Mayor's banquet speech to reinforce these fears.

I had no doubt last evening, after the Autumn Statement, that we should get a battering. U-turns. Let rip. Political advantage, etc. We have had all that, but curiously without conviction.

As the Daily Mail said this morning: "... it would be totally out of character for either he (the Chancellor) or Margaret Thatcher, to stop pile driving [ie building sound foundations] and start jerry building."

As of now, I believe that you and the Chancellor are living on your reputations.

This is not a question of whether you are right or wrong. Most people haven't a clue either way. But their gut feeling is that they don't believe you are for turning, after six years.

What therefore you and your colleagues have to do is to:

- extol the virtues of prudent, tough, careful management of the country's finances

- explain that the economic performance as a result of this prudent management is creating more resources for both public and private sectors
- you are not by any stretch of the imagination privatising for "family silver" reasons but because private management produces more wealth for public as well as private good
- the amount of public borrowing is falling by any calculation as a proportion of GDP
- therefore, if all things are equal and unchanged, you hope to reduce taxes
- But, there is a long way to go to next Budget/Spring; don't count your chickens
- but do count on the Government to put nothing - and most of all inflation - at risk
- after 6 years' hard work this Government is not now in the business of throwing it away; it is in the business of winning a third term in the interests of the country.

But what interestingly has happened is that the markets are OK. The Opposition is in a state of frustration/sulk/defeat because it does not know where to turn. [The Daily Mail said this morning that the "Opposition ... looked and sounded in the Commons as if they had just lost the next election."]

But perhaps most important - after the markets - the press are not interested. They are concentrating on the Anglo-Irish Summit.

This leaves me with the thought: when you have two problems
announce each on successive days.

One other plus point: I am astounded that the housing shock
condition report has attracted so little notice. This is a
vindication of the policy of involving the Lord President,
Chief Whip and myself in awkward presentational problems so
that we can hammer them out.

So far, so good. We can't count on it lasting.

But remember your are not turning, have not turned and will
not turn.

That's the Maggie they know.



BERNARD INGHAM

13 November 1985



CONFIDENTIAL

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

Prime Minister 2

A small plus
point for Mr Baker.

12 November 1985

Dear Mr,

DR N
13/11

mb

Thank you for copying me your minute of 31 October to the Prime Minister. In your PS you asked me whether there are likely to be any additional new town receipts this year which can be surrendered to the Reserve.

I am glad to be able to say that our programme of new town disposals is indeed running well this year. Our latest forecasts suggest that we can increase the estimate of receipts from disposal of commercial and industrial properties from £100.75m to £115m. As you know, I should have liked to transfer some of these additional receipts to support some of my other hard-pressed programmes. But in view of the general position on the Reserve, I am prepared to forego this and to surrender the additional amounts to the Reserve.

I am copying this letter to the Prime Minister, Nigel Lawson, and Sir Robert Armstrong.

Handwritten signature of Kenneth Baker

KENNETH BAKER

Public exp.: Econ Pol

PC 33



Econ Pol. Public Exp.
PC 33

SECRET



10 DOWNING STREET

From the Press Secretary

Robert Culpin Esq
Head of Information
HM Treasury
Parliament Street
London SW1

11 November 1985

Mr. Wicks

The Chief Whip, by arrangement with the Chief Secretary, asked me to prepare a layman's speaking note on the Autumn Statement for his purposes.

I attach my draft which I need to have cleared by 10am tomorrow (Tuesday).

The information on which it is based has been quarried from the draft brief. I am clearing each paragraph in the annex with the affected Departments.

I am copying to the Lord President, the Chancellor of the Duchy of Lancaster, the Lord Privy Seal and the Chief Secretary, as well as the Chief Whip.

John Burt

Bernard Ingham

BERNARD INGHAM

SECRET

SECRET

DRAFT SPEAKING NOTE - AUTUMN STATEMENT

The Autumn Statement on public expenditure, made today (November 12, 1985), like the Queen's Speech last week, seeks to build on the progress made by the Government's policies of maintaining sound money and encouraging enterprise.

These policies have brought the longest period of sustained economic growth since the war combined with low inflation and a balance of payments surplus. And the encouragement of enterprise has helped to generate 677,000 new jobs over the last couple of years - more than in the rest of the European Community put together.

What is more, the outlook for the next year on growth (up another 3%), on inflation (down to below 4%) and on trade and job creation is set fair.

The review of public expenditure which led up to today's Autumn Statement has reinforced this prospect because it has held public spending broadly stable in real terms (ie allowing for inflation) over the next three years - the period covered by the review.

By keeping spending steady in real terms during a period of economic growth the Government is thus planning to reduce the proportion of national income taken by the State. That will leave more resources for industry, commerce and the individual. And this is, of course, consistent with the Government's further aim of reducing the burden of taxation and so encouraging enterprise and job creation.

Government revenue, including taxation, is the other side of the equation from public expenditure. This is dealt with in the Budget in the Spring.

SECRET

No decisions have yet been taken about fiscal policy and the Autumn Statement deliberately offers no guide to any likely room for manoeuvre by the Chancellor of the Exchequer. Experience has shown that information given in the past, inevitably incomplete so far in advance of the Budget, has been misinterpreted.

With investment at an all time high, company profits at their highest level since the early 1970s and signs that unemployment is flattening out, the major threat to the longest recovery since 1945 remains excessive pay settlements. These only add to costs and therefore reduce our competitiveness at home as well as abroad.

The Autumn Statement shows that public expenditure is under firm control while at the same time allowing more to be spent on council house renovation, public health, social security, science, the arts, overseas aid and law and order.

The Government has achieved this by reducing the amount allowed next year for contingencies, within the planned total spending, from £6bn to a more realistic £4.5bn and making positive use of some of the money expected to be realised from the return of State industries to the private sector - a highly popular feature of the Government's efforts to increase competition in our economy.

The Autumn Statement thus strikes a careful balance between the Government's economic objectives and social priorities.

But the need for rigorous control over public spending remains if Britain's economic revival is to be carried forward. The planned totals for public spending for the three years ahead - broadly flat in real terms and

SECRET

3.

representing a decreasing proportion of total national income - underlines the Government's determination to keep a tight rein on spending.

Useful points from the Government's spending programme, announced today, are set out in the attached annex.

November 12, 1985

SECRET

SECRET

PUBLIC SPENDING - TALKING POINTS

1. To encourage employers to take on more workers, the earnings limit in the reduced rate bands for employers' and employees' National Insurance Contributions have been raised in line with inflation to maintain the relief; Class I rates of NI contributions remain unchanged for the third successive year.
2. The Autumn Statement does not assume higher energy prices. Price decisions are for the industries themselves taking into account, among other things, the financial framework within which they must operate. Domestic electricity prices are down 8% in real terms since 1979; and gas prices are down 4%.
3. The cost of the coal strike over the two years 1984-85 and 1985-86, taken together, is now estimated at £4bn - the equivalent of 4p off the standard rate of income tax.
4. Increased spending on social programmes can be summarised as follows:

Housing: the figures assume increased spending on council house renovation of £660m over the three years - an increase of 18% on the previous provision of £3.6bn over the same period.

Health: increased provision for the NHS will maintain the Government's record of increased spending every year since 1979. [Capital spending on the NHS has risen by 25% and waiting lists have fallen over the same period.]

SECRET

Social Security: No major policy changes have been announced in the Autumn Statement. Decisions on the social security review - the most fundamental look at the welfare state for 40 years - have still to be taken. The increased provision mainly reflects the consequences of a 7% uprating of benefits this month in line with the increase in the Index of Retail Prices over the 12 months to May 1985. The index is expected to be around 5.5% by the end of this year.

Science: The Science budget is up £15m a year to fund high priority research programmes. University funding is up £9m a year mainly to provide additional equipment to strengthen the research base.

Overseas Aid: The aid programme will be maintained to 1988-89 at the same level in real terms as in 1985-86. Another £20m has been allocated for 1986-87 and another £30m for 1987-88. The UK aid programme is the sixth largest among Western donors and the third largest in the European Community.

Arts: The Government remains committed to keep up the level of support. There is increased provision of over £19m and £17m in the next two years respectively for central and local authority elements of the programme. The increased provision is over and above the Government's decision in July to facilitate acceptance of works of art in lieu of tax, expected to be worth on average £10m a year.

Roads: Provision for capital spending on national and local roads has been increased by more than £150m over the next 3 years (£37m, £52m and £65m respectively).

NB: These increases are offset by increased sales of Government assets and the normal process of rolling forward the reserve within the public expenditure total contingencies.

5. MISCELLANEOUS

Defence: The current financial year will bring the seventh successive year of real growth in defence expenditure. The Government announced in 1984 that it would not aim to meet the NATO target of a real increase in expenditure after this financial year. Taking this into account, the totals announced in the Autumn Statement reflect no change in the planned provision for defence. This means continued improvements in capability because the MoD will retain the benefits of improved efficiency.

Urban Programme: Provision is maintained over the next three years. This programme (only a fraction of spending on inner cities) has tripled since 1979 from £93m to £338m in 1985-86. £1900m has been spent on the urban programme since 1979.

Environment: There is increased provision for local authority capital expenditure on local environmental services, Nature Conservancy Council; Countryside Commission; Royal Palaces and historic buildings; and ancient monuments.

November 1985

Autumn Statement

HOUSINGGOVERNMENT SPENDINGAUTUMN STATEMENT**

	£ million			
Cmnd 9428*	1985-86	1986-87	1987-88	1988-89
capital	**	3,250	3,210	3,110
current	**	1,100	1,100	1,100
receipts	**	-1,600	-1,480	-1,340
net	2,700	2,750(+220)	2,830(+200)	2,880

* adjusted to reflect transfer of central government housing administration to DOE

** see Defensive (iv)

HOUSING STOCK CONDITION INQUIRY

We recognise this is a problem and we shall be considering the findings of the inquiry with the local authority associations. We have already devoted considerable more resources to renovation both in the public and private sectors and the £220m increase in housing provision announced by my right honourable Friend for 1986-87 will enable even greater priority to be given to this work.

GOVERNMENT RECORDIn the Private Sector

- i) The number of renovation grants paid in private sector has averaged 150,000 a year under this Government; compared with less than 100,000 under Labour.
- ii) Under Labour expenditure on improvement and insulation grants fell from £431 million in 1974/75 (84/85 prices) to £175 million in 1978/79, a fall of 59 per cent. Under

this Government it has risen from £204 million in 1979/80 to £752 million in 1984/85, an increase of 268 per cent.

In the Public Sector

- i) The number of local authority renovations completed has run at 75,000 a year under this Government compared with 47,000 under Labour.
- ii) Under this Government spending by local authorities on the renovation of their housing has increased by 15 per cent in real terms and is now running at £1.1 billion a year. This is in addition to the £1.2 billion spent annually on day to day repairs and maintenance.
- iii) The additional provision announced by my right honourable Friend should be sufficient to renovate more than 750,000 dwellings.

Housing and Home Ownership

- i) The dwelling stock rose by 1.2 million between 1979/85; owner occupation increased by 2 million; building societies approved more than 1 million mortgages in 1984 for the first time.
- ii) Gross expenditure on housing (including house building) fell 50 per cent between 1974/75 and 1978/79, but a further 24 per cent between 1979/80 and 1984/85.

(A)

C. R. Middleton

D1

(ix) Historic comparisons of PSBR/Money GDP ratios

	Rounded PSBR	PSBR	Unrounded PSBR excluding privatisation proceeds	PSFD*	Per cent
1971-72	1 $\frac{3}{4}$	1.6	1.6	1.1	
1972-73	3 $\frac{1}{2}$	3.6	3.6	3.0	
1973-74	5 $\frac{3}{4}$	5.8	5.8	4.6	
1974-75	9	8.9	8.9	6.7	
1975-76	9 $\frac{1}{4}$	9.3	9.3	7.4	
1976-97	6 $\frac{1}{2}$	6.4	6.4	5.8	
1977-78	3 $\frac{1}{2}$	3.6	3.9	4.4	
1978-79	5 $\frac{1}{4}$	5.4	5.4	4.9	
1974-75 to 1978-79	6 $\frac{3}{4}$	6.7	6.8	5.8	
1979-80	4 $\frac{3}{4}$	4.8	5.3	3.9	
1980-81	5 $\frac{1}{2}$	5.4	5.5	5.1	
1981-82	3 $\frac{1}{4}$	3.3	3.3	2.2	
1982-83	3	3.1	3.3	3.0	
1983-84	3 $\frac{1}{4}$	3.2	3.6	3.9	
1984-85	3	3.1	3.8	3.8	2.09
1979-80 to 1984-85	3 $\frac{3}{4}$	3.8	4.1	3.7	
1985-86 (projected)	2 $\frac{1}{4}$	2.2	2.9	3.1	2.50

* Public sector financial deficit

Positive

- (i) Government's strategy to maintain monetary conditions which will bring about further reduction in inflation, supported by lower public sector borrowing, remains on course.
- (ii) Steady pursuit of MTFs policies has enabled economy to enter fifth year of sustained growth at average rate, so far, of 3 per cent a year, accompanied by fall in inflation from average of 15 per cent (and rising) under Labour to less than 6 per cent now (and falling).
- (iii) Autumn Statement confirms prospect of continued strong growth and falling inflation, with public expenditure as proportion of GDP continuing its downward trend since peak year of 1982-83.
- (iv) PSBR in 1985-86 expected to be lowest as percentage of money GDP (2 $\frac{1}{4}$) since 1971-72.

A, (B)

	Planning total		Planning total in Real Terms (1984-85 prices)		GGE as % of GDP	
	As defined	Excluding Privatisation	As defined	Excluding Privatisation	As defined	Excluding Privatisation
1971-72					41	41
1972-73					40½	40½
1973-74	29.3	29.3	111.9	111.9	42½	42½
1974-75	39.4	39.4	126.1	126.1	48	48
1975-76	48.9	48.9	124.5	124.5	48½	48½
1976-77	54.5	54.5	122.6	122.6	46	46
1977-78	56.8	56.8	112.2	112.2	42	42
1978-79	65.7	65.7	117.4	117.4	43	43
1979-80	77.0	78.0	117.6	119.1	43½	44
1980-81	92.7	93.1	119.3	119.8	46	46
1981-82	104.6	104.6	122.3	122.2	46	46
1982-83	113.4	113.9	123.8	124.4	46½	47
1983-84	120.3	121.5	125.8	126.9	45½	46
1984-85	129.7	131.8	129.7	131.8	45½	46
1985-86	134.2	136.7	127.8	130.2	44½	45
1986-87	139.1	143.9	126.8	131.1	43	44
1987-88	143.9	148.7	126.7	130.9	41½	43
1988-89	148.7	153.3	127.1	131.2	41	42

*Redman's public spending
as of 22/10/85*

AUTUMN STATEMENT: ORAL STATEMENT

L. S. M. S.

With permission, Mr Speaker, I should like to make a statement.

2. I am laying before the House today an Autumn Statement which brings together the Government's outline public expenditure plans, proposals for National Insurance contributions next year, and the forecast of economic prospects for 1986 required by the 1975 Industry Act.

3. This year's Autumn Statement contains considerably more information than its predecessors. It breaks new ground by providing a forecast of the public expenditure outturn for 1985-86 for each department, and the plans not just for the year immediately ahead but for each of the next three years. Both these innovations meet specific requests from the Treasury and Civil Service Committee and I hope they will be welcomed by honourable Members.

4. The outturn for this financial year is expected to be the same as set out in the Budget, that is, £134 billion. After allowing for inflation, this is lower than last year, which bore the brunt of the public expenditure cost of the coal strike.

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6. In order to meet contingencies, the plans contain large reserves, rising from £4½ billion in 1986-87 to £8 billion in 1988-89. The reduction in the reserve for 1986-87 as compared with the provisional reserve for that year which I announced at the time of the Budget chiefly reflects the fact that the passage of time allows part of the reserve in any given year to be allocated to individual expenditure programmes as their costs become known more accurately. But the £4½ billion reserve for the year immediately ahead remains a substantial figure.

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8. The PSBR would, of course, have been running at a higher level than this were it not for the proceeds from privatisation, to which I will turn in a moment. But even without the privatisation proceeds, this year's forecast PSBR would still be the smallest as a percentage of GDP since 1971-72.

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33. Overall, the economy in 1986 is expected to grow at a further 3 per cent - the fifth successive year of growth at an average of 3 per cent a year, and into the sixth; the best performance since before the first oil shock. At the same time, inflation is expected to fall further, to $3\frac{3}{4}$ per cent in the fourth quarter of 1986.

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10 DOWNING STREET

Prime Minister 2

This is nearly

final.

See in particular the
important point in para 11.

DRS
11/11



David

See subject to

Checking last minute

cheques (as is being attached)

Pro 11/11

Recd.

11/11

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4. The Government's objective of reducing the burden of taxation requires that public expenditure be kept under firm control. Following this year's review, the public expenditure totals for 1986-87 and 1987-88 will be held to the levels set out in the Budget - that is to say, £139 billion and £144 billion respectively. For 1988-89 the total has been set at £149 billion.

5. The outturn for this year, 1985-86, is expected to be the same as set out in the Budget, that is, £134 billion. After allowing for inflation, this represents a decline in real terms on 1984-85, which bore the brunt of the public expenditure cost of the coal strike. Over the next 3 years public expenditure will remain little changed in real terms from the level expected this year. With a growing economy, public expenditure as a percentage of national output will continue the declining path it has been on since 1982-83, and by 1988-89 it should be back to its lowest level since 1972-73.

SECRET

6. Although I see no reason at the present time to expect the public expenditure planning total outturn for this year to exceed the figure I set at the time of the Budget, I do now expect the PSBR for this year, 1985-86, to be about £1 billion higher than I envisaged in the Budget: some £8 billion rather than £7 billion. The reason for this is the shortfall in sterling oil revenues as a result of a higher sterling/dollar exchange rate than was assumed at the time of the Budget. But even £8 billion - and the margin of uncertainty at this time of year is still considerable - would imply the smallest PSBR as a percentage of GDP for 14 years.

7. A major development this year has been that, as a consequence of the growing momentum of the Government's privatisation programme, there will be a substantial increase in receipts from this source, from £2½ billion this year to £4¾ billion in each of the next three years. These revised figures include for the first time proceeds arising from the privatisation of the British Gas Corporation. In addition to the long-term economic benefits from transferring major state-owned businesses to the private sector, privatisation provides the opportunity for a massive boost to wider share ownership, both by employees and the general public.

8. In the light of this, the House will wish to know that, even if the proceeds from privatisations were to be ignored altogether, the public expenditure planning total would still be broadly level in real terms over the next three years and general Government expenditure would still be on a steadily declining path as a percentage of GDP

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SECRET

10. The regular annual review of public spending provides an opportunity to reconsider priorities and adjust the balance between programmes. While some programmes have had to be held back, for others it has been possible to make significant additions. But across all programmes there has been strong pressure for economies and greater efficiency. We must not fall into the trap of measuring programmes solely by the money put in: it is the output that is delivered that matters.

11. There will be increased spending on the National Health Service of £250 million in 1986-87 and £300 million in 1987-88. On top of this, Health Authorities are able to spend the savings from their cost improvement programmes which are expected to amount to £150 million this year and still more in future years. This should enable Health Authorities to meet demographic pressures and deliver improvements in services as well.

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26. The surplus on the current account of the balance of payments still looks like turning out at £3 billion, as forecast in the Budget, and the overall growth of the economy this year still looks like turning out at $3\frac{1}{2}$ per cent, as I forecast. [This will, incidentally, be the highest rate of growth we have achieved in any year since 1973.]

27. The pattern of growth has, however, been slightly different than I envisaged. At the time of the Budget, both the current spending of central and local Government, and total fixed investment, were forecast to rise at 2 per cent. In the event, it looks as if there will have been no increase at all in the current expenditure of central and local Government this year, but that total fixed investment will rise by 4 per cent. And within this latter figure, business investment is expected to be up by between 7 and 8 per cent.

28. As a result of this steady advance, the substantial growth in employment that has been taking place since 1983 has now been followed by a levelling out in unemployment - albeit at a painfully high level. The prospect here is for some improvement, not least because the measures I announced in the Budget to help on the jobs front, will have their effect in 1986. But that improvement could easily be put at risk by excessive pay settlements.

29. The overall prospect for 1986 is one of continued growth and still lower inflation. The composition of growth is likely to change somewhat, with consumer spending taking up the running as exports - which had an exceptional rise of 7 per cent this year - growing more slowly. Despite this the current account balance of payments surplus is expected to be even larger, at £4 billion, and fixed investment is forecast to grow, once again, slightly faster than the economy as a whole.

30. Overall, the economy in 1986 is expected to grow at a further 3 per cent - implying the fifth successive year of growth at an average of 3 per cent a year, and into the sixth - the best performance for over 20 years [check]. At the same time, inflation is expected to fall further, to $3\frac{3}{4}$ per cent by the fourth quarter of 1986 - again, the lowest figure since the 'sixties [check].

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CONFIDENTIAL

NOTE OF A MEETING HELD IN THE CHIEF SECRETARY'S OFFICE, TREASURY CHAMBERS, ON 8 NOVEMBER 1985

Present: Chief Secretary Secretary of State for Employment
 Mr Monck Mr Dawe
 Mr Turnbull Mr L Lewis
 Mr Shaw
 Mr Broadbent
 Mr MacAuslan

AUTUMN STATEMENT: ENTERPRISE AND EMPLOYMENT

The Chief Secretary, opening the meeting, said that it was necessary to follow up the remits in Mr Norgrove's letter of 7 November to Mr Lewis about the pilot schemes for the long term unemployed, the loan guarantee scheme, and the timing and content of announcements in the context of the Autumn Statement. He stressed that it would be impossible for the Treasury to consider making extra resources available at this stage.

Loan Guarantee Scheme

2. It was agreed that the Loan Guarantee Scheme should be extended under existing rules to the end of 1985-86, with the extra costs being absorbed by DE within the existing baseline, and with no commitment on the part of the Treasury as to what might be agreed for thereafter. There would be discussions between the Treasury and DE about the possibility of a successor scheme. Any announcement might be made in the Budget. It would be acceptable if the timing of the Budget meant that there was likely to be a short gap between the expiry of the existing scheme and the start of any successor.

Pilots to help the long term unemployed find jobs

3. It was agreed that, subject to satisfactory discussions between officials on the practical details, the Secretary of State should announce on Wednesday 13 November that pilot schemes would be set up from 1 January 1986 to test the effectiveness of a "guarantee" and an "enterprise" scheme for the long term unemployed. The pilots would last 6 months; they would take place in 5-7 areas (possibly including one each in Scotland and Wales) to be chosen with the agreement of the Treasury. Of these areas, about 3 might be devoted to the 2 year+ unemployed, and about 3 to the 1 year+. The areas would be defined by means of local authority boundaries.

4. The costs would be borne by DE within existing provision. The Secretary of State said that he could find £2.7m in 1986-87 from money offered but not required for ATP. DE would inform the Northern Ireland Office of the scheme before announcement, but would not offer to finance any scheme that might be proposed for NI.

5. It was agreed in discussion of whether the allowance should be taxable that a decision (in which the Financial Secretary should be involved) would be needed by Tuesday. The use of retrospective legislation would not be attractive.

6. The "enterprise" scheme was a necessary companion of the guarantee scheme at the pilot stage. All those applying for the "enterprise" scheme should be interviewed at Jobcentres.

7. Officials would have to discuss a number of issues, starting with a meeting early in the week beginning 11 November. These issues should include the evaluation procedures. The Chief Secretary expressed great concern that the procedures should be adequate. He would be asking his officials for a report back, following which he might want further discussion with the Secretary of State. It was agreed that the evaluation would be continuous; officials should set out the dates by which different sorts of results might become available. Control groups in comparable areas should be sought. Officials should also involve DHSS in the discussions and should explore any interaction with the proposed family credit scheme, as well as ensuring that there were mechanisms for delivering the benefit savings that might result and for identifying them as savings on the DHSS programme. Officials would also need to discuss other practical points such as the areas to be chosen, the costs of the two pilots, the eligibility rules, and the other destinations (apart from the "enterprise" scheme) for those called for interview. (The Secretary of State had mentioned that some of the new CP places agreed in the Budget could be used for this purpose). Territorial departments would be involved.

8. There would be no commitment on the part of the Treasury to agree to any extension of the pilots, nor to any extra finance for DE if extensions were agreed.

Announcements

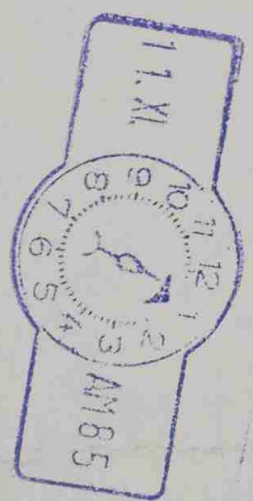
9. It was agreed that the Secretary of State should make a statement in the Lords after questions on Wednesday 13 November (with an equivalent statement in the Commons by the Paymaster General), covering in full the abolition of rebates from the redundancy fund, the Budget increases for CP & YTS, the Survey increases in EAS, tourism, and LEAs, and the pilots and extension of LGS just agreed. There would be a press release at the same time. The press would be briefed more fully the following weekend. It was agreed that there would be no suggestion in public of any commitment to extend the pilots, nor of the possibility that the pilots might be extended before the evaluation was completed. While the public line would be therefore that the pilots would run for 6 months and then be assessed before any decision was taken whether to extend them, the Secretary of State reserved his right to propose extension in the discussions leading up to the Budget, and the Chief Secretary stressed that the Treasury was not committed to agreeing to any extension.

10. The Chancellor would say in his statement that the Secretary of State would be making a statement. The Autumn Statement text would mention reductions in expenditure from the redundancy fund and increases for EAS, small firms and tourism, but would give no

further details. Treasury Ministers would if pressed before Wednesday afternoon not go beyond mentioning the forthcoming statements on Wednesday and referring questions to DE.

11. The text of the Autumn Statement would be agreed between DE and the Treasury in the course of the afternoon. It was agreed that the tables should be annotated to give the changes between Cmd 9428 and the revised baseline as well as the changes (-70 and -210 for 1986-87 and 1987-88 respectively) between the new baseline and Cmd 9428 adjusted. Officials of the two Departments would show their opposite numbers texts of the relevant parts of the statements, press notices, and briefing.

Circulation: those present
Chancellor
Financial Secretary
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Anson
Mr Burgner
Mr Monger
Mr Scholar
Mr Watson
Ms Noble
Ms Sinclair
Mr White
Ms Henderson
Mr Rayner
Mr Davies
Mr Lord



hnb Prime Minister

ENVIRONMENT

NEWS RELEASE

541

8 November 1985

SUCCESS OF GOVERNMENT ECONOMIC POLICY ESSENTIAL SAYS BAKER

Speaking at Leatherhead today, Kenneth Baker, Secretary of State for the Environment, said:

"I believe it was absolutely essential to stick to the Public Expenditure total that the Cabinet agreed in July. That we have been able to do. That is the success story this week, not the misleading press accounts of Ministerial wrangles.

"The Government rightly remains fully committed to its economic strategy, and to restraining the total level of Government expenditure. Otherwise we would slip back into the bad old cycle of soaring inflation, stop-go economic policy and higher unemployment levels.

"I am of course very glad that the Government has decided, within the totals agreed, to increase the amount for the renovation of council property. Next week I shall publish a report which this Government commissioned. It shows that a significant backlog of repair work needing to be done on parts of our municipal housing stock has developed over the last generation.

"This is a task which faces us as a nation for many years to come. This week's decision shows the collective determination of the Government to tackle this task.

"Ignore the press speculation about Whitehall in-fighting, and blood on Ministerial carpets. The increase in the provision for housing renovation was a collective decision, a team decision. It demonstrates the commitment of the Government to improve conditions for those who live in our worst housing, particularly in our towns and cities."

Press Enquiries: 01 212 3492, 4682/3/4
(out of hours: 01 212 7132)

Public Enquiries: 01 212 3434
(ask for Public Enquiries Unit)

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2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

8 November 1985

Jim Myles

W 8/11

AUTUMN STATEMENT: WATER AUTHORITIES

I understand that your autumn statement will be made on 12 November.

Last year our difficulties with the water authorities were compounded because news of the higher charges they would be required to levy leaked some days before your statement and before the chairmen had been forewarned (letters to them were in the post but not received when the news spread).

I would be most grateful if you could avoid any reference to the water authorities in your statement this year and that the line in response to any press enquiries about water charges should be:

"The water authorities EFL for 1986/7 remains unchanged; the Department of the Environment will be discussing the implications for the authorities' 1986/7 budgets with them in the normal way over the next few weeks".

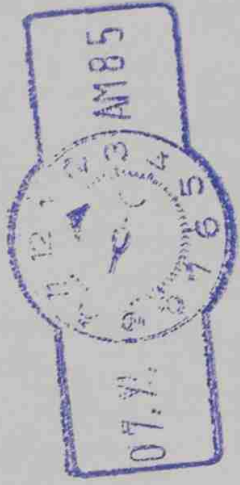
No indication of our attitude to water privatisation should be given at this stage.

I am sure you will understand the vital importance of this if we are to carry forward our policies for the water authorities with the minimum of trouble.

I am copying this letter to the Prime Minister as Chairman of E(A), to Nicholas Edwards, and the Chief Whip.

Ken Baker

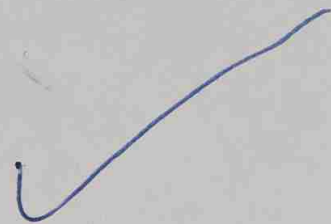
KENNETH BAKER





10 DOWNING STREET

Mr. Rawlins



From the Press Secretary

Brian Mower Esq
Director of Information
Home Office
50 Queen Anne's Gate
London SW1

7 November 1985

Dear Brian,

This note is to let you know of the arrangements made for the presentation of the Autumn Statement on Tuesday, November 12, 1985.

The Treasury is of course in the lead on the Statement itself and the Chancellor and Chief Secretary will be active in explaining the overall situation.

The Lord President has asked me, however, to let you know that Ministers are agreed that:

- i. each individual Department should prepare its own positive brief for the media;
- ii. individual Ministers should take every opportunity to explain their circumstances in the most positive fashion to the public and their particular media clientele; and
- iii. detailed matters be dealt with by the responsible Department.

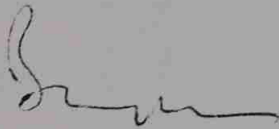
You or your colleagues may feel there would be value in holding press briefings immediately after the Chancellor's statement in the House and subsequently giving radio and television interviews.

What I would much appreciate at the usual meeting of MIO on Monday, November 11 would be a detailed rundown from Heads of Information on their plans.

It would also be extremely helpful if, before close of play tomorrow (Friday, November 8), you would let me know of any speaking notes you are intending to produce. I think you should

be guided on whether to prepare a speaking note by your assessment of the political sensitivity of the particular issue. So far as I am concerned, your watchword should be: if it's difficult - explain it on paper.

I am copying to all other Heads of Information.



BERNARD INGHAM

CCB



GWYDDFA GYMREIG
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switsfwrdd)
01-233 6106 (Llinell Union)

Oddi wrth Ysgrifennydd Gwladol Cymru

The Rt Hon Nicholas Edwards MP

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switchboard)
01-233 6106 (Direct Line)

From The Secretary of State for Wales

7th November 1985

Den - JH

R8

"TERRITORIAL" IMPLICATIONS OF LOCAL AUTHORITY OVERSPENDING IN ENGLAND

I am responding to your letter of 6 November in reply to mine of 4 November (about capital) and 5 November (about current). We subsequently discussed the matter last night.

I note that you see difficulties of principle in offering any compensation to a territory which observes our spending plans when England does not. In answer to that I have to make two points. First of all my Private Secretary's letter of 29 November 1984 made it clear beyond doubt that I only agreed to what was then being proposed on the understanding that Wales would receive such compensation. If your predecessor had been unable to accept this condition the proposals should not have been implemented without collective discussion of the principle. Instead the principle involved was not disputed by your predecessor: his Private Secretary's reply of 3 December 1984 simply said that such an eventuality would not arise. I note you are saying the same thing now in reply to George Younger about the coming year. Secondly, the greater success we have achieved in Wales in getting local authorities near to our spending plans has led Cabinet colleagues to reaffirm, on a number of occasions, that virtue must be rewarded. If it is not, the lesson from the experience will be to overspend. That would destroy the patient work of this Administration in Wales.

That being said, I understand all too well the particular problem you face in acceding to my request for an additional £38 million on this occasion. In present circumstances, therefore, I reluctantly accept that there should be no addition to my local authority capital baseline as a direct consequential of the 1984/85 local authority capital overspend in England. As you say I shall have some small consequential increase from the PES

/decisions in respect ...

The Rt Hon John McGregor OBE MP
Chief Secretary
HM Treasury
Parliament Street
London
SW1P 3AG



decisions in respect of England for 1986/87: and my allocation total will be enlarged by using the same 83 per cent assumption about spending that is being applied in England (though Welsh statistics indicate that a more accurate figure for Wales would be 80 per cent). These factors may add up to a positive presentation as you suggest. It remains to be seen whether local authorities will see through that.

Turning to current expenditure, I am sorry that you do not recognise the particular difficulties this presents for me in 1987/88, which I explained in my letter of 5 November. Anyone who looks at the last White Paper and compares it with our new plans will see the Welsh baseline cut by £25 million whilst the English one is increased. Once again the lesson to which I referred above will be evident if nothing is done to meet the point. As a very minimum we agreed in our conversation last night that the treatment of the figures would have to be explained. For that purpose my officials have discussed with yours a possible form of words. I understand that agreement has been reached that the general GB position should be explained in the Autumn Statement on the following lines:

No decision has been taken on provision for 1987/88 and 1988/89. Meanwhile the figures for those years shown in Table X and included in departmental totals in Table Y repeat those for 1986/87. They will be reconsidered in the 1986 survey in the light of local authorities' budgets for 1986/87 and other factors. Account has been taken of this in setting the level of the Reserve.

This is satisfactory as far as it goes, but will need some expansion to satisfy Welsh local authorities. For this purpose your officials have agreed that this explanation may be amplified in the Public Expenditure White Paper by a statement along the lines:

The Government remains committed to its pledge to Welsh local authorities that if their spending remains near target, as it is at present, the figures for the later years will maintain the 1979/80 level in cost terms.

Any statement I make to Welsh local authorities, or more generally at the time of the Autumn Statement, will reflect the sense of these two texts.

On that basis I reluctantly accept that the 1986/87 figure of £1,368 million for Welsh local authority current expenditure should be repeated for each of the subsequent years. This is on the firm agreement between us that after the publication of the Public Expenditure White Paper without further ado £43 million will be added to the £1,368 million to form a baseline of £1,411 million in respect of 1987/88 and £45 million will be added to form a baseline of £1,413 million for 1988/89 as a starting point for the 1986 survey, and that I shall receive a full formula consequential to any addition to the English local authority current baseline hereafter agreed for any reason, the distribution of that consequential between current and capital spending to be at my discretion.

/To avoid any ...



To avoid any possible future misunderstanding I would be glad if you could confirm the above agreement in writing.

/ I am copying this letter to the Prime Minister, George Younger, other members of E(A) and Sir Robert Armstrong.

J. C.
Abel

Public Econ Pol.
Expenditure

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SECRETARY OF STATE
FOR
NORTHERN IRELAND

CCBG
NORTHERN IRELAND OFFICE
WHITEHALL
LONDON SW1A 2AZ

The Rt Hon John MacGregor MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

PM

7th November 1985

TERRITORIAL IMPLICATIONS FOR LOCAL AUTHORITY CAPITAL OVERSPENDING
IN ENGLAND

I have seen a copy of George Younger's letter to you of 28 October 1985 about the implications for the territorials of the treatment of local authority capital expenditure in this year's Survey.

ATTACHED

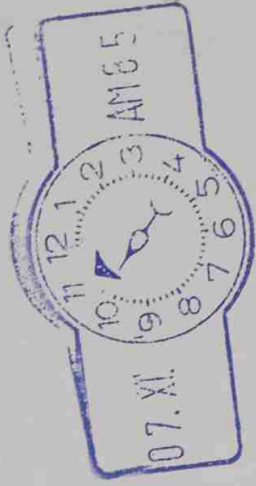
I very much share his concern that the proposed treatment will have a deleterious effect on the territorial blocks to the extent that allocations are set at lower levels than they might otherwise have been. I strongly support George's suggestion that the territorial blocks should be excused from the reductions up to the extent of the formula equivalent of local authority capital overspending in the preceding year. This would produce the same effect as the treatment we received in the 1984 Survey.

I am copying this to the Prime Minister and members of E(A) and to Sir Robert Armstrong.

TK

CONFIDENTIAL

Econ 101: Public Exp



CONFIDENTIAL



Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Kenneth Baker MP
 Secretary of State for the Environment
 Department of the Environment
 2 Marsham Street
 London
 SW1P 3EB

6 November 1985

Dear Kenneth,

PUBLIC EXPENDITURE SURVEY: HOUSING

I am writing to record the basis on which we have agreed a settlement of provision and allocations for Housing.

The main elements in the proposal were as follows:

- (i) Net provision for the housing programme to be increased by +197, + 177, + 157 compared to the Survey baseline;
- (ii) Gross capital expenditure to be increased by + 163, + 104, + 195 compared to the Survey baseline;
- (iii) Capital receipts to be increased by + 70, + 50, + 50;
- (iv) Current expenditure to be increased by + 104, + 123, + 12, as in the MISC 120 offer;
- (v) Capital allocations in 1986-87 to be determined on the assumption that local authorities will use 83 per cent of available spending power;
- (vi) On the assumption that Housing Corporation gross capital provision is reduced by £30 million this would allow you to issue allocations to local authorities in 1986-87 totalling £1500 million;

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CONFIDENTIAL

(vii) However I am prepared for you to distribute provision between local authorities and the Housing Corporation as you wish provided allocations are agreed between us and derived from provision on the basis of the 83 per cent use assumption;

(viii) Capital allocations in 1987-88 to be determined on the assumption that local authorities will use at least 85 per cent of available spending power.

... The attached table sets out the implications of this agreement for the major housing lines. As I explained, the Autumn Statement will not give an outturn figure for local authority gross capital expenditure in 1985-86. Such a figure will appear in the 1986 Public Expenditure White Paper but will, no doubt, be revised to reflect the latest forecast of outturn.

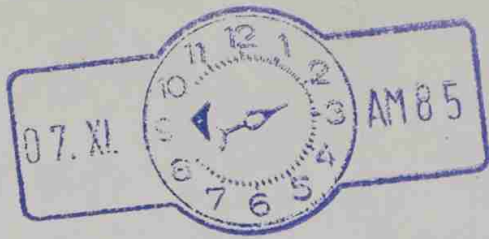
Yours ever,



JOHN MacGREGOR

CONFIDENTIAL

	1985-86		1986-87	1987-88	1988-89
	PROVISION	OUTTURN			
Renovation	1070	1130	1441 (+247)	1541 (+327)	1529 (+327)
Gross Capital	3056	3284	3250 (+163)	3208 (+104)	3105 (+195)
Net Capital	1323	1633	1649 (+ 93)	1726 (+ 54)	1770 (+145)
Net Total	2290	2717	2741 (+197)	2825 (+177)	2869 (+157)



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WST

DW & see

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Norman Fowler MP
Secretary of State
Department of Health and Social Security
Alexander Fleming House
Elephant and Castle
London
SE1 6BY

pa

6 November 1985

Dear Norman,

MISC 120: HEALTH AND PERSONAL SOCIAL SERVICES

My officials have informed me of your proposals for allocating the MISC 120 settlement of your programme between its components. I understand the figures are:

	<u>1986-87</u>	<u>1987-88</u>	<u>£M</u> <u>1988-89</u>
HCHS current	+ 157	+ 196	+ 374
CFS/FPS admin	+ 13	+ 14	+ 21
FPS	+ 80	+ 90	+ 205
Total	<u>+ 250</u>	<u>+ 300</u>	<u>+ 600</u>

You will no doubt be considering the best way to present these figures publicly. I hope that you will emphasise strongly the real growth (above the GDP deflator) in the HCHS: 2.2 per cent in 1986-87, and 1.1 per cent (more than sufficient to cover demographic provision) in each of 1987-88 and 1988-89. This should give you a good response to the pressure for more HCHS spending from the BMA, Royal College of Nursing and others. I hope that you will also be emphasising the important part to be played by efficiency savings.

I understand that, of the increases which MISC 120 was able to agree, the proportion allocated to HCHS current

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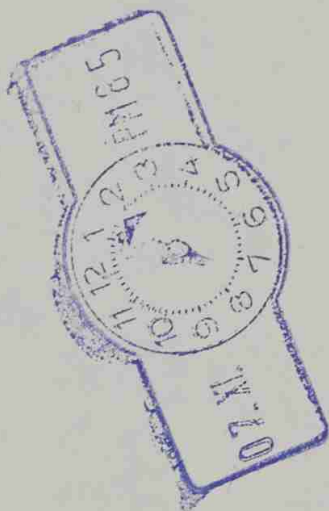
SECRET

is somewhat higher than might have been expected; since you expect to make a number of small savings, which we had not discussed, in respect of pharmacists' discounts, oxygen concentrators and sight test fees, in addition to the rather larger savings to which you were already committed. These are all welcome to me. But as we have found before, FPS savings can be difficult to secure in their originally intended form; although I know that you will take all possible steps to deliver all the savings which you have agreed to make. I think therefore, that I should make it clear that if any of these measures do not produce the expected savings I shall expect you to make other policy changes to contain FPS expenditure. If this does not prove possible I shall expect you to make equivalent savings in your cash-limited programmes rather than make a claim on the Reserve.

Copies of this letter go to Willie Whitelaw and other members of MISC 120.

Yours ever,
John

JOHN MacGREGOR



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Ref. A085/2846

PRIME MINISTER

Public Expenditure Survey 1985

(C(85) 26)

BACKGROUND

Flag A At their meeting on 11 July the Cabinet decided that the public expenditure planning totals should be £139.1 billion for 1986-87, £143.9 billion for 1987-88 and £148.2 billion for 1988-89 (CC(85) 25th Conclusions, Minute 4). Since then there have been extensive bilateral discussions between the Chief Secretary, Treasury and spending Ministers and, more recently, in the Ministerial Group on Public Expenditure (MISC 120) under the chairmanship of the Lord President of the Council.

Flag B 2. The results are summarised in the memorandum by the Lord President (C(85) 26). As that paper shows, agreement has so far been reached with spending Ministers on all the programmes except housing. On this basis, the overall changes, compared with the Survey baseline and hence to the planning totals, are summarised in the following table. (All figures in this minute, unless otherwise indicated, are in £ million.)

SECRET

	£ million		
	<u>1986-87</u>	<u>1987-88</u>	<u>1988-89</u>
Agreed by Chief Secretary	+1,179	+1,608	+1,157
Local authority current expenditures (see paragraph 6h.)	+646	+359	-323
Changes in asset sales, the Reserve, and the 1988-89 planning total	-3,500	-2,500	-2,377
Agreed recommendations by MISC 120	+1,750	+664	+1,506
Net excess over planning totals	+51	+112	-51
Additional bids by the Secretary of State for the Environment, plus territorial consequentials	+819	+1,163	+1,072

It now seems likely that agreement may be reached in the course of today on housing, which would add £197 million to the baseline in the first year, £177 million in the second year, and £157 million in the last year. I will arrange to let you have separate briefing on the latest developments on this, and the Lord President will report orally at Cabinet tomorrow.

3. In broad terms, subject to the outcome on housing, there is a small gap to be bridged in each of 1986-87 and 1987-88. For 1988-89, the figures are slightly in credit, after taking credit for the addition of another £0.5 billion to the planning total proposed by the Chief Secretary at the beginning of the MISC 120

discussions. If the Secretary of State for the Environment's proposals for the housing programme were accepted, the excesses would be £0.8 billion, £1.3 billion and £1.0 billion for the three Survey years. These figures take no account of the further changes to be made to the social security figures resulting from the latest assessment of the takeup of benefits and from changes in the assumptions about the level of unemployment, which seem likely to add £0.3 billion, £0.5 billion and £0.5 billion respectively to the planning totals in the three Survey years.

MAIN ISSUES

4. The main issues before the Cabinet are as follows:

a. Are the recommendations agreed between MISC 120 (or the Chief Secretary) and spending Ministers acceptable?

b. Subject to the Lord President's report, what changes should be made to existing provision for housing?

c. In the light of the conclusions on a. and b. above, is the outcome of the 1985 Public Expenditure Survey satisfactory? What is to be done to bridge any remaining gaps between the recommendations in C(85) 26 and the planning totals?

(d) Announcements.

Agreed programmes

5. The recommendations agreed between MISC 120 and the spending Ministers are set out in Annexes C to K of C(85) 26; in addition, Annex B gives brief details of changes agreed bilaterally between the Chief Secretary, Treasury and spending Ministers.

6. Items which seem most likely to attract comments and questions from members of the Cabinet are as follows:

a. Defence. The baseline is unchanged for the first two Survey years, so requiring the Secretary of State for Defence to absorb the costs of pay settlements and equipment cost increases higher than the provision for inflation. For the last year, the Secretary of State for Defence has agreed also to absorb £192 million for the costs of the Falklands operations within the previous Falklands-exclusive baseline figure. Given the projections for the GDP deflator, the figures imply real reductions in aggregate provision for defence of about 2 per cent in each year; part of this decline reflects the fact that the costs of the Falklands operations are themselves declining; excluding the Falklands, real defence provision is projected to decline by about 1 per cent of each of the first two Survey years, and 2 per cent in the third year. This position reflects MISC 120's judgment about the priorities to be attached to the different expenditure programmes, and also the increasing scope for efficiency savings on defence procurement.

b. Aid. Although the Cabinet paper does not say so in so many words, the agreement with the Foreign and Commonwealth Secretary provides for a flat total aid programme in real terms throughout the period. Within this total there will be rising provision for multilateral aid and ATP, which means that there will be some continuing real reduction in United Kingdom bilateral aid programmes. In presenting the figures the Ministers concerned will no doubt wish to concentrate on the aggregate for the programme as a whole.

c. Education and Science. The Secretary of State for Education and Science has agreed a settlement which falls well short of his bids on the universities, science and

school building. It is possible that the Lord President's Ministerial Group on R & D priorities (MISC 119) may recommend some changes at the margin which might further help the Secretary of State for Education and Science, but the position on this is not yet clear. There also remains a problem of financing the "switch" in higher education towards science and technology in the third year. The transfers from other programmes to finance it in 1986-87 and 1987-88 were not carried forward into the third Survey year, since the assistance was intended to be transitional; but the Secretary of State for Education and Science does not consider that higher education institutions will be able to carry the burden within existing provision from 1988-89 because of the continuing high costs of necessary redundancies/early retirements among arts and social science staff. If the switch cannot be financed in any other way, the money will have to come from local authority capital.

d. Arts and Libraries. This small programme has attracted a disproportionate amount of attention, not least because of the effect of the abolition of the GLC and the Metropolitan Counties. The settlement agreed with the Minister for the Arts gives for 1986-87 a total Grant to the Arts Council only a few million pounds short of the figures for which Sir William Rees-Mogg has been pressing in discussion with Ministers. For the later years, the settlement assumes that efforts by the Arts Council and the performing companies to secure replacement funding from the successor authorities will be more successful.

e. Health Service. MISC 120 has been relatively generous to the health service but, without a greater effort, it is doubtful whether the NHS hospitals will be able to deliver sufficient efficiency savings to absorb both the impact of this year's pay increases for nurses and the continuing demographic increase in the burdens on the service. For

1988-89, the settlement presupposes some restriction of the coverage of the present exemptions from prescription charges.

f. Social Security. Given that MISC 111 has not yet completed its work, it should be possible to avoid any detailed discussion of social security. But Ministers will need to be aware of the further postponement of the promised abolition of the retirement pensioners' earnings rule, and of the proposed further restrictions on single payments which may well prove highly controversial. The savings arising from requiring employers to take over payment of maternity allowance on the same basis as Statutory Sick Pay will be offset in PSBR terms by a reduction in employers' National Insurance contributions. The provisional figure to be shown in the Autumn Statement for 1988-89 represents some rounding down of the total projected by the Secretary of State for Social Services after allowing for the agreed savings.

g. Water. The MISC 120 recommendations, which involve no change to baseline, take into account the fact that the water industry should be able to finance in 1986-87 the increase in investment previously planned, on the basis of an increase in domestic water charges of about 8 per cent or slightly less (1 per cent less for other consumers). This represents some relaxation of the demanding programme agreed last year by E(NI) for improvements in the industry's return on assets; but there may still be resistance to the required increase in charges by some water authorities. The prospect of early privatisation may, however, make it possible for Ministers to defuse much of this opposition.

h. Local Authority Current Expenditure. The Rate Support Grant figures for 1986-87 have been agreed in E(LA), but some overspend in relation to the agreed figures is

inevitable. Thereafter it has not proved possible to set any "realistic figures". Showing rising expenditure in cash terms would on the one hand be taken as a challenge to local authorities to increase their overspend, while at the same time it would risk appearing not to give enough to meet the requirements of Government policy, eg on the police or the restructuring of teachers' pay. The solution adopted is to put in constant figures in cash terms, and increase the size of the Reserve. The fact that the figures for 1987-88 and 1988-89 are purely conventional, and that further (unspecified) provision will in due course be found from the Reserve, will be made clear in the Autumn Statement.

Housing

7. The arguments on the disagreement between MISC 120 and the Secretary of State for the Environment were covered in the separate brief submitted on 5 November by Mr Unwin. As noted above, discussion is still in train in an attempt to reach an agreement, and separate briefing will be provided.

Scotland

8. A different sort of difficulty arises in the case of Scotland, as is explained in C(85) 26. MISC 120 do not recommend that further savings should be sought in this public expenditure round from the Secretary of State for Scotland. They believe, nonetheless, that an equitable evaluation of priorities would result in substantial reduction in the Scottish block - the evidence is clear that Scotland is over-provided relative to the rest of the United Kingdom. Making changes would, however, be politically a very difficult issue; and unless the Government are willing to confront it Ministers cannot overtly acknowledge the present Scottish over-provision. If such acknowledgment were ever to be made it would clearly be essential for this to be based on indisputable up-to-date evidence, and for that reason

MISC 120 recommend that a fresh needs assessment should be made covering the whole United Kingdom, whose results could be taken into account in future public expenditure rounds. This assessment would be made on a confidential basis within the Government, but Ministers would have available to them, in the event of its becoming public knowledge, the defence that it was not looking specifically at any one part of the United Kingdom, but was intended to reassess the position of every part of the country in the light of the major structural economic changes of the last decade.

Outcome of the 1985 Survey

9. Even if the recommendations of MISC 120 are accepted as they stand, there will remain excesses over the agreed planning totals. To these excesses will need to be added, before the Chancellor of the Exchequer's Autumn Statement, the impact of changes to the social security figures, which as explained above will substantially increase the problem of bridging the gap. I understand that the Chancellor of the Exchequer has indicated in discussion with you that he is looking to bridge the gap through further changes in receipts from asset sales and in the Reserve; he will no doubt wish to make this clear to the Cabinet.

Announcements

10. Unless the Cabinet judge that the outcome of the 1985 Survey is unsatisfactory, the results will be reflected in the Autumn Statement which the Chancellor of the Exchequer intends to publish on Tuesday 12 November; further details will appear in due course in the mid-1986 Public Expenditure White Paper. As is noted in C(85) 26, the Chancellor intends publishing summary figures for each programme for all three Survey years in next week's Autumn Statement; in the past only the first year's figures have been given. This fuller publication responds to substantial Parliamentary pressure, and should make it possible

for the Government's decisions about each programme to be presented in a more effective and coherent way. In previous years details about the second and third years have tended to leak out piecemeal, making the task of overall presentation much more difficult. The fuller publication may also have the incidental effect of partially compensating the Treasury Committee for the loss of information about projected revenue in the year immediately ahead and the scope for a fiscal adjustment in the next Spring Budget, which the Chancellor had decided to exclude from this year's Autumn Statement. We know of no particular difficulties created for individual Ministers by the publication of three years' figures rather than only one as hitherto; any problems presented by the figures would, of course, have to be coped with in any event before long, when the full White Paper is published early next year.

11. You will also wish to settle a form of words to be used in reply to questions from the media that are bound to follow immediately on tomorrow's Cabinet. Any mention of housing will require particular care.

HANDLING

12. You may find it convenient to divide the discussion into the following parts:

- a. general situation and agreed programmes, including Scotland;
- b. housing;
- c. outcome of the Survey and announcements.

13. The discussion of the general situation could be opened by the Lord President of the Council introducing his memorandum and reporting the position on housing. You could then ask the Chief

Secretary, Treasury whether he wishes to add any comments. This part of the discussion will then offer an opportunity to members of the Cabinet to question any of the agreed recommendations from MISC 120, or features of the bilateral agreements between the Chief Secretary, Treasury and spending Ministers, though you will not wish to encourage the reopening of agreements.

14. The final part of the discussion could be introduced by the Chancellor of the Exchequer who could give an outline of the general economic situation and the main likely features of the Autumn Statement. He would also be able to explain how the conclusions of the Cabinet on the 1985 Survey fitted into the Statement.

CONCLUSIONS

15. You will wish the Cabinet to reach conclusions on the following:-

- a. Are the recommendations agreed between MISC 120 and the spending Ministers concerned, and summarised in paragraphs 7-21 of C(85) 26, together with the Lord President's recommendations on housing, endorsed?
- b. Should a fresh needs assessment be undertaken on a confidential basis within the Government, to serve as a basis for the allocation of future public provision to the different parts of the United Kingdom?
- c. In the light of the conclusion of a., is the outcome of the 1985 Public Expenditure Survey satisfactory?

d. If so, the main features of the Survey will be reflected in the Autumn Statement, with further details given in the 1986 Public Expenditure White Paper. What guidance should be given in reply to immediate inquiries from the media?

ms

for

ROBERT ARMSTRONG

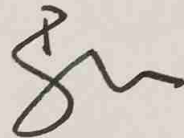
6 November 1985

MR NORGROVE

PUBLIC EXPENDITURE

I attach a short speaking note for the Prime Minister to use in opening the discussion at Cabinet tomorrow. I have discussed this with the Treasury.

2. As I mentioned to you on the telephone, it looks as if, taking into account all the consequential (except the social security estimating changes), the total net excess over baseline will be something like £290 million, £320 million and £135 million. These figures should be substituted for the (hastily calculated) numbers in paragraph 6 of my earlier minute to you on the housing agreement.



J B UNWIN

SECRET

Presentation

CABINET, 7 November: Public Expenditure

OPENING SPEAKING NOTE FOR THE PRIME MINISTER

I am very grateful to the members of MISC 120, and the Lord President in particular, for the enormous skill and effort they have devoted to the task the Cabinet gave them. This was to make recommendations on those public expenditure issues that had not been resolved between the Chief Secretary and the spending Ministers concerned, within the framework of the Cabinet's firm and announced decision in July on the public expenditure planning totals for next year and the two following years.

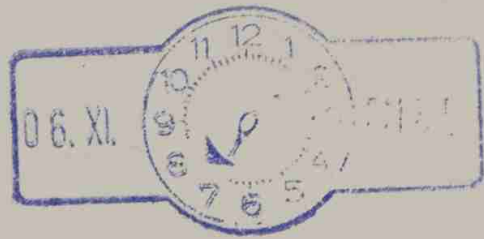
2. The task we set them was very difficult. They were faced with a larger number of disagreed issues, and higher outstanding bids, than in any previous year. Given the size of the problem, the Cabinet will therefore want me to congratulate the Lord President and his colleagues on being able to recommend proposals that entail relatively small excesses over the baseline totals.

3. This represents a considerable achievement which should enable the Government publicly to confirm our determination to stick to the planning totals to which we are committed; and the Chancellor of the Exchequer to proceed with his autumn statement on 12 ^{November} ~~December~~.

4. I am grateful also for the cooperation of all our colleagues responsible for spending programmes both in the discussions prior to and with the Star Chamber. I know that in many cases the proposals agreed have meant willingness to take and defend very difficult decisions. I am grateful to colleagues for the readiness to do this, and so to enable us to validate our collective public expenditure targets.

5. I should like to ask the Lord President to comment on the MISC 120 report and to explain the position which I understand has now been reached on housing. Subject to that I hope we can endorse the recommendations so that the Chancellor can proceed with the preparation of his autumn statement.

SECRET





cc BG

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Nicholas Edwards MP
 Secretary of State for Wales
 Welsh Office
 Gwydyr House
 Whitehall
 London
 SW1A 2ER

NBH

6 November 1985

Dee Nil,

**"TERRITORIAL" IMPLICATIONS OF LOCAL AUTHORITY CAPITAL
 OVERSPENDING IN ENGLAND**

Thank you for your letter of 4 November. George Younger also wrote to me on this subject on 28 October.

will be sent to the Treasury

The proposals you have both made cause me great difficulty. In your different ways you are proposing that you should benefit from formula consequentials of English overspending in a previous year. The formula arrangements are rightly based on provision, not on outturn, and it would be wrong to base consequentials on overspending which is contrary to our plans and intentions. It was one thing for my predecessor to accept that, when a specific penalty is applied to the English cash limit, as in 1985-86, other territories should be exempted from the formula consequentials of that penalty. It is quite another to claim formula consequentials of overspending itself in the form of exemption from other survey reductions, as George proposes, and even more in the form of formula increases, as you propose.

That amounts to arguing that Scotland and Wales must benefit from unintended overspending in England, and thus increase its unacceptable cost still further. Whatever our intentions about relative shares of provision for Scotland and Wales, I cannot accept that they should be determined by levels of spending in England which exceed what we intend and provide for.

George suggests that discussions in the current survey are being conducted in a manner which leads colleagues to accept lower figures for provision in England on the assumption that overspending will continue. This is not the case, as you will know. My position throughout has been based on the need to reach decisions on both provision

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and allocations for English programmes which are designed to deliver spending in line with provision, without overspending. This in itself should help you and George to present the plans for Scotland and Wales.

There will be consequentials for Scotland and Wales from decisions on the relevant English local authority capital programmes for the Survey period. In part these reflect the taut control system we plan for England. In that way, Scotland and Wales will benefit directly from the steps being taken to deal with English overspending. I can also agree that, as in England, the normal cash limit penalty should not be required in Wales in 1986-87 in respect of £16 million overspending in 1984-85. And provision for local authority capital spending in Wales will get the further benefit of the £11 million transferred from provision for current expenditure. Taking all these factors together, I think that the position on local authority capital expenditure in Wales could be presented positively, without the difficulties you fear.

Besides the difficulties of principle, you will know how difficult it would be to accommodate at this stage of the Survey an extra £38 million for Wales in our public expenditure plans. For all these reasons, therefore I am afraid I cannot accept either your proposal or George Younger's.

On a separate point, colleagues have agreed that provision for local authority current expenditure in England in 1987-88 and 1988-89 should be set at the same cash level as in 1986-87, on the explicit basis that decisions for the two later years remain to be taken. Given that decision, it seems essential that provision for Scotland and Wales should be treated in the same way. I recognise that this would mean lower figures, for the purposes of the Autumn Statement and Public Expenditure White Paper, than would have resulted from the normal operation of the formula. I can therefore give you a firm assurance that the relevant amounts will be added back to the baseline for Scottish and Welsh local authority current expenditure before the start of next year's RSG discussions, so that those discussions would start from figures reflecting the operation of the formula. I should have no objection if, in Wales, you wished to use some of the relevant amount for capital rather than current spending.

I am sending copies of this letter to the Prime Minister, George Younger, other members of E(A) and to Sir Robert Armstrong.



Yours ever,
JL

JOHN MACGREGOR

CONFIDENTIAL

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19

P 01776

SECRET

MR NORCROVE

PUBLIC EXPENDITURE: HOUSING

Subject to clearance with Sir Keith Joseph and Mr Ridley of certain consequentials for their programmes, the Chief Secretary has reached agreement with Mr Baker on housing. The Lord President is content with the agreement, and will report orally at Cabinet tomorrow (the Cabinet paper, which we have now had to circulate, leaves the position on housing open).

2. The essence of the agreement is as follows. In 1986-87 gross capital expenditure on housing will be set at £3250 million (compared with the 1985-86 provision of £3051 million and estimated outturn of £3284 million). This is consistent with allocations of £1500 million (compared with £1600 million in 1985-86) on the assumption that local authorities use 83% of the spending power available to them (compared with the 85% previously assumed and the likely take up this year of 81%). Mr Baker has also offered additional receipts of £70 million.

3. The overall effect of this in 1986-87 is an addition above baseline for housing of £197 million. This is £77 million more than the Star Chamber's previous offer.*

Renovation Programme

4. In addition to the extra amounts offered by MISC 120, Mr Baker can boost the provision for renovation by savings on new build and elsewhere. This should enable him to increase expenditure on renovation in the first year by some £250 million, and some £325 million in each of the later two years. This would permit an overall renovation programme (in response to the housing survey report) of some £15 billion in under 10 years.

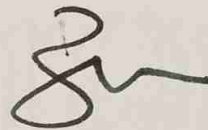
*In the two later years the MISC 120 offer will also be increased by £77m, giving additions to baseline of £177 million and £157 million.

SECRET

5. On the assumption (which Mr Baker has assured the Star Chamber he will seek to secure) that local authorities do in practice devote to renovation the sums now available to them, the total spend on renovation would reach some £1440 million in 1986-87, £1541 million in 1987-88, and £1530 million in 1988-89.

Overall Effects

6. The effect of this agreement will be to take the net excesses over the planning totals to some £140 million in 1986-87, £200 million in 1987-88, and less than £50 million in 1988-89 (the precise figures are still being calculated).



J B UNWIN

Cabinet Office
6 November 1985

SECRET

SECRET

Save for Cabinet
on Thu 18

5 November 1985

PRIME MINISTER

ASSET SALES AND THE RESERVE

The tables below show how the figures for future asset sales and the Reserve have changed during this year's public expenditure negotiations.

It is striking that the big increase in asset sales was agreed at the July Cabinet as a result of the decision in April to sell BGC. The BGC sale must not slip as this would throw the figures completely out.

ASSET SALES (£ Billion)

	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>	<u>1988-89</u>
January 1985				
Public Expenditure				
White Paper	2.5	2.25	2.25	[2.25]
March 1985				
Budget Statement	2.5	2*	2*	2*
July 1985				
Cabinet Paper	-	4.5	3.5	3.5
November 1985				
Misc 120 Report	-	4.5	4.25	4

* Rounded to the nearest billion.

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The Reserve for next year looks quite tight as the teachers' pay settlement will be a charge on it. But this year's problems have been caused by coal strike costs and we must hope that nothing similar occurs next year.

THE RESERVE (£ Billion)

	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>	<u>1988-89</u>
January 1985 Public Expenditure White Paper	3	4	5	-
March 1985 Budget Statement	5	6	7	-
July 1985 Cabinet Paper	-	5	6	7
November 1985 Misc 120 Report	-	4.75	6.5	8

David Willetts
DAVID WILLETTS

SECRET

010/1290

POSSIBLE MAJOR ASSET SALES 1986-87 ONWARDS

	<u>£ billion</u>
British telecom (3rd instalment)	1
British Airways	1 - 1½
British Gas	5 - 7
British Petroleum	3
Rolls Royce	½ - 1
British Telecom ¹	7
Water Authorities ²	5 - 6
	<hr/> 22½ - 26½

1. Further sales of BT shares possible from April 1988
2. DOE estimate (assumes legislation in 1986-87)

SPECIAL SALES OF ASSETS
PRESENT WORKING ASSUMPTIONS
1985-86 to 1988-89

Please See Attached Explanatory Note

£ million

	1985-86	1986-87	1987-88	1988-89
BRITISH AEROSPACE	346	-	-	-
BRITISH AIRPORTS AUTHORITY	-	-	750	-
BRITISH AIRWAYS BOARD	-	1250	-	-
BGC WYTCH FARM	-	-	130	-
BRITISH GAS	-	2400	1800	1800
BRITISH PETROLEUM	-	-	1500*	1500*
BRITISH TECHNOLOGY GROUP	28	15	15	5
BRITISH TELECOM	1159	1170	-	1500*
BRITISH TELECOM LOAN STOCK	61	53	23	85
BRITTOIL	431	-	-	-
CABLE & WIRELESS	550	-	-	-
FORESTRY COMMISSION	12	10	10	10
LAND SETTLEMENT ASSOC	4	1	1	1
ROLLS ROYCE	-	-	700	-
ROYAL ORDNANCE FACTORIES	-	200	-	-
PLANT BREEDING INSTITUTE	-	25	-	-
MOTORWAY LEASES	1	3	8	10
WATER AUTHORITIES	-	-	-	500
EXTERNAL FINANCE OFFSETS	-	-	-	-
SPECIAL SALES OF ASSETS TOTAL	2592	5127	4937	5411
CURRENT PUBLISHED TARGET	2500	2250	2250	-
NBC SUBSIDIARIES	-	-	100	-
BL SUBSIDIARIES	-	100	-	-
BS SUBSIDIARIES	75	-	-	-
BR SUBSIDIARIES	26	-	-	-
STG SUBSIDIARIES	-	-	5	-
PO SUBSIDIARIES (GIROBANK)	-	70	-	-
TOTAL PRIVATISATION RECEIPTS	2693	5297	5042	5411

* Timing variable.

Notes

1. All figures to the nearest £ million.
2. TSB sale will not score as privatisation but expected February 1986 (receipts around - £1,000m).
3. Only BL sale assumed at present is Unipart in 1986-87.
4. BNFL sale possible at some point with net receipts around £300 million for a 50 per cent sale but no date programmed.
5. Shorts sale possible in period with net receipts possibly around £25 million but no date programmed.
Treatment of any receipts not yet decided.

SPECIAL SALES OF ASSETS

as at: 9 October 1985

PRESENT WORKING ASSUMPTIONS 1985-86 TO 1988-89

EXPLANATORY NOTE

1. British Aerospace

Remaining Government holding sold in early May.

2. British Airports Authority

Legislation in 1985-86 Session. 100 per cent sale assumed in April-July 1987 with £750m receipts in 1987-88.

3. British Airways Board

100 per cent sale assumed in May-June 1986 with £1.25 billion receipts in 1986-87.

4. British Gas Corporation

Legislation in 1985-86 Session. 100 per cent sale assumed Autumn 1986 with net receipts £5-7 billion. Table assumes £6 billion receipts from debt and equity phased as follows:

	<u>£ billion</u>		
<u>1986-87</u>	<u>1987-88</u>	<u>1988-89</u>	
2.4	1.8	1.8	

(equivalent to BT phasing 40:30:30).

Receipts and phasing still very uncertain. Debt created before privatisation and sold subsequently will be treated as special sales of assets.

5. BGC Wytch Farm

The Wytch Farm sale brought in a first tranche of some £82m in 1984-85. This was retained by BGC in order to pay capital gains tax in

1985-86. The second tranche, depending on levels of production, is assumed to be received in 1987-88 and is credited to special sales of assets (£130m).

6. British Petroleum

Government holding 31.7 per cent (market value £3,152m). Further share sales possible from September 1985 onwards. Table assumes holding sold 1987-88 with £1½ billion receipts in 1987-88 and 1988-89.

7. British Technology Group

Book value of BTG's remaining holdings in 50 companies is £38m. £35m receipts assumed in period 1986-87 to 1988-89.

8. British Telecom

50.2 per cent of BT sold in November 1984. Table assumes total net receipts of £3660m. Receipts accrue over an 18 month period as follows:

<u>Initial call</u> <u>November 1984</u>	<u>Second call</u> <u>June 1985</u>	<u>Final call</u> <u>April 1986</u>
£1350m	£1160m	£1150m

Present holding 49.8 per cent (market value £7,020m) plus £750m preference stock. Further sales possible from April 1988 onwards and £1½ billion receipts assumed for 1988-89.

9. British Telecom loan stock

Repayment of BT loan stock held by Secretary of State scores as special sales of assets. £2750 million outstanding redeemable from 1985 to 2006.

10. Britoil

Remaining Government holding sold end-July (partly-paid: £206 million second instalment due 1 November 1985).

1. Cable and Wireless

Government holding 23.1 per cent (market value £600m). Further share sales possible from late November 1985 onwards. Sale of remaining holding assumed in 1985-86 producing receipts of £550m.

12. Forestry Commission

Figures assume continuing programme of property disposals reflecting results of 1984 PES decisions.

13. Land Settlement Association

Minor disposals assumed.

14. Rolls Royce

Sale of 100 per cent assumed for April-July 1987 producing net receipts of £700m (latest merchant bank estimate is that sale receipts might be £900m of which £200m would need to be injected into the company).

15. Royal Ordnance Factories

Vesting as PLC took place on 2 January 1985; sale of 100 per cent assumed for 1986-87 producing receipts of £200m.

16. Plant Breeding Institute

Minor MAFF sale assumed for 1986-87 with receipts of £25m.

17. Motorway Leases

Continued small disposals assumed.

18. Water Authorities

Discussion document issued 1 April. Primary legislation possible in 1986-87 Session. Sales of individual authorities assumed 1988-89 onwards producing £500m receipts in 1988-89.

19. National Bus Company subsidiaries

NBC to be restructured into smaller companies before sale. Receipts treated as negative external finance as existing NLF debt is repaid by NBC. Considerable uncertainty over timing and amounts. Sales could start in 1986 though table assumes no significant receipts before 1987-88.

20. BL subsidiaries

Jaguar sold in August 1984 with receipts of £297m retained by BL. Table assumes disposal of Unipart by end-1985 with receipts of £100m retained by BL: decisions on other disposals to be taken in the context of separate discussions about Landrover/Leyland Vehicles.

21. BS subsidiaries

Warship yards assumed to fetch £75m in 1985-86.

22. BR subsidiaries

Sealink sold in July 1984 for £66m (£40m in 1984-85, £26m in 1985-86). BREL privatisation possible 1986-87 onwards but no feasible propositions yet and likely proceeds unknown.

23. Scottish Transport Group subsidiaries

Decisions on Scottish Bus Group deferred. Disposals assumed at £5m for 1987-88.

24. Post Office subsidiaries (National Girobank)

Decisions in principle yet to be taken. No legislation required. 100 per cent disposal assumed in 1986-87 producing receipts of £70m which are retained by PO because of statutory constraints but reflected in negative external finance. This timing and the amount are highly uncertain.

5. External Finance Offsets

Where a candidate is expected to be privatised during the period covered by this table then an assumption is made as to the timing of the sale. Where no timing has been publicly announced, external finance baselines continue to be included in published aggregate expenditure plans. This line represents the total adjustment that must be made to allow for these external finance items and is included to prevent double-counting. Currently there are no entries under this head.

PE2

9 October 1985

CONFIDENTIAL

PRIME MINISTER

PUBLIC EXPENDITURE: HOUSING

I understand that you have decided to see Mr. Baker tomorrow evening on housing.

I suggest that you see Mr. Unwin for 20 minutes or so beforehand so that you can discuss with him the position now reached on housing, which is set out in the minute below. You will not be negotiating with Mr. Baker, but the background set out here may help.

If you agree, I would cancel the briefing meeting arranged with the Chancellor and the Chief Secretary for 1745, since the main question at issue for Cabinet is housing.

You will be getting the usual full Cabinet Office brief for Cabinet, and I hope the Policy Unit will be providing you with material on the more general arguments about the state of the housing stock, the housing review and so on.

Lord Whitelaw may want a few minutes with you before Cabinet on Thursday morning.

Do you want me to arrange early interventions by sympathetic members of Cabinet in the discussion, e.g. Mr. Tebbit and Mr. Brittan to follow early on after Lord Whitelaw?

Yes not

DN

DAVID NORGROVE

5 November 1985

CONFIDENTIAL

MISC 120: Housing

MISC 120 have been unable to reach agreement with the Secretary of State for the Environment. Mr Baker may therefore seek a meeting with you before Cabinet on 7 November.

The positions taken

2. A wide gulf remains between the Group and Mr Baker. At the outset the Treasury argued for a small net reduction on the total housing programme, made up of an agreed increase in current expenditure (mainly resulting from higher interest rates), to be offset by a reduction in net capital. The Secretary of State asked for a large increase in the total housing programme, including increases of £550 million for renovation of the public sector stock and £50 million for new provision for rent. The Group endorsed his higher priority for renovation, and offered additions of £100, £200 and £200 million for this purpose, but considered that this should largely be financed by reductions in other housing capital expenditure (mainly new construction). In further discussion with the Group today Mr Baker finally offered to reduce his demand for higher gross capital expenditure in 1986-87 from £600 million to £300 million,* meanwhile offering another £70 million of receipts in 1986-87. The Group, for their part, would have been inclined to settle for a gross increase above their original offer of £135 million, consisting of £65 million 'new' money and respending of £70 million of additional capital receipts; but the gulf was too wide to bridge.

What is at issue

3. For the purposes of this argument, there are three significant statistics: gross capital expenditure (which is what impacts on the housing stock), net capital expenditure (which is what affects the public expenditure programmes), and capital allocations to local authorities. The relevant statistics are summarised in the attached table, which concentrates on 1986/87; the argument with Mr Baker has not in effect proceeded beyond next year, and it would be reasonable to expect that the eventual broad outcome

* but on the basis of 'fudged allocations figures - see paragraphs 6-7.

SECRET

in terms of changes from baseline for 1986-87 will be carried forward into the 2 subsequent years.

4. Mr Baker has not sought to argue directly against the Group's proposed reductions in capital expenditure on new construction. He has argued instead that provision for gross capital in 1986/87 must not be lower than the estimated outturn for the current year of £3284 million; this is itself an overspend of £233 million on last year's White Paper provision, and is £200 million higher than the 1986-87 baseline. However, Mr Baker has argued that even an increase of £200 million over baseline would not be sufficient, because it would involve a reduction in allocations from the current year's £1600 million* to about £1430 million, on the generally applied assumption that local authorities will use each year 85 per cent of their total spending power (which largely consists of allocations plus the prescribed proportion of accumulated unspent capital receipts).

5. The Group considered the argument about allocations to be entirely presentational. Under the present arrangements for the treatment of capital receipts, each authority's bank of accumulated unspent capital receipts can be expected to increase steadily each year, which should in principle mean lower allocations each year to maintain a constant level of gross capital expenditure. The Group believe that Mr Baker could explain this satisfactorily, meanwhile pointing to a satisfactory story on the movements in gross and net capital expenditure from one year to the next. Mr Baker, by contrast, has argued throughout that a figure for allocations lower than £1600 million will be interpreted by local authorities and commentators as a 'cut in housing provision'.

6. Mr Baker has sought to come a little closer to the Group's position by proposing to assume that local authorities use smaller proportions of their aggregate spending power each year. The effect of this is to increase the allocations figure which would be consistent with given gross and net capital expenditure totals.

* previous Ministerial statements have never held out to local authorities the prospect of more than 70 per cent of the 1984/85 level, or about £1260 million.

SECRET

On this basis Mr Baker seemed prepared to examine the possibility of keeping gross capital expenditure in 1986/87 flat at its 1985/86 outturn level, but only on the understanding that allocations would be set at £1690 million on the assumption of 81 per cent use of local authority spending power. The Group were unwilling to accept this allocations 'fudge'; its effect would either be to produce a further overspend, as local authorities used a larger proportion of their spending power than had been assumed, or else store up trouble for future years, which could only be countered by still further reductions in allocations. The Chief Secretary pointed out that other Ministers had settled on the basis of the 85 per cent assumption, and that a different assumption for the housing programme would mean reopening a wide variety of other Departmental programmes.

Renovation

7. So far as renovation, which is agreed to be the top priority, is concerned, the provision for the current year was £1070 million, and the estimated outturn is £1130 million. On Mr Baker's proposals, expenditure in 1986-87 would be of the order of £1750 million, i.e. an increase of £600 million, or more than 50 per cent. On the basis of his bottom line position taken in the Group (with allocations reflecting the assumption of 83 per cent use of spending power) total expenditure on renovation next year would be about £1500 million, but with a significant risk of overspend. By contrast, on the basis of the highest offer contemplated by the Group, expenditure on renovation* would be £1430 million (£300 million above the current year's outturn, and £360 million above provision for the current year).

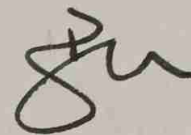
The wider context

8. The Group point out that, even in their initial offer, housing capital would be relatively generously treated by comparison with, for example, provision for schools and universities. The revised offer they contemplated would be generous, and would in effect validate the current year's substantial overspend by local authorities, which ought in principle to be eliminated. So far as the overall planning totals are concerned, this offer is absolutely at the limit of what could be

*partly financed by reductions in other capital expenditure which Mr Baker does not propose.

SECRET

accommodated within the agreed aggregates, after allowing for the estimating changes, etc on the social security programme and the further changes in the Reserve and in asset sales which you discussed with the Chancellor of the Exchequer and the Chief Secretary. If Mr Baker were to secure further concessions on housing capital, it would not appear possible for the Government to keep public expenditure within next year's agreed planning totals.



J B UNWIN

Cabinet Office
5 November 1985

SECRET

SECRET

£ million

	1984/85	1985/86		1986/87				
	Out-turn	Provision	Estimated out-turn	Baseline	Mr Baker's initial proposal	MISC 120 offer	Mr Baker's last offer	Possible MISC 120 compromise
Gross capital	3893	3051	3284	3087	3662	3102	3386	3238
Capital receipts	-1784	-1731	-1651	-1531	-1531	-1531	-1601	-1601
Net Capital	2109	1320	1633	1556	2131	1571	1785	1637
Allocations	1852	1600	1600	1158	1790	1203	1650*	1357

* on the assumption that local authorities will use 83 per cent, not 85 per cent of their total spending power.

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SECRET AND PERSONAL CC DN



16

Treasury Chambers, Parliament Street, SW1P 3AG

CHIEF WHIP

The Chief Secretary asked me to send you a copy of the attached note on a strictly personal basis.

A handwritten signature in black ink, appearing to be 'H. G. G.' with a large flourish.

5 November 1985

1. The Government has carried out a detailed review of its priorities in the housing programme. It has decided that total public expenditure provision should be increased by some [£150 million] in both 1986-87 and 1987-88 compared with the plans set out in the last public expenditure white paper.

2. Part of that increase reflects extra current spending via additional rate fund contributions to local authorities housing revenue accounts.

3. But gross capital spending is also increased from the earlier plans by [some £100 million] a year. Within that increased total, the Government believes there should be a substantial shift of spending patterns by local authorities. The key priority now is for increased spending on renovation of the existing public sector housing stock. But this has to be matched by lower priority being given to improvement grants to the private sector and public sector provision of new houses.

4. Spending on improvement grants has been running at a very high level in recent years, totalling some £2½ b. since 1982-83, much of it discretionary spending. This has enabled substantial improvements to be made in the private sector housing stock. For the next few years, the priority in this area should be limited to mandatory grants and to discretionary improvement grants for the disabled.

5. We believe the great majority of provision of new houses should be carried out by the private sector. By comparison with most other countries, the UK has a very high proportion of the existing housing stock within the public sector. And, as our policies have proved, most people do want to buy their own homes. So the provision of new houses in the public sector does not need to be as great as in the past. We are now providing for an annual public sector new building programme of some 30,000 homes. This is more than sufficient to meet priority needs and will enable a small reallocation of existing resources to renovation of the public sector stock.

6. Estimates of the required spending on renovation are necessarily imprecise. The existing plans already provide for an increase over expected spending in the current year to some £1200 million a year.

7. But we have now decided this should be substantially increased, by some [£200 million] in 1986-87 and, as the programme gathers pace, by some [£300 million] in the later years. So total spending will be raised to some £1½ billion a year, one of the largest public sector investment programmes. The Government consider this will be sufficient to tackle the problems which have been identified, providing for total spending of £15 billion over the next 10 years.

Allocations

1. In 1986-87 allocations will be set at a level which enable local authorities fully to carry out the priorities and programmes set out in the Government's plans.

2. Allocations are that part of local authorities borrowing and spending power distributed by central government. On top, local authorities' have other spending power, because they can also spend part of their capital receipts.

3. Allocations for 1986-87 do not need to be as high as 1985-86. This is because;

(i) authorities have access to larger receipts - itself a reflection of the success of the Government's Right to Buy policies;

(ii) the 1985-86 allocations led to overspending on the Government's plans - in particular £150 million on improvement grants.

CONFIDENTIAL



10 DOWNING STREET

L03A0E

file Lb

cc Prof Griffiths

From the Private Secretary

5 November 1985

LOCAL AUTHORITY EXPENDITURE: SCOTLAND: AGGREGATE EXCHEQUER
GRANT 1986-87

The Prime Minister has seen your Secretary of State's undated minute of last month reporting the outcome of his discussions with the Chief Secretary about the appropriate level of Aggregate Exchequer Grant for Scotland for 1986-87. Her own view is that it would be better to transfer money from the block grant to AEG and face political criticism for that, than to face criticism about rate increases. However, she regards this as a decision for your Secretary of State's judgement.

DAVID NORGROVE

John Graham, Esq.,
Scottish Office.

CONFIDENTIAL

A handwritten signature, possibly 'JG', in the bottom right corner of the page.

CONFIDENTIAL

CF file

SRW



10 DOWNING STREET

From the Private Secretary

4 November 1985

STAR CHAMBER

The Prime Minister has seen the Lord President's minute of 1 November reporting the outcome of the work of the Star Chamber (MISC 120). She has commented that the results are excellent and she agrees that the Lord President's memorandum may be circulated to Cabinet on Wednesday.

(DAVID NORGROVE)

Miss Joan MacNaughton,
Lord President's Office.

CONFIDENTIAL

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10 DOWNING STREET

From the Private Secretary

4 November 1985

PUBLIC EXPENDITURE: 1985-86 OUTTURN

The Prime Minister was most concerned to learn from the Chief Secretary's minute of 31 October that there is the prospect of an overspend on the 1985-86 planning total. She regards it as vital that this should not be allowed to happen. She hopes her colleagues will take every possible measure to keep within the resources they have available to them, and to avoid bids against the Reserve.

I am copying this letter to Private Secretaries to members of the Cabinet and to Michael Stark.

(DAVID NORGROVE)

Richard Broadbent, Esq.,
HM Treasury.

CONFIDENTIAL

BM

010

Y SWYDDFA GYMREIG
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switsfwrdd)
01-233 6106 (Llinell Union)

Oddi wrth Ysgrifennydd Gwladol Cymru



The Rt Hon Nicholas Edwards MP

cc 130
WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switchboard)
01-233 6106 (Direct Line)

From The Secretary of State for Wales

4th November 1985

R N B P M

Dear Chief Secretary,

"TERRITORIAL" IMPLICATIONS OF LOCAL AUTHORITY CAPITAL OVERSPENDING IN ENGLAND

I am most concerned to hear from my officials about a problem that has arisen over arrangements for taking account of local authority capital overspend in England in setting the level of capital provision for Wales. The problem, and our suggested solution, was clearly set out in a letter from Mr C L Jones to Mr Alistair Pirie of 30 September 1985. My clear understanding is that any expenditure excess in England would be taken into account in setting the aggregate level of capital provision for future years for Wales.

I have based my entire strategy for managing local authority capital expenditure in recent years on this vital assumption, which has been consistently recognised by colleagues.

The measures I introduced to control capital expenditure in 1984/85 were very successful in reducing overspending from an initial forecast of around £90 million to £16 million (5 per cent of net capital provision). In England the final overspend for 1984/85 is £900 million (over 35 per cent). Normally the overspend in England would have led to a commensurate reduction in provision for 1986/87. We have, however, decided to "write it off" using resources from the Contingency Reserve. It would therefore be consistent with the understanding set out in your predecessor's Private Secretary's letter in response to my private secretary's letter of 29 November for provision for Wales for 1986/87 to reflect this decision.

This issue clearly raises an important question of equity. My local authority associations have not been slow to point out that the use of the Contingency Reserve to "write off" overspending in England materially

/affected each country's ...

The Rt Hon John McGregor OBE MP
Chief Secretary
HM Treasury
Parliament Street
London
SW1



affected each country's share of the total resources earmarked for local authority capital investment in 1984/85. The same applies, of course, to the position in the present year. If no allowance was made for the additional endorsed spending in England the share for Wales of local authority capital investment would, over a period of years, and contrary to our intentions, be lower than would otherwise have been the case. Whatever the political exigencies in England such an inequitable outcome for Wales would be impossible for me to defend.

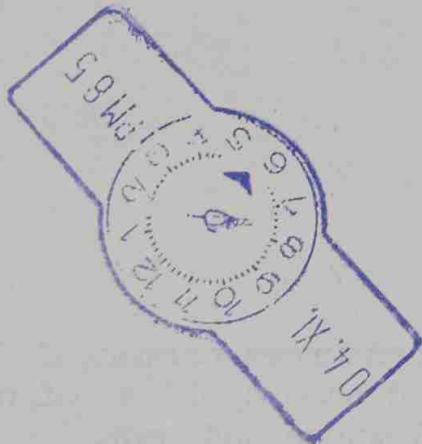
On the basis of my calculations the additional provision for Wales in 1986/87 amounts to £38 million, and I hope you will agree that this adjustment should now be made.

/ Copies of this letter go to the Prime Minister and to members of E(A) and to Sir Robert Armstrong.

Yours faithfully
R. C. Williams

Approved by the Secretary of State
and signed in his absence

exam 101: publicity



[Faint, illegible handwritten text]

SECRET

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10 DOWNING STREET

From the Private Secretary

4 November, 1985.

PUBLIC EXPENDITURE CABINET

The Chancellor and Chief Secretary today discussed with the Prime Minister the Chief Secretary's minute of 1 November.

The Chief Secretary described to the Prime Minister the potentially more sensitive decisions which had been taken as part of the work of MISC 120. The likely market reception of the proposals on the Reserve and asset sales was also discussed. The Chancellor doubted that there would be an adverse effect on confidence.

The Prime Minister agreed the proposals on asset sales and the Reserve set out in the Chief Secretary's minute and that the Treasury should proceed as proposed there.

I am copying this letter to Rachel Lomax (HM Treasury).

(David Norgrove)

A handwritten signature in dark ink, appearing to be 'DN' or similar initials.

Richard Broadbent, Esq.,
HM Treasury.

SECRET

P 01769

1. DN B see
2. p.c.

CC B/G

From: J B UNWIN
4 November 1985

COPY FOR

SIR ROBIN NICHOLSON

cc Mr Addison - No 10
Miss MacNaughton
Mr Stark
Mr Wiggins

- R+O .

MISC 119 AND PUBLIC EXPENDITURE SETTLEMENT

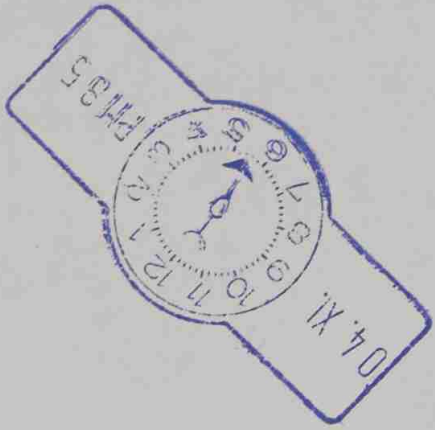
att. ~~unwin~~

Thank you for your minute of 1 November about the relationship of MISC 119 decisions to the current PES exercise.

2. I do not think there is any real problem here. Since MISC 119 is unlikely to lead to any net addition to public expenditure, I do not see that the Treasury could object to any small reallocation of provision between Departments either in 1986-87 or the later years if MISC 119 so decides. So far as the mechanics are concerned, there should be no problem in making any such adjustments between the autumn statement itself and publication of the detailed figures in the next Public Expenditure White Paper next January/February. The figures in the autumn statement will be in aggregate by Departments - there will be no detailed breakdown. In any case, there are always a number of adjustments between the autumn statement and the White Paper, not least to reflect estimating changes on some of the major demand-led programmes.

3. I do not think it is feasible, or that we need, to inject this into this week's final public expenditure decisions. I will, however, ensure that the point is properly covered when we come to the decision making phase in MISC 119.

J B UNWIN



→ Nick Owen

CC 2/10

A

Pa

W0747

MR UNWIN

1 November 1985

MISC 119 AND PUBLIC EXPENDITURE SETTLEMENT.

You spoke to me a week or two ago saying that final agreement on some of the PES bilaterals would need to await the outcome of MISC 119. Since that time the MISC 119 timetable has slipped a little and it is clear that the PES settlement will precede the completion of MISC 119. In past years the PES settlement has been absolute and no subsequent changes, however small, have been allowed.

2. I am reasonably optimistic that MISC 119 will come up with some proposals which will meet Ministers' wishes, expressed at E(A) on 31 July, to make Government R & D more relevant to the innovative vitality of the UK economy. It would be a great pity if such changes could not be implemented before April 1987 and much valuable momentum would be lost as well as a crucial signal to UK industry at this time. I therefore suggest that, exceptionally, the PES settlement be made subject to any outcome of MISC 119 agreed by Ministers. Changes are, of course, likely to be largely in the nature of re-allocation between Departments and any net additions or subtractions will be so small as to be insignificant in overall public expenditure terms.

3. I am copying this minute to Ms McNaughton, Michael Stark and Mark Addison.

PP SIR ROBIN NICHOLSON
Chief Scientific Adviser

Jane Lane.

SECRET

PRIME MINISTER

1 November 1985

PUBLIC EXPENDITURE

The Overall Picture

The papers by Viscount Whitelaw and John MacGregor show that despite all the problems with individual programmes, it may nevertheless be possible to achieve the political boost of a public expenditure round that goes fairly smoothly, and holds to the baselines. Last year's round may have been a factor in the run on sterling over the winter - we need to do better this year.

Housing

The crucial remaining programme is housing. The Star Chamber is convinced that because of political pressures Kenneth Baker should be given an extra £100 million (1986-87), £200 million (1987-88), and £200 million (1988-89) for improving the public sector housing stock. In return, he is to settle his other programmes at or close to the baseline.

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We recommend against conceding any increase as:

- The critics may not be placated. The extra money will seem small compared with the supposed £19 billion backlog of repairs. It might actually be easier to defend a nil increase than one which is so modest.
- It would be neat to hold housing to the baseline as well as defence. The survey would look like a solid confirmation of existing plans.

Assets Sales and the Reserve

After achieving as tough a deal as possible on departmental programmes, we then need to bridge the remaining gap to get to the baseline. The gap should not be there, but it is a tribute to the efforts of John MacGregor and the Star Chamber that it is not larger.

We recommend the highest possible figure for asset sales. There will be the normal charges of fudging the figures and selling the family silver, but asset sales are Government policy, and a big target for receipts helps drive it forward.

The more we get from asset sales, the bigger the size of the Reserve compatible with sticking to the baseline. Our

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failure to keep to the Reserve this year shows how prudent
it is to have a large figure. Large Reserves in the later
years also give more room for manoeuvre during the
politically-crucial 1986 Survey.

Conclusion

We recommend that you:

- resist pressures for increases in the housing programme;
- go for the maximum size of asset sales;
- go for a big Reserve;
- thereby achieve the baseline in total.

David Willetts
DAVID WILLETTS

SECRET



10 DOWNING STREET

Prime Minister

Any comments? (I suggest
some censorship on page 10,
but this is very minor.)

I would delay your
approval until after
you have seen Tony
Thurston on Sunday
morning.

DRN

1/11

Excellent news. An
mark from the
US and President's name
no

cc BB
BC
14

FROM: CHIEF SECRETARY

DATE: 1 November 1985

PRIME MINISTER

PUBLIC EXPENDITURE CABINET

The Lord President is submitting to you a draft of the report of the MISC 120 Group. Agreement has now been reached on all programmes except housing. This minute sets out the arithmetic at the end of the Survey process and suggests how the remaining gap can be bridged and the way in which the results of the Survey should be presented.

The results of MISC 120

2. At its July meeting Cabinet decided that the planning totals should be

<u>£ billion</u>		
139.1	143.9	148.2

At the conclusion of the bilaterals, bids outstanding were some

3.4	4.7	5.7
-----	-----	-----

after allowing for lower reserves and higher asset sales proposed in July. As you are aware, I reconsidered the position on asset sales and the Reserve following the Cabinet meeting in October. In order to assist the Group in its work I concluded it was possible to reduce the Reserve and increase asset sales slightly more. I also considered a small addition of £0.5 billion could be made to the so far unpublished planning total in 1988-89.

3. During the course of the discussions on local authority current expenditure it became clear that agreement could be reached on the figures for 1987-88 and 1988-89 only by a very substantial addition to programmes, especially for education and law and order; or by setting the figures at the cash level for 1986-87 and transferring the increase that had previously been set aside (including the provision for restructuring of teachers' pay) to the Reserve. It was agreed to adopt the latter course and add £¼ billion, £¾ billion and £1 billion to the Reserve.

4. The net result of these changes is that the baseline against which the MISC 120 Report is measured embodies

	<u>£ billion</u>		
Planning total	139.1	143.9	148.7
Reserves	4.75	6.5	8.0
Asset sales	4.50	4.25	4.0

5. Lord Whitelaw has now reached a settlement with Michael Heseltine for defence at baseline for all three years.

6. Discussions are still continuing with Kenneth Baker to see if a settlement can be reached at the MISC 120 offer of

+120 +100 +80

7. I am still discussing with Peter Walker the figures for coal and gas but I expect these to be resolved at the figures I have proposed.

8. On Scotland, the Group has concluded that the option of a major revision of the block should not be pursued this year, though a study should now be set in hand. This leaves a number of smaller proposals to be sorted out. I hope to settle these with George Younger as soon as possible after he returns on Monday.

Closing the Gap

9. Table A attached sets out the position in relation to baseline which MISC 120 will be reporting to Cabinet at the conclusion of its work. Although, given the magnitude of the task, it has done well and driven some hard bargains there are overshoots of

0.2 0.25 0.1

Thus it will be clear to Cabinet that even if housing is settled at the Group's offer, which is incorporated into the figuring, our targets, revised in the third year, cannot be hit without some further adjustments by the Treasury. Obviously our first priority must be to settle housing, either before or at Cabinet, with the smallest possible addition to the offer. I believe there are good arguments for the position the Group has taken.

10. There is, however, a further element to be taken into account. The discussions on social security were conducted in the knowledge that revised costings were being prepared to take account of increases in the take-up of benefits. Our best estimates of the additions that are necessary over and above the MISC 120 figures are

+0.3 +0.3 +0.3

In addition, you advised that it would be better to revert to a flat profile for the assumption on unemployment. The effect of this is to add back

The Treasury had not brought your proposal of a fall between this year and next and flat thereafter. They are happy about it.

- +0.1 +0.2

I do not believe it is sensible to ignore these estimating changes; to do so would merely create a claim on the Reserve before the planning period has even begun. We should not plan on this basis especially when there are so many other potential claims on the Reserve.

SECRET

11. Adding in these estimating changes, the gap which I will have to bridge therefore becomes

0.5 0.65 0.6

plus any further concession which may be made on housing. I need, therefore, to be ready to cope with gaps of the order of

$\frac{1}{2}$ $\frac{3}{4}$ $\frac{3}{4}$

12. I start from the principle that it is extremely undesirable to make further additions to the published planning totals for years 1 and 2 which have already been increased in the Budget. This would undermine the principle of sticking to cash plans and undermine our ability to resist upward pressures in future Surveys. Some marginal adjustment could be made to the so far unpublished year 3 while remaining consistent to our objective of holding expenditure broadly constant in real terms and of securing a fall in the ratio of public expenditure to GDP.

13. The Reserves embodied in the MISC 120 arithmetic are substantial, but so too are the likely pressures upon them. We must, for example, be ready to meet the inevitable additions to local authority current expenditure for which no increase has been provided; and the settlement reached on social security in the last year is a provisional one, pending the outcome of the MISC 111 discussions. If we are to maintain Reserves which are both substantial and rising, there is only limited scope for further reductions.

14. On asset sales, however, the Chancellor and I believe a significant adjustment can be made. It is Government policy to achieve a very substantial transfer of assets to the private sector and we are progressively raising our sights in this area. Kenneth Baker will, for example, be bringing proposals to E(A) shortly recommending that regional water authorities be privatised. We could therefore publish more ambitious plans.

SECRET

The Chancellor and I can elaborate on our latest projections. We believe we should set ourselves the objective of sales of £4¾ billion in each year. This provides extra receipts of

*This looks well feasible
- see extra pps attached.*

<u>£ billion</u>		
$\frac{1}{4}$	$\frac{1}{2}$	$\frac{3}{4}$

15. There are difficulties to this course. We will have to counter the criticism that higher asset sales are being used to finance higher programmes. And if one of the major sales runs into difficulties we cannot at short notice put something in its place. In my view, this is another reason for ensuring that we have substantial Reserves so that the planning totals are not put under pressure in later years. Taking these risks into account, together with the other likely pressures, I believe we could adopt Reserves of:

<u>£ billion</u>		
$4\frac{1}{2}$	$6\frac{1}{4}$	8

16. This would contribute an extra

$\frac{1}{4}$	$\frac{1}{4}$	-
---------------	---------------	---

and taken together with the increase in asset sales allow us to bridge the likely gap.

17. The figures we would present would then be

*You will want to ask
(a) what the last published figures were (I cannot say for sure)
(b) what the markets expect.*

	<u>£ billion</u>		
Planning total	139.1	143.9	148.7
Asset sales	4.75	4.75	4.75
Reserves	4.50	6.25	8.0

Next Steps

Scheduled for Monday morning 18. I would welcome the opportunity to discuss these proposals with you and the Chancellor. When we have agreed our approach (which may need minor adjustments to reflect any last minute changes in the arithmetic) I would not propose to circulate a paper to Cabinet. Assuming we reach a settlement on housing at the end of the Cabinet discussion, I or the Chancellor would

set out for colleagues broadly how we proposed to present the figures in the Autumn Statement. We could also offer to write to colleagues the following day setting out the figures precisely.



for JOHN MacGREGOR

[Approved by the Chief Secretary]

SECRET

TABLE A

MISC 120 PROPOSALS

	1986-87		1987-88		1988-89	
	Baseline	MISC 120 PROPOSALS	Baseline	MISC 120 PROPOSALS	Baseline	MISC 120 PROPOSALS
+ MOD(1)	18,560	0	18,859	0	19,033	0
+ FCO-ODA/ATP	1,296	21	1,317	29	1,350	37
+ ATP contributions + from other depts		-4		-11		-11
+ ENERGY	294	22	293	32	300	35
+ DOE-HOUSING	2,424	120	2,526	100	2,589	80
+ DOE-OTHER	848	-20	860	-20	882	-15
+ DES	3,418	81	3,505	75	3,593	60
+ OAL	333	7	342	9	350	12
+ HEALTH & PSS	14,945	250	15,622	300	16,012	600
+ SOCIAL SEC.	41,547	891	43,553	181	44,642	380
+ SCOTLAND	4,300	-27	4,373	-1	4,482	-18
+ Territorial + consequences		90		110		185
+ NAT IND						
+ Electricity	-1,447	31	-1,487	-198	-1,524	243
+ Water E&W	123	0	15	0	15	0
+ Coal	382	318	392	158	402	-2
+ BGC	-470	50				
+ TOTAL AGREED + IN BILATERALS	52,509	-1,675	53,724	-533	56,574	-1543
= PLANNING TOTALS	139,062	155	143,894	231	148,700	43

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TABLE B

PROGRAMMES AGREED OUTSIDE MISC 120P
1.11.85

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SCORECARD

£million

EX		1986-87		1987-88		1988-89	
		Baseline 999,999	AGREED 99,999	Baseline 999,999	AGREED 99999	Baseline 999,999	AGREED 99999
+	1. FCO-OTHER	603	38	619	43	635	63
+	2. EC	640	10	830	320	850	100
+	3. IBAP/AFF CAP	1,277	272	1,304	334	1,337	336
+	4. AFF domestic	713	8	699	5	717	3
+	5. FORESTRY	53	0	54	0	56	0
+	6. TRADE/INDUSTR	1,162	-13	980	12	1,004	-25
+	7. ECGD	78	200	-43	213	-44	138
+	8. EMPLOYMENT	3,704	-74	3,901	-207	3,999	-125
+	9. TRANSPORT	1,955	27	1,995	33	2,045	52
+	10. DOE-PSA	-120	7	-128	0	-131	0
+	11. LCD	574	21	610	39	625	73
+	12. HOME OFFICE	1,061	43	1,104	44	1,131	55
+	13. CIVIL SUPER	1,114	65	1,226	86	1,257	147
+	14. WALES	1,708	-1	1,735	-1	1,779	-4
+	15. N. IRELAND	4,464	53	4,603	76	4,717	105
+	16. CHANCELLOR'S	1,825	163	1,842	169	1,888	143
+	17. OTHER (incl ter consequences)	366	170	396	170	406	205
	NAT IND						
+	20. Settled	1,495	-4	1,265	-77	1,299	-459
+	21. RMPS & SRP	309	194	318	-41	326	-50
+	23. BGC			-390	390	-400	400
+	24. LA REL CUR(UKA)	26,032	646	26,301	359	26,959	-323
+	25. SPECIAL SALES OF ASSETS	-2,250	-2,250	-2,250	-2000	-2,250	-1750
+	26. RESERVE	6,000	-1,250	7,000	-500	7,000	1000
+	27. 3.3% increase in 1988-89					1,627	-1627
+	28. less double counting	-254		-247		-258	
+=	TOTAL AGREED	52,509	-1,675	53,724	-533	56,574	-1543

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CLON POL : Public Expend R 33





PRIME MINISTER

STAR CHAMBER

I thought that you would like to see for the weekend the attached draft report to the Cabinet on the work of the Star Chamber (MISC 120).

2. As you will see, a few passages are still provisional, since the Chief Secretary and I are still in discussion with one or two Ministers; and the detailed figures still have to be finalised. But, subject to my comments below, the picture is now substantially complete and you will see that, if our recommendations are endorsed by the Cabinet, the excess net bids above baseline with which we started of some £3.4 billion, £4.7 billion and £5.7 billion will have been reduced in the Star Chamber to £0.2 billion, £0.2 billion and £0.05 billion respectively. In achieving this, I have been greatly indebted to my colleagues on MISC 120 who have spent very long hours and taken a great deal of trouble in studying all the claims. I have also very much admired John MacGregor's performance as Chief Secretary.

3. Subject to the points that John MacGregor and I are still pursuing, this reflects agreement with the spending Ministers concerned on all programmes except housing. The most important development since my interim report to you of 25 October is settlement of the defence programme. Following my discussion with you yesterday, and subsequent consideration with my colleagues in the Star Chamber, I have agreed with Michael Heseltine that he should accept as his total Ministry of Defence baseline for the first two years the figures already in the 1985 Survey - that is, £18,560 million and £18,859 million respectively. For the third year, I persuaded him, as I suggested to you, to accept the baseline figure of £19,033 million without any



addition on top of that for the Falklands. This is not as large a reduction as the Star Chamber itself sought; and less still than the Chief Secretary's original proposal. But in the circumstances I do not think this is at all a bad settlement and it marks a decisive switch in the defence programme from the previous commitment to real terms growth to a genuine cash planning figure. In view of this, I hope I was right in telling Michael Heseltine that he did not need to come to Cabinet next Thursday and that he could keep to his original travel plans. I felt that there was very great advantage in getting this settled and out of the way before the weekend.

4. I have also been able to settle the overseas aid programme with Geoffrey Howe. The settlement falls short of his original bids, but will enable him to maintain the real value of the total aid programme, including the increase in the Aid and Trade Programme that we agreed in July.

5. At the time of preparing this report, the only outstanding issue is that of housing, and the draft assumes that this will remain in contention and will be a matter for the Cabinet to decide. The issues were summarised in paragraphs 12 and 13 of my minute to you of 25 October. I very much hope, however, that it might still be possible to persuade Kenneth Baker to drop his very large bids and accept the Star Chamber's proposal. I am sure you will agree that it would be most unfortunate, from a number of points of view, if he alone were to take a disputed issue to the Cabinet. He is away in the United States this weekend, but John Wakeham and I will be in touch with him first thing on Monday morning to try to reach a settlement with him. If we succeed, then we shall be able to put a fully agreed report to the Cabinet.



6. The outcome will, of course, still leave some excess over the baseline in each year. In addition, when we get to the autumn statement itself, I understand that the Treasury will need to take into account some further large estimating changes that are likely to arise on the social security programme. But my judgement is that the numbers are manageable and that they could not be reduced further without raising major political difficulties. The Chancellor and the Chief Secretary are considering how best to handle the gap and will be reporting to you separately.

7. I will, of course, let you know the outcome of my further contact with Kenneth Baker. In the meantime, if you have any comments on the draft report, I should be glad to know them. I imagine that you will not wish to circulate the report to Cabinet until next Wednesday.

Wells

Privy Council Office
1 November 1985



SECRET

DRAFT

PUBLIC EXPENDITURE SURVEY 1985

Memorandum by the Lord President of the Council

At their meeting on 11 July the Cabinet decided that the public expenditure planning totals should be £139.1 billion for 1986/87, £143.9 billion for 1987-88, and £148.2 billion for 1988-89, and invited the Chief Secretary, Treasury, to pursue bilateral discussions of expenditure programmes with the Ministers responsible. On 3 October the Chief Secretary, Treasury reported progress. The Prime Minister invited me to be the Chairman of the Ministerial Group on Public Expenditure (MISC 120) to consider and make recommendations on those issues which had not been resolved by the Chief Secretary, Treasury and the spending Ministers concerned (CC(85) 24th conclusions, minute 4; CC(85) 28th conclusions, minute 4).

2. This Memorandum sets out the recommendations of MISC 120. I should like to express my gratitude both to the members of the Group and the spending Ministers who have appeared before us for the care and thoroughness which they have brought to the task.

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A large number of programmes were agreed in bilateral discussions between the Chief Secretary, and the spending Ministers concerned. The effects on the Survey baseline are set out in Annex A; brief descriptions of the policy implications are in Annex B. MISC 120 were, however, left with an unprecedentedly large number of programmes to consider, with aggregate bids above the agreed baseline in the three years remaining at some £3.4 billion, £4.7 billion and £5.7 billion respectively, after allowing for the lower Reserves and large additional asset sales proposed by the then Chief Secretary in July and for changes agreed bilaterally between the Chief Secretary and spending Ministers.

4. In order to assist the Group's substantive discussions on the individual programmes, the Chief Secretary, Treasury reconsidered the prospects for receipts from asset sales and the size of the contingency reserve it would be prudent to keep in hand. He also considered whether it would be appropriate, in the light of the latest projection of inflation to make some small adjustment to the planning total for 1988-89 consistently with the Government's determination to hold that total broadly constant in real terms. He concluded that the following changes, though not without risk, would be possible.

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	£ billion		
	1986-87	1987-88	1988-89
Reduction in Reserve	0.5	0.25	0
Increase in receipts			
from asset sales	0	0.75	0.5
Increase in Planning Total	0	0	0.5

5. The Group have made major strides towards removing the outstanding excesses. The total agreed reductions in the additional bids amount to about £1.5 billion in each of the first two years, and £2.5 billion in the third. Changes in the economic projections reduced the social security additional bids by about £0.2 billion, £0.7 billion and £0.7 billion in each of three years, so somewhat reducing the extent of the Group's task. On the basis of the Group's proposals there would be excesses of about £0.2 billion in each of the first two years, and a small excess in the third year. Excesses of the order of £1 billion would remain in each Survey year if the main outstanding additional bid on housing were allowed. Since the Group discussed the Social Security programmed it has become clear that later estimating changes reflecting later assessments of claimant numbers and of the rate of take up of benefits, will add further to our problems, perhaps by as much as £¹/₂ billion by the third Survey year. There thus remain difficulties in holding to the agreed public expenditure planning totals.

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The Group have reached agreement with the spending Ministers concerned on the recommendations to be put to the Cabinet on all the programmes which they considered, except Housing. The recommendations on the agreed programmes are summarised in paragraphs 7 to 21. All figures are in £ million unless otherwise stated, and further details are provided in annexes to . A particular question arises about Scotland which is summarised in paragraph 15.

AGREED PROGRAMMES

Defence

The Survey baseline is as follows -

	18560	18859	19033
<i>of which</i>			
<i>Falklands</i>	442	292	192

These figures of course include a declining path for Falklands expenditure

The Secretary of State for Defence had proposed the following additions to baseline -

+ 422	+ 595	+ 897
-------	-------	-------

In discussion with the Group he accepted that, with the ending of the NATO commitment to 3 per cent real annual growth, there need be no question of further real increases in the defence programme. In these circumstances the future size of the defence programme should reflect on the one hand the requirement to maintain a defence capability sufficient

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Provision (ATP) agreed by the Ministerial Committee on Exports (EX(85) 3rd meeting, Item 1; EX(85) 4th Meeting, Item 1). Part of the cost of the latter will be met during the survey period by transfers from the Votes of other Departments interested in promoting the new facility.

Energy (Departmental Programme)

9. MISC 120 and the Secretary of State for Energy have agreed on savings on £5 million per annum from the nuclear research and development programme which will be found across the whole programme.

Department of the Environment: Other

10. Following discussions with the Group, the Secretary of State for the Environment and the Chief Secretary, Treasury have agreed the following reductions below baseline in the DOE "Other" programme -

-20

-20

-15

These figures are net of a substantial increase in receipts from the sale of new town assets. The urban programme which is an element in DOE Other is assumed to remain at baseline, pending further discussions among Ministers of possible Government policy responses to the recent disturbances in inner cities.

Education and Science

11. MISC 120 have agreed with the Secretary of State for Education and Science to recommend that the following additions should be made to his Department's Survey baseline:-

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Changes agreed bilaterally	28.5	23.5	8.0
Science and Universities	25	25	25
Local Authority capital	27	25	25

The changes agreed bilaterally primarily reflect spending on mandatory student awards and (in the first two years) expenditure on the "switch" transferred from other programmes to enable universities to increase their output of graduates in science and technology. The other additions will enable the Secretary of State to allocate some additional resources to key areas in science and the universities without relaxing the pressure on the latter for greater efficiency; and also provide some greater flexibility in essential local authority capital expenditure.

Arts and Libraries

12. MISC 120 have agreed with the Minister of State, Privy Council Office (Minister for the Arts) on the following net additions to the baseline provision for the arts and libraries:

7	9	12
---	---	----

These figures include additional provision for the Arts Council of

14	9	8
----	---	---

The Minister of State, Privy Council Office, believes that this will be sufficient to meet the requirements and political pressures arising from the abolition of the Greater London Council and the Metropolitan

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Councils, and to maintain the Arts Council's regional development strategy. The larger addition in 1986-87 reflects the need to ensure that there are no immediate adverse effects through abolition. In later years the Minister for the Arts expects to be able to secure more substantial contributions from the successor authorities towards the costs of the performing arts.

Health and Personal Social Services

13. There were large bids for additional expenditure on both the cash-limited parts of the programme (principally the hospital and community health services) and the demand-determined family practitioner services, which are not at present subject to a cash limit. They total -

409	487	870
-----	-----	-----

14. Following a re-examination of these bids the Secretary of State for Social Services has identified further savings that could be made by intensifying the campaign for increased efficiency in the hospital and community health services; and changes in provision for certain centrally financed services and for family practitioner services administration. These changes yield the following savings on the bids set out above -

159	184	270
-----	-----	-----

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SC 120 and the Secretary of State for Social Services jointly recommend them. The agreed additions to baseline then become

250 300 600

This will allow an increase of 2 per cent in real terms on hospitals and community health services current spending in 1986-87.

Scotland

15. The Group would like to have secured savings on the Scottish block of the order of -

100 150 200

reflecting their judgement that public service provision in Scotland is now generally too high in relation to comparable provision in England and Wales. For example Scottish local authority rents are 30 per cent lower as a proportion of average earnings than those charged in England, and health expenditure per head is over 25 per cent higher than the English average. Furthermore it is noteworthy that the population of Scotland has fallen by 1.5 per cent relative to England since the underlying base for the Scottish block was set in parallel with a needs assessment based on 1976 data. The Secretary of State for Scotland, however, considers that in general no changes can be made in the overall block provision

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other than as a result of the application to Scotland of variations in English programmes, by means of the automatic "formula" which regulates such marginal changes. The only other reductions the Secretary of State will contemplate are those which could not be readily detected by critics well-versed in the formula, or which could be justified by reference to particular Scottish circumstances. He has offered reductions in respect of lower rate fund contributions to housing revenue accounts.

Is it wise to be this explicit?

8.7 20.7 9.6

[Allowing for other changes agreed bilaterally,] the net changes to the Scottish programme are

[-28] -2 -20

The Group do not recommend further reductions on this occasion. They believe, however, that the present position is unsatisfactory, and should not be allowed to continue indefinitely. There is a clear case for a fresh assessment of need to serve as the basis for the allocation of public provisions as between England, Scotland, Wales and Northern Ireland. The objective would be to establish new baselines for the territorial block provisions, and a new mechanism for adjusting those baselines in the light of future economic, demographic and other relevant changes. The Group recommend that this fresh assessment of need be undertaken in time to be taken into account in decisions on the 1986 public expenditure survey; the work should be undertaken on a

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confidential basis within Government, but Ministers would need to be ready to explain that the assessment was required to take account of changes over the last decade throughout the United Kingdom and implied no prejudgements about the conclusions.

Electricity Industry

16. The Survey baseline is as follows -

-1447 -1487 -1524

Following substantial reduction of the electricity supply industry's initial bids, the Secretary of State for Energy sought the following changes in the baseline provision -

+169 -124 +568

After re-examination of the scope for further savings, and some rephrasing of working capital requirements from 1986-87 to 1987-88, and given that, on the latest available evidence, the timetable for construction of the Sizewell PWR is likely to slip a year, the Group and the Secretary of State for Energy have agreed to recommend the following changes from the above baseline -

+31 -198 +243

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The Chief Secretary, Treasury has agreed that if, contrary to expectations, it were possible to begin construction of Sizewell next year, as previously hoped, any resulting additional expenditure above the baseline should be met from the Reserve.

Water

17. Following discussion with the Group, the Chief Secretary, Treasury and the Secretary of State for the Environment have agreed that there should be no increase in the baseline provision during the survey period. This is consistent with maintaining planned investment at broadly the same levels as envisaged last year, and an average increase in domestic charges of about 8 per cent, or slightly lower, next Spring. The Group recommend that the figures should be settled on this basis, while noting the concern of the Secretary of State for the Environment at the potential political problems when the House of Commons is asked to approve the necessary Rate of Return Order next January or February. They also note that a settlement on the proposal basis represents some relaxation of the rate of improvement in the water industry's financial performance sought by E(NI) last year.

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Treasury are trying
hard to settle this
without your
intervention.

Coal and Gas Industries

18. [It is not possible to provide well considered figures about the coal industry, since the NCB has yet to produce a corporate plan following the ending of the miners' strike. Considerable uncertainty remains about the rate at which capacity can be reduced. The Chief Secretary's best view of the likely requirements of the coal industry for external finance indicates increases above baseline of

[318]

[158]

[-2]

The Secretary of State for Energy does not wish to propose alternative figures, but warns that the state of the market and the rate of pit closures could require additional expenditure of £150-200 million in each survey year.]

19. For the British Gas Corporation, which is due to be privatised next autumn, the Chief Secretary, Treasury and the Secretary of State for Energy have agreed that the baseline negative external financing requirement of £470 million should be revised to £420 million to cover the period before privatisation takes place. This figure will not be separately identified in the Autumn Statement or in the forthcoming White Paper.

Social Security

20. There are large additional bids stemming mainly from changed economic assumptions and higher take-up of benefits which are inevitable without policy changes. Following the Chief Secretary's bilateral discussions,

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and taking account of further revision to the figures in the light of the autumn economic forecast, the bids above the Survey baseline totalled -

+982 +459 +1144

21. After a careful and detailed examination of options for further savings, including possible accelerated implementation of some of the measures in the Social Security Reviews, the Group, with the agreement of the Secretary of State for Social Services, recommend the following further savings -

	1986-87	1987-88	1988-89
No uprating of Child Benefit in July 1986, but full uprating in April 1987. Further savings in 1988-89	16	-27	23
A new drive against social security fraud	25	30	30
Reduction of help with mortgage interest from July 1986	10	*	*
Further restrictions on single payments	40	80	160
Delay abolition of retirement pensioners' earnings rule until April 1989	-	30	105
Require employers to take over payment of maternity allowance on the same basis as Statutory Sick Pay	-	140	170
Introduce selective provision to replace maternity and death grant.	-	25	*
Adjustment required to reach agreed provisional total for the programme	-	-	276
Total Savings	91	278	764

* Saving already scored in base figures

The total for expenditure on social security in 1988-89 has been calculated by adding to the adjusted 1987-88 baseline the £380 million needed to meet the cost of a full $3\frac{1}{4}$ per cent uprating of benefits in April 1988, reflecting the latest projections of the course of the Retail Prices Index, rather than the $2\frac{1}{2}$ per cent increase assumed in the baseline. It should be emphasised that the 1988-89 figures are provisional, and will depend on decisions still to be taken in the context of the social security Review.

The agreed changes from baseline on social security are thus -

+891	+181	+380
------	------	------

DISAGREED PROGRAMME: HOUSING

22. The Group have not been able to reach agreement with the Secretary of State for the Environment on the housing programme.

The baseline provision is as follows -

1986-87	1987-88	1988-89
2424	2526	2589

In discussion with the Group the Secretary of State for the Environment has insisted on the following net additions to the baseline -

+679	+968	+892
------	------	------

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24. These additions include agreed amounts of £144 million, £158 million and £57 million to meet the unavoidable effect of interest rate changes on housing subsidy and rate fund contributions and on option mortgages. The remainder of the bid is made up as follows -

New provision for rent	+ 50	+ 50	+ 50
Renovation of public sector stock	+550	+850	+850
Other changes	- 55	- 85	- 65

On housing renovation the Secretary of State bases his case on the report compiled from information supplied by local authorities which indicates a backlog of £19 billion of repairs and improvements which are urgently required. To forestall further dilapidation and cost escalation, he considers that sufficient resources should be provided to reduce the backlog very substantially over a period of 10 years.

He also seeks increases for new housing provision by local authorities and the Housing Corporation; this would allow the construction of 36,000 houses each year in 1986-87 and 1987-88 and 28,000 in 1988-89.

23. The Group considered these bids very carefully, particularly in relation to housing renovation. They do not, however, accept the case for a public sector housing renovation programme on the scale suggested. They believe that the Government's record on public sector housing is a good one, and they doubt whether taxpayers should be asked to fund improvements to the public sector stock which would be beyond the reach

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of the occupiers if the houses were in owner occupation. However, they recognised the need to respond constructively to the report and they proposed to the Secretary of State for the Environment the following increases above baseline provision for housing renovation which, together with existing provision, would be enough to finance a £15 billion renovation programme over 11 years -

+100 +200 +200

24. They believe, however, that such priority for renovation can only be justified if lower priority is accorded to new construction. They therefore suggested to the Secretary of State for the Environment reductions in expenditure on new public sector build consistent with the maintenance of 30,000 starts in 1986-87 and 1987-88, and 28,000 in 1988-89. This would involve reductions below baseline of -

- 70 -190 -120

so producing overall net changes in the housing baseline of -

+120 +100 + 80

25. The Secretary of State for the Environment made it clear that he could not accept these proposals and that in particular in his view the additional provision for public sector renovation was not an adequate response to the needs he perceives. He also argued that gross capital expenditure on housing in 1986-87 should not be lower than the expected out-turn for 1985-86 of £3300 million (an overspend of £250 million on the White Paper provision), and that capital allocations should be

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maintained at not less than the current year's level of £1600 million, which would require an increase in provision above baseline of £300-350 million in addition to the agreed bids noted in paragraph 23. The Group, however, do not feel that it would be appropriate, given the overall constraints, to go beyond the additions they have suggested for housing renovation, and they consider that the changes they recommend are a reasonable and constructive response to the established needs.]

Local Authority Current Expenditure and the Reserve

26. Inevitably a major concern remains about the future course of local authority current expenditure. In general the Government must rely on indirect means to control this expenditure, and the outcome is likely to be influenced also by changes in the political complexion of individual authorities. A major uncertainty remains about whether or when the authorities might be in a position to call on the additional resources held out by the Government for restructuring teachers' pay following an agreement on teachers' duties and on the better management of the teaching force. There is a risk, in the present climate, that any figures put in would only be regarded as a challenge to be exceeded; and to give in the White Paper a breakdown between services of an aggregate the Chief Secretary could accept in advance of negotiation with the authorities would almost certainly show lower expenditure than Government policy would indicate on, for example, police and personal social services. The Chief Secretary has therefore agreed with the Environment Secretary and the Ministers responsible for the main services that the

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agreed 1986-87 figures (without any addition for teachers' pay) should be projected forward unchanged in cash terms for the following two years, with a clear proviso that future expenditure provision will be determined in the context of each successive year's Rate Support Grant settlement, and that regard has been had to this in determining the size of the Reserve. The Reserve has accordingly been increased above the level at which it would otherwise have stood by £0.25 billion, £0.75 billion and £1.5 billion for the three years, principally on this account. Taking into account the other changes set out in paragraph 4 above, the Reserve thus now stands at £4.75 billion, £6.5 billion and £8 billion for the three years.

RECOMMENDATIONS

27. I invite the Cabinet -

- a. to endorse the agreements reached, as summarised in paragraphs 7 to 21 above.
- b. To decide the appropriate provision for the housing programme in the light of the considerations set out in paragraphs 22 to 25 above.
- c. To agree that a fresh assessment of need be undertaken, on a confidential basis within Government, to serve as the basis for the allocation of public provision as between England, Scotland, Wales and Northern Ireland.

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MISC 120 : PROGRAMMES PREVIOUSLY AGREED

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SCORECARD

£million

EX		1986-87		1987-88		1988-89	
		Baseline 999,999	AGREED 99,999	Baseline 999,999	AGREED 99999	Baseline 999,999	AGREED 99999
+	1. FCO-OTHER	603	38	619	43	635	63
+	2. EC	640	10	830	320	850	100
+	3. IBAP/AFF CAP	1,277	272	1,304	334	1,337	336
+	4. AFF domestic	713	8	699	5	717	3
+	5. FORESTRY	53	0	54	0	56	0
+	6. TRADE/INDUSTR	1,162	-13	980	12	1,004	-25
+	7. ECGD	78	200	-43	213	-44	138
+	8. EMPLOYMENT	3,704	-74	3,901	-207	3,999	-125
+	9. TRANSPORT	1,955	27	1,995	33	2,045	52
+	10. DOE-PSA	-120	7	-128	0	-131	0
+	11. LCD	574	21	610	39	625	73
+	12. HOME OFFICE	1,061	43	1,104	44	1,131	55
+	13. CIVIL SUPER	1,114	65	1,226	86	1,257	147
+	14. WALES	1,708	-1	1,735	-1	1,779	-4
+	15. N. IRELAND	4,464	53	4,603	76	4,717	105
+	16. CHANCELLOR'S	1,825	163	1,842	169	1,888	143
+	17. OTHER (inc ter consequences)	366	170	396	170	406	205
	NAT IND						
+	20. Settled	1,495	-4	1,265	-77	1,299	-459
+	21. RMPS & SRP	309	194	318	-41	326	-50
+	23. BGC			-390	390	-400	400
+	24. LA REL CUR(UKA)	26,032	646	26,301	359	26,959	-323
+	25. SPECIAL SALES OF ASSETS	-2,250	-2,250	-2,250	-2000	-2,250	-1750
+	26. RESERVE	6,000	-1,250	7,000	-500	7,000	1000
+	27. 3.3 % increase in 1988-89					1,627	-1627
+	28. less double counting	-254		-247		-258	
=+	TOTAL AGREED	52,509	-1,675	53,724	-533	56,574	-1543

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MISC 120 : PROGRAMMES CONSIDERED BY THE GROUP

	1986-87		1987-88		1988-89	
	Baseline	MISC 120 PROPOSALS	Baseline	MISC 120 PROPOSALS	Baseline	MISC 120 PROPOSALS
+ MOD(1)	18,560	0	18,859	0	19,033	0
+ FCO-ODA/ATP	1,296	21	1,317	29	1,350	37
+ ATP contributions from other depts		-4		-11		-11
+ ENERGY	294	22	293	32	300	35
+ DOE-HOUSING	2,424	120	2,526	100	2,589	80
+ DOE-OTHER	848	-20	860	-20	882	-15
+ DES	3,418	81	3,505	75	3,593	60
+ OAL	333	7	342	9	350	12
+ HEALTH & PSS	14,945	250	15,622	300	16,012	600
+ SOCIAL SEC.	41,547	891	43,553	181	44,642	380
+ SCOTLAND	4,300	-27	4,373	-1	4,482	-18
+ Territorial consequences NAT IND		90		110		185
+ Electricity	-1,447	31	-1,487	-198	-1,524	243
+ Water E&W	123	0	15	0	15	0
+ Coal	382	318	392	158	402	-2
+ BGC	-470	50				
+ TOTAL AGREED IN BILATERALS	52,509	-1,675	53,724	-533	56,574	-1543
= PLANNING TOTALS	139,062	155	143,894	231	148,700	43
NET ADDITION SOUGHT BY THE ENVIRONMENT SECRETARY		559		868		812
plus further territorial consequences		112		174		162

(12)

PRIME MINISTERPUBLIC EXPENDITURE

You may like to know the proposed timetable towards Cabinet next Thursday.

You should receive tomorrow night a draft report from MISC 120 to Cabinet about the results of their discussions. The Chancellor intends to send you a minute with proposals about how the public expenditure totals are to be handled in the Autumn Statement. There is a real risk that the public expenditure planning totals presently set will be exceeded, even allowing for the extra asset sales and reductions in the reserve which the Treasury felt able to offer at the start of MISC 120.

The Treasury may still have a little room for manoeuvre, though I have no firm grounds for this being so. But none of the options, whether a further reduction in the reserve, another increase in asset sales, fudging the figures, or increasing the planning total, is at all attractive. The markets will study these figures closely and, as you will know, their confidence is always fragile: the difficulties with the markets last year started from scepticism about the Autumn Statement.

I have accordingly pencilled in a meeting for you with the Chancellor and the Chief Secretary on Monday morning to discuss the handling of this area in the light of the Chancellor's minute.

Mr Unwin will aim to let you have the brief for Cabinet on Tuesday evening, with a view to a discussion of handling on Wednesday evening or Thursday morning. This task will of course be eased if Mr Heseltine does not go to Cabinet.

Lord Whitelaw told the Chief Secretary this evening that he would be willing to recommend acceptance of base line for defence if that seems necessary after further discussion with Mr Heseltine. The Chief Secretary took that reasonably well. The Star Chamber will however at least start by proposing to Mr Heseltine that the third year should be held flat in cash terms, with the Falklands addition on top. (My suggestion about the Royal Ordnance Factories, as it turns out, may help to avoid a later dispute, but it amounts more to avoiding an additional bid than to finding money to finance other expenditure, I am afraid.)

If Mr Heseltine settles, the Chief Whip will then see Mr Baker early next week to try to persuade him also to settle outside Cabinet. If the Chief Whip fails, Lord Whitelaw will then see Mr Baker.

One final point. You mentioned today the idea that there might be no uprating for the unpledged benefits next July. This has apparantly been discussed in the Star Chamber but all except the Chief Secretary thought it politically not on. It may nevertheless at least be worth mentioning when MISC 111 comes to discuss savings under the review. (One of the measures already agreed is of course that Child Benefit should not be uprated next July.)

Martin Sawyer

pp. DAVID NORGROVE
31 October 1985

CONFIDENTIAL



FROM: CHIEF SECRETARY

DATE: 31 October 1985

Prime Minister
 Agree to
 support work

Strongly?
 PRIME MINISTER

Dev
 ||||

Yes - absolutely
 with
 me

PUBLIC EXPENDITURE: 1985-86 OUTTURN

I am sending this minute to warn colleagues that claims on this year's Reserve are now expected to go beyond the amount available in the Reserve, so that we are facing the prospect of an overspend on the 1985-86 planning total. This is most worrying, not least in view of the increase in the Reserve in this year's Budget to meet the pressures that were building up from expenditures outside colleagues' direct control. This increase was presented as prudent and realistic, but also adequate. The pressures have remained intense; but they reinforce the need for adequate control in areas where we have some discretion.

2 I recognise that at this stage in the year any general moratorium or across-the-board reductions in provision would have damaging consequences for efficient management. But if we eschew such action, it is essential that colleagues should be vigilant in avoiding any overspend on provision and, where necessary, should take action to prevent it. For my part, I will apply firmly and strictly the existing cash limit and other controls. I will insist that colleagues offset any bids on the Reserve wherever possible by savings elsewhere within their programme. I will be especially reluctant to concede any increase in a cash limit. Even where the increase is in a demand-led programme, the scope for offsetting savings must also be explored, in line with the rules established for the new-style Reserve. Extra unanticipated receipts or an underspend arising on one

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cash limit should not be used to finance additional expenditure elsewhere, but should be surrendered to the Reserve, again in accordance with the normal rules. The same firm approach must be applied to nationalised industry EFLs. I have asked my officials to take a similar line in their discussions with all spending departments.

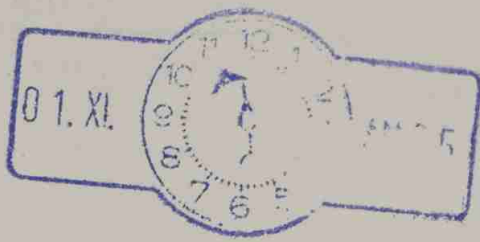
3 I am aware that this approach will mean some unpalatable choices; but we must show that our in-year expenditure control mechanisms can be made to work if our plans which will be published in the Autumn Statement and White Paper are to carry credibility. I hope therefore that colleagues will give their full support to these efforts to minimise any potential overspend this year, and if at all possible to remove it.

4 I am copying this letter to other members of Cabinet, and to Sir Robert Armstrong.



JOHN MacGREGOR

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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Viscount Whitelaw CH MC
 Lord President of the Council
 Privy Council Office
 38 Whitehall
 London
 SW1A 2AT

31st October 1985

Dear Willie,

MISC 120: ENERGY

FILE WITH Dr.?

I am grateful to Peter Walker for sending me a copy of his letter of 25 October recording the outcome of our discussion in MISC 120 on 24 October. I am content with the figures he sets out, including his costings of a further year's delay in beginning construction of Sizewell. I have noted Peter's views about the position we might face if in the event Sizewell went ahead before Autumn 1987. This is something we can discuss at the time if necessary.

I am copying this letter to the other members of MISC 120 and to Peter Walker.

Yours ever,
JH

JOHN MacGREGOR

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~~NAT FUND
POLICY
PT 10~~

Rebue by.

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CBG

*Mr Middleton
Mr Bailey
Mr Anson
Mr Jameson
Mr Schell
Mr Watson
Mr Norton
Mr Allan
Mr Pirie
Mr Sudge
Mr Cupper
Mr Lord*

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon George Younger TD MP
Secretary of State for Scotland
Scottish Office
Dover House
Whitehall
London
SW1A 2AU

pc

30 October 1985

Dear George,

LOCAL AUTHORITY EXPENDITURE: SCOTLAND: AEG 1986-87

attached

Thank you for your letter of 24 October.

I am afraid I cannot accept your proposal to limit penalties at outturn to £80 million. This could give very perverse signals to local authorities and it provides no certainty at all that the cost would be kept to the equivalent of a £2,000 million AEG at settlement with the existing penalty tariff. I cannot go beyond that. As you know, I regard £2,000 million as a fair figure for Scotland by comparison with the AEG figure already announced for England.

Nevertheless you have made it clear that you regard the political consequences of a settlement at this level as serious and overriding. In the light of your comments I am prepared on this occasion to agree to your earlier proposal to announce an AEG of £2,025 million, provided that the additional £25 million is found from savings within the Scottish block. That seems to be the only alternative, given the difficulties you see in a tougher penalty regime.

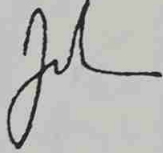
The result of proceeding in this way will be to produce a net reduction in your block in public expenditure of £25 million in 1986-87. This is in addition to the savings of, in rounded figures, £9 million, £21 million and £10 million which will arise from the proposal in your letter of 24 October to Willie Whitelaw to alter the way in which economic assumptions are applied to your housing programme. I am prepared to agree to this proposal (subject to the figures being verified by our officials - in 1988-89 I understand the saving to be the £10 million I mention above rather than the £25 million you referred to).

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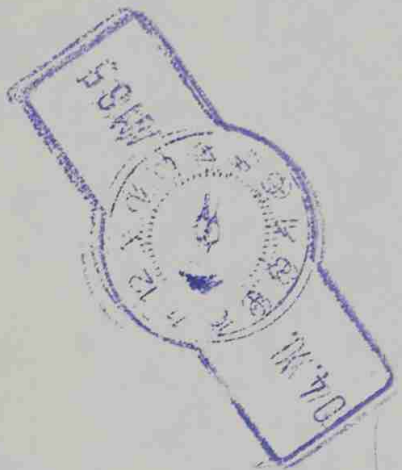
We have of course yet to conclude discussions on other aspects of your programme.

I am copying this letter to Willie Whitelaw, other MISC 120 members and to Brian Unwin (Cabinet Office).

Yours ever,


JOHN MacGREGOR

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PRIME MINISTER

PUBLIC EXPENDITURE

You discussed yesterday with the Lord President and Chief Secretary the handling of public expenditure next week and the problem of Mr. Heseltine's visit to the Far East.

The Lord President has thought further about this. He feels "very very strongly indeed" that defence should come to Cabinet with housing, both because it would be tactically right in survey terms, and because it would avoid ill-feeling about an apparently private deal.

The problem is that if Mr. Heseltine's trip goes ahead as planned he will miss the public expenditure discussion in Cabinet which is at present scheduled for Thursday next week, 7 November. Mr. Heseltine intends to leave for Malaysia on the evening of Tuesday 5 November, returning via Burma, Thailand and a meeting of the WEU in Rome on 14 November.

One option would be to hold Cabinet on Tuesday 5 November. Lord Whitelaw believes this would be terribly difficult for his group to prepare for, but just about possible. A number of Cabinet Ministers also have plans to be out of London that day. Cabinet on Thursday, as planned, would be far preferable.

There are apparently no specific reasons for Mr. Heseltine to go to Malaysia next week. So if he were required to attend Cabinet on Thursday, 7 November he could either switch Malaysia to the end of the tour and miss the WEU, or he could postpone Malaysia to another time. Either would be awkward given our relations with Malaysia and particularly the problems with tin. However, Mr. Heseltine's PPS seemed reasonably relaxed about the prospect of moving or postponing the Malaysian part of the trip and it might be possible to

smooth relations for example by a personal message from you to the Malaysian Prime Minister if that really seemed necessary. I do not know what would be lost if he missed the WEU: FCO could not say.

Nonetheless, it seems right to press Mr. Heseltine very strongly on the need for him to be at Cabinet on Thursday, 7 November, unless he is prepared to settle with Lord Whitelaw before then. If he refuses, it would then be necessary to consider whether you wanted to insist, taking account of his reasons.

Content?

Yes not

DAN

David Norgrove
29 October 1985

CONFIDENTIAL

LOCAL AUTHORITY EXPENDITURE:

SCOTLAND - AGGREGATE EXCHEQUER GRANT (AEG) 1986-87 pa

The Chief Secretary and the Secretary of State have been discussing the appropriate level of AEG in Scotland for 1986-87. The Secretary of State has argued that AEG of up to £2025 million is necessary to avoid politically unacceptable rate increases. The Chief Secretary has suggested AEG of £2,000 million but has said he would accept a figure of £2015 million being announced, providing this was accompanied by tougher penalties for overspending than at present which would achieve an effect broadly similar to AEG of £2,000 million.

2 In his letter of 24 October, Mr Younger says he is prepared to accept the offer of £2015 million with tougher penalties (subject to some limiting of the penalties). However, he records his concern about the political consequences of the rate increases which he thinks will follow from a settlement at this level with the tougher penalty regime.

3 If the political problems of a settlement at £2015 million with a tougher penalty regime are felt to be overriding, an alternative would be to revert to the Chief Secretary's original proposal of AEG of £2,000 million with the present penalty system; and suggest to Mr Younger that he increases the level of AEG to £2025 million if that is what he judges is necessary by finding the extra £25 million from his block budget.

4 The effect of this proposal would be to create a £25 million saving on the block budget. Mr Younger would have to justify this by reference to the greater priority he attached to increasing AEG. There is a precedent for

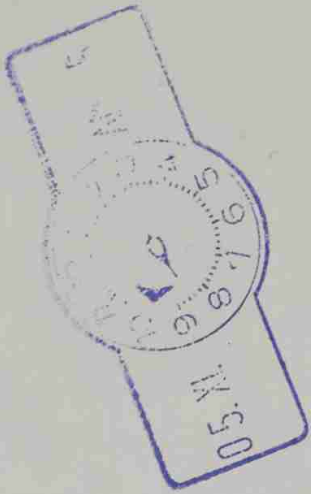
CONFIDENTIAL

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such a switch. A similar switch was made in respect of domestic rate relief following the rates revaluation in 1985-86. The amount involved was £26 million. Providing local authorities use the higher level of AEG to reduce rates rather than to increase expenditure the public expenditure saving will be carried through to outturn-taxes (in this case rates) will be that much lower. It is of course Mr Younger's case that authorities will not reduce expenditure below a certain level but will increase rates instead.

5 The saving would arise in 1986-87 only although in principle similar agreements could be reached in the annual RSG settlements in later years.

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PUBLIC EXPENDITURE: ELECTRICITY

Line to take

It is satisfactory that the external financing requirements for the electricity industry have now been settled in the Star Chamber.

2. It was a great pity that the CEGB had felt it necessary to introduce a major additional bid at a late stage in this year's discussions. It is particularly disappointing that some of the AGRs (including Heysham I) are still requiring large scale capital expenditure to put them right. The need for expenditure to improve endurance is appreciated.

3. Although some of the savings in the IFR settlement were found on the Sizewell programme, there has been no policy change with respect to the project. Indeed there is still approximately £500 million provided for it in the IFR period. The working assumption underlying the settlement is that consent will not be given until Autumn 1987, and that the expenditure pattern for the purposes of the Autumn Statement and the Public Expenditure White Paper should be adjusted accordingly. But the Board will be expected to be ready to proceed with the project with all due speed at any time if the Government so decides.

4. It is important that no contracts are let ahead of Ministerial decisions and that draft contracts are tautly negotiated.

Prime Minister.

(i) He will not wish to say any of this to the press.

(ii) To Lord Marshall, you will probably wish to avoid going into the kind of detail.

MEA 31/10

J

BackgroundKey figures

£ million	1986-87	1987-88	1988-89	TOTAL
Baseline	-1447	-1487	-1524	-4458
Industry original bid	+169	-124	+568	+613
Industry revised bid	+135	+155	+176	+466
Industry total bid	<u>+304</u>	<u>+31</u>	<u>+744</u>	<u>+1079</u>
Savings	<u>-273</u>	<u>-229</u>	<u>-501</u>	<u>+1003</u>
of which CEGB capital	-163	-219	-181	-563
of which Sizewell	-132	-166	-66	-364
Final agreed external financing requirements	-1416	-1685	-1281	-4382

CCP/9



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

AUTUMN STATEMENT: FORECAST FISCAL ADJUSTMENT

We have on several occasions discussed the problems which arise from publishing in the Autumn Statement a forecast of the size of the fiscal adjustment - ie the scope for the tax cuts or expenditure increases - which may be available in the next year's Budget.

We first published a fiscal adjustment forecast with the new Autumn Statement in 1982. These forecasts are, inevitably, always highly uncertain. They are based on revenue and expenditure estimates, all of which are subject to major uncertainties; the revenue forecasts are themselves based on conventional assumptions of revalorisation and unchanged tax rates; and the fiscal adjustment forecasts rest, too, on an assumption for the PSBR - normally that shown in the previous Budget's MTFs. We have stressed these uncertainties on every possible occasion, and have drawn attention to the large differences in earlier years between the fiscal adjustment actually made in the Budget, and that which had been forecast in the preceding autumn.

But many commentators including market analysts have chosen to ignore all this. Last year, you will recall, attention focussed heavily on the forecast fiscal adjustment, which was invested with a quite unjustified significance. There was even speculation that the true figure might be considerably larger than the £1½ billion we published. This speculation unsettled the markets - where there were fears that we might be relaxing our determination to maintain downward pressure on inflation. This contributed to sterling's difficulties in the early part of this year which you will remember very clearly.



I do not believe that we should run these risks again, and I have gone out of my way to say so - to the TCSC and more widely. So I suggest that we take a final decision to revert to earlier practice and publish no forecast of the fiscal adjustment. This, in turn, will mean publishing no revised revenue forecasts - since commentators would otherwise themselves be able to derive a 'government' fiscal adjustment forecast from our other published figures.

There will certainly be some criticism of this, probably led by the Treasury and Civil Service Committee, with accusations that we are being needlessly secretive, going into reverse on the reforms introduced by Geoffrey Howe, and so on. In handling this we will be much helped if we publish in the Autumn Statement - for the first time and as requested by the TCSC - three years' expenditure figures rather than only one. I hope colleagues will agree to a proposal to this effect at the next Cabinet discussion of public expenditure.

I have consulted John Wakeham about all this. John agrees that we need to activate sympathetic backbenchers (of whom there are quite a few) to speak out and not leave the floor to the TCSC and other critics. I intend, too, to write to Terence Higgins as Chairman of the TCSC, informing him of our decision, stressing the uncertainties and dangers of the fiscal adjustment forecast, and suggesting that, because it is a forecast of no operational significance and on which no decisions are based, its disappearance is no real loss. I hope at the same time to be able to tell him that we will be improving the information we give the House by publishing three years' expenditure figures in the Autumn Statement.

You may find it helpful to have the attached copy of the briefing material we have prepared, to assist the presentation of this decision.

A handwritten signature in dark ink, appearing to be 'N.L.' with a flourish.

N.L.

28 October 1985

DRAFT AUTUMN STATEMENT BRIEF

FORECAST FISCAL ADJUSTMENT

Factual

1. The Autumn Statement this year gives 3 years' expenditure plans.
2. There are no forecasts of revenue in the Autumn Statement in any of the 3 years.
3. And it does not therefore subtract the one from the other to give a fiscal adjustment. The practice of calculating the fiscal adjustment for the year ahead has been discontinued.

Positive

1. Providing expenditure plans for 3 years ahead is a new step. It gives Parliament more information than in the past. It responds to a request from the Treasury and Civil Service Select Committee.
2. The fiscal adjustment calculation for the year ahead which has been dropped was pure arithmetic. It imparted no genuine new information. It was the difference between decisions and a forecast based on conventional assumptions.
3. The fiscal adjustment calculation, first introduced in 1982, has been increasingly misinterpreted as giving a guide to the Government's intentions in the forthcoming Budget. Notwithstanding repeated health warnings, it has caused damaging speculation at home and ferment in the financial markets. It played a large part in the sterling slide in the winter of 1985. The Government has accordingly decided to drop it.

4. The proper time to give this information is in the Budget. The MTFs figures are reviewed then. And the revenue forecasts will inevitably be different from those based on present information which is incomplete and out of date by the time of the Budget.

Defensive

1. Removing fiscal adjustment a retrograde step? Government something to hide. No. Old fiscal adjustment figure no more than arithmetic. Based on difference between Government's decision on expenditure plans and forecast revenue (on which no decisions were made), and on PSBR as shown in the last year's MTFs. In the past Autumn Statement forecasts of fiscal adjustment made in subsequent Budget were subject to a margin of error of $+\pounds 1\frac{1}{2}$ billion. New revenue forecast prepared and MTFs itself further reviewed before the Budget. Fiscal adjustment figure published in Autumn Statement therefore very uncertain (but commentators frequently overlooked this).

2. No fiscal adjustment means commentators cannot use Autumn Statement to produce their own Budget representations - defeats purpose of Autumn Statement. Fiscal adjustment forecast never intended to be basis for Budget representations. Subject to a margin of error; gave little useful information; and no operational decisions could or should have been based on it. It is partly because commentators interpreted it as basis for Budget representations, that Government has now decided to discontinue publishing forecast fiscal adjustment.

3. Withholding Information from Parliament. Fiscal adjustment figure included for first time when Autumn Statement introduced in 1982. Always expected that Autumn Statement would evolve over time. Experience shows fiscal adjustment not helpful and can be damaging, so now dropped. Autumn Statement, however, further developed to include 3 years' expenditure plans.

4. Treasury must have produced, internally, revised revenue forecasts for 1986-87. How can you justify not giving them? Many more forecasts produced internally than are published. No

Presumption that they should all be published, particularly when no operational decisions based on them. Indeed, presumption is of no unnecessary publication of information where it is market-sensitive (eg interest rates). Publishing revenue forecasts could lead commentators to derive implied Government fiscal adjustment forecast. Experience shows such speculation, when apparently based on Government figures, (which inevitably have special status) can unsettle the markets. Plenty of outside forecasts available.

5. Autumn Statement unbalanced - three years' expenditure figures but not revenue. Not comparing like with like. Expenditure plans are outcome of Government's decisions on programmes. Revenue figures published in Autumn Statement are forecast with no policy commitments. Revenue and expenditure brought together in the MTFs at Budget time. Government has never undertaken to update MTFs in the Autumn Statement.

6. What about 'revenue determines expenditure'? Revenue does indeed determine expenditure. As Chancellor told TCSC in April, the 1985 "Green Paper sets out very clearly the taxation objective in the medium term which determines what public expenditure we think we can afford" - eg that it should remain flat in real terms. MTFs reviewed each year at Budget time against this background; revenue and expenditure totals then determined. Autumn Statement gives departmental breakdown of these totals and is not itself an update of MTFs.

7. Government could publish fiscal adjustment and give adequate warning about uncertainties. Experience shows warnings are not heeded. Extensive "health warnings" in 1984 - eg in Chancellor's oral statement on 12 November and in printed Autumn Statement:

"Any estimate of the extent of the fiscal adjustment for 1985-86 is extremely uncertain: it depends on revenue and expenditure estimates all of which are subject to major uncertainties in both directions."

Warnings repeated by the Chancellor in his Sunday Times article, "A Budget for Jobs", Sunday, 30 December.

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"(And may add that I wish I were as confident as the press appear to be that I will have even half the scope for tax cuts that they write about)".

Background

Forecasts of the economic prospects for the year ahead have been published twice a year, as required by the Industry Act 1976. The Act gives considerable discretion over what to publish, and there is no requirement to publish forecasts of the revenue, the PSBR or the implied fiscal adjustment.

Until 1982, the IAF did not include revenue forecasts. It included expenditure forecasts and some indication of the unconstrained PSBR - ie the difference between expenditure and revenue (the latter forecasts being prepared within the Treasury, based on conventional assumptions about indexation and revalorisation, but not themselves published).

In the 1980s pressure began to build up in favour of a 'Green Budget'. (It took the form of the Armstrong Report on Budgetary Reform in 1980, and the TCSC Report on Budgetary Reform in 1982.) This would involve publication, about 3-4 months before the Budget, of a Green Budget - ie the Government's 'whole economic and fiscal strategy' in provisional form. It would give revenue projections based on a revised MTFs, the Government's view of the fiscal adjustment and alternative packages for using that fiscal adjustment.

The Government responded in October 1982, saying that an early update of the MTFs, or making early proposals for tax decisions, would mean taking decisions earlier than necessary; relying on incomplete economic information; and running the risk of requiring a change of direction in mid year. But, in their response to the TCSC Report, the Government agreed to publish an Autumn Statement which would include estimates of revenue, expenditure and borrowing in an expanded Industry Act forecast. The Government added, in its response, that it expected the contents of the Autumn Statement to evolve over time.

No commitment was made to publish a fiscal adjustment, but, in practice, each of the 3 Autumn Statements beginning in 1982 has

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included a quantified but heavily qualified assessment of what fiscal adjustment was implied by the expenditure, revenue and borrowing figures (the latter figure being that set out in the previous MTFS). Chancellors have not themselves emphasised the significance of the fiscal adjustment, except in 1983, when the Chancellor spent some time during the Autumn Statement debate discussing why the Autumn Statement showed a negative fiscal adjustment (ie an increase in taxes) for 1984-85. In the 1982 and 1984 Autumn Statements there was a small positive fiscal adjustment (£1 billion and £1½ billion respectively); the table attached compares the fiscal adjustment in the Autumn Statement with the actual adjustment made in the following Budget.

In April 1985, the Chancellor told the TCSC:

"I must say I have increasingly, during the time that I have been Chancellor, come to feel that the practice in the Autumn of giving a fiscal adjustment and an implicit forecast for the PSBR for the year ahead does far more harm than good. It conveys no useful information really, because no Budget judgement has been taken at that time and, as for the forecast of the PSBR, it is subject to an enormous margin of error and all it does is create misapprehensions of one kind and another and then one has to spend a lot of time trying to correct those misapprehensions. I must say, and I say it to you, Mr Chairman, I think in the light of experience this is not really a very helpful practice, and it might well be sensible to discontinue it.

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AUTUMN STATEMENT

PREDICTION OF FISCAL ADJUSTMENT

Date of Autumn Statement	Forecast for	PSBR		Fiscal adjustment*			£ billion
		Autumn Statement forecast	FSBR forecast	Forecast in Autumn Statement	Made in FSBR	Difference ^o (4) - (3) - (2) + (1)	Error ^o as a proportion of original forecast
		(1)	(2)	(3)	(4)	(5)	
1982	1983-84	8	8.2	+1	+1.7	+ $\frac{1}{2}$	50
1983	1984-85	8	7.2	- $\frac{1}{2}$	-	+1 $\frac{1}{4}$	250
1984	1985-86	7	7.1	+1 $\frac{1}{2}$	+0.7	- $\frac{3}{4}$	50

* + = lower taxes

^o adjusted for difference in PSBR forecast;
+ = higher adjustment in FSBR

P 01755

SECRET AND PERSONAL

From: J B UNWIN
28 October 1985

cf
cc to me and 11
return to Mr Unwin pm.
JBU
28/10
BU

LORD PRESIDENT OF THE COUNCIL

STAR CHAMBER: STATE OF PLAY

The table attached to your minute to the Prime Minister shows that the present state of departmental bids exceeds the baseline by the following amounts:

		£ billion
1986-87	1987-88	1988-89
1.825	2.045	2.713

This is not, of course, an estimate of the likely outcome. I thought, therefore, that it might be helpful to you to have my own present guess of the outcome. This is marked in manuscript on the attached copy of the score sheet. It assumes that we can get further reductions of some 955, 1540, and 1690 in the three years. This would produce the following excesses over baseline at the end of the exercise:

0.87	0.505	1.023
------	-------	-------

2. As you will see from my detailed interpolations, this depends heavily on getting defence to baseline and holding Mr Baker down to a bit more in each year than you have offered.

3. If you could get this far, it will still be extremely difficult, but perhaps just manageable, especially in the second year. I do not think the Treasury could credibly add to the figures for asset sales; but it should be possible to take something more out of the Reserve in the other years, and to accept some increase in the planning total in the last year consistent with maintaining a level profile in real terms. But it would be very tight indeed, and provide a strong case for getting defence down to the Star Chamber's below baseline target.

J B UNWIN

	1986-87			1987-88			1988-89		
	Baseline	MISC 120 Proposal	Departments' Present Position	Baseline	MISC 120 Proposal	Departments' Present Position	Baseline	MISC 120 Proposal	Departments' Present Position
TOTAL AGREED ϕ									
SO FAR	52,509	-1726	Possible Outcome (ie further savings) 1726	53,724	-616	Possible Outcome (ie further savings) -616	56,574	-1531	Possible Outcome (ie further savings) 1531
DEFENCE	18,560	-200	-170 +171	18,859	-300	-360 [+362]	19,033	-208	-650 [+655]
ODA (Incl ATP)	1,296	0	[+15]	1,317	0	[+15]	1,350	0	[+20]
ENERGY (Departmental Programme)	294	+22	+27	293	+32	+37	300	+35	+40
HOUSING	2,424	+120	-600 [+790]	2,526	+100	-750 [+968]	2,589	+80	-700 [+892]
DOE Other	848	-25	-10	860	-20	[0]	882	-15	[0]
EDUCATION AND SCIENCE	3,418	+80	+80	3,505	+75	+75	3,593	+60	+60
ARTS & LIBRARIES \ddagger	333	-1	+10 +15	342	+5	+15 +23	350	+10	+20 +27
HEALTH	14,945	+200	-50 +301	15,622	+250	-75 +382	16,012	+450	-100 +766
SOCIAL SECURITY	41,547	+857	-50 +941	43,553	+140	-200 +181	44,642	+644	-50 +816
SCOTLAND	4,300	-100	-2	4,373	-100	-1	4,482	-100	-19
ELECTRICITY*	-1447	+90*	-65 +90*	-1487	-94*	-110 -94*	-1524	+309*	-70 +309*
WATER	123	0	-30 +33	15	0	0	15	-60	-60 0
COAL \ddagger	382	+400	+508	392	+283	+333	402	+150	+198
GAS \ddagger	-470	+160	+272	-	-	-	-	-	-
Territorial Consequences	-	+80	+320	-	+100	+380	-	+155	+480
TOTAL	139,062	-43	-955 +1825	143,894	-145	-1540 +2045	148,700	-51	-1690 +2713
			870			505			1023

ϕ Includes additions to asset sales, lower Reserves and increase in 1988-89 planning total

\ddagger Programmes not yet considered by MISC 120

*Agreed figures, but subject to further reductions to reflect assumed slippage of Sizewell.

NB: Figures in square brackets reflect secretariat's interpretation of current Departmental positions.

FILE
CONFIDENTIAL

DA
(51)



10 DOWNING STREET

From the Private Secretary

28 October 1985

AUTUMN STATEMENT: FORECAST FISCAL ADJUSTMENT

The Prime Minister has seen the Chancellor's minute to her of today, which they briefly discussed. She agrees that a figure for the fiscal adjustment should not be published in this year's Autumn Statement. She also agrees that three years' expenditure figures should be published provided colleagues agree to this at the next Cabinet discussion of public expenditure.

(David Norgrove)

Mrs. Rachel Lomax,
HM Treasury.

CONFIDENTIAL

6



SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

CONFIDENTIAL

The Rt Hon John MacGregor MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

28 October 1985

Local Chief Secretary

"TERRITORIAL" IMPLICATIONS OF LOCAL AUTHORITY CAPITAL
OVERSPENDING IN ENGLAND

My officials have been in correspondence with yours about the need to carry forward into this Survey and future Surveys arrangements analogous to those adopted in last year's Survey to compensate my block (and, by extension, Nick Edwards' block) for the consequences of local authority capital overspending in England.

Michael Ancram and I had regarded this as settled in principle by the E(A) discussions last November, at which he registered our view strongly, and had regarded your predecessor's Private Secretary's response to Nick Edwards' Private Secretary's letter of 29 November 1984 as implicit confirmation of this. However, the lack of progress in the recent discussions between officials suggest that there is some doubt about this. Consequently, I think that it is important that I seek confirmation from you that you are not seeking to introduce a change of principle.

The arrangements in last year's Survey were straightforward because reductions were being imposed on English programmes to reflect the previous year's local authority capital overspending and we were therefore simply spared the formula consequences of those reductions. The situation this Survey is complicated by the fact that no reductions are being imposed in respect of last year's local authority capital overspending in England. This might arguably be of little concern to me if it were not for the fact that the combination of the absence of penalties for past overspending and a capital control system which, for this year at least, continues to generate inevitable overspending, leads colleagues responsible for relevant programmes in England to accept lower figures in the Survey than they would otherwise do. This factor has been quite explicit in your discussions in the current Survey and has a direct and obvious deleterious effect on the territorial blocks.

The arrangements I propose for the present Survey and future Surveys is that my block should be excused formula reductions up to the extent of the formula equivalent of local authority capital overspending in the preceding year. This seems to me to be as close as it is possible to get to the arrangement which operated last year.

Since this matter clearly bears upon the continuing discussion by (E(A) of capital expenditure control south of the border, I am copying this letter to the Prime Minister and members of E(A).

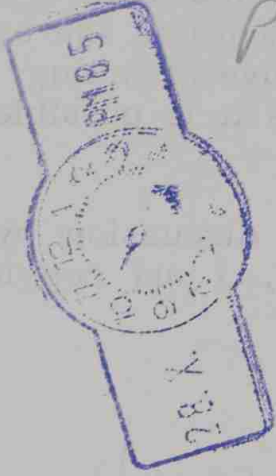
Yours sincerely
Andy Rinning

ANDY RINNING
Private Secretary

Approved by the Secretary of State and
signed in his absence

Beon Pol
PUBLIC EXPENDITURES

PT 33



[Faint, illegible handwritten text]

[Faint, illegible handwritten text]

FILE
CONFIDENTIAL

DA
(54)



10 DOWNING STREET

From the Private Secretary

28 October 1985

PUBLIC EXPENDITURE ASSUMPTIONS

The Prime Minister has seen your letter to me of 17 October. She discussed this briefly with the Chancellor today.

The Prime Minister said she would prefer an assumption of 3 million unemployed (as defined in the table in your letter) to be published for each of the three years 1986-87 to 1988-89. The Chancellor undertook to see whether this could now be done.

(David Norgrove)

Mrs. Rachel Lomax,
HM Treasury.

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6

50

DN was seen

CCB

COPY TO MEMBERS OF MISC 120
AT THE REQUEST OF THE CHIEF SECRETARY



SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

The Rt Hon John MacGregor MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

CHIEF SECRETARY	
REC.	23 OCT 1985
ACTION	Mr Instone
COPIES TO	ex Mr Bailey
	Mr Anson Mr Turnbull
	Mr James Mr Gray
	Mr Pirie Mr Lord

28 October 1985

Dear Chief Secretary

Mr Watson Mr Stredder
Mr Norton

will request if required

PES 1985: HOUSING

There is a point in Kenneth Baker's letter to you of 23 September setting out his proposals on his Housing programme on which I think it is appropriate that I should comment because it touches directly upon the Scottish block.

2. Kenneth offers to withdraw his bid for an additional £50 million per year for capital expenditure by the Housing Corporation if you will agree to proposals for the private financing of loans to housing associations which would generate capital receipts, which I understand it is proposed should also be £50 million and which would increase gross capital expenditure without any increase in the programme total. My interest is, of course, that if Kenneth's bid were to be successful the Scottish block would be increased by just under £6 million through the operation of the formula but that there would be no comparable automatic benefit to my programmes if you were to accept Kenneth's offer. Clearly, this is inequitable and I am simply placing on record that if you accept the offer I must insist on your agreement to the Housing Corporation in Scotland generating capital receipts of just under £6 million by the same means, in order to preserve equity.

Yours sincerely
Andy Rinning

ANDY RINNING
Private Secretary

Approved by the Secretary of State and signed in his absence

SECRET

PRIME MINISTER

PUBLIC EXPENDITURE

The Chancellor may try at your bilateral to lobby you about differences he has with the Chief Secretary, and possibly also with the Star Chamber.

I am told privately that the Chief Secretary believes it would be best for two programmes to go to Cabinet for settlement. These are likely to be defence and housing. Apparently many spending Ministers have said in Star Chamber meetings that they would cut defence in order to find resources for their bids. I am also told that Cabinet colleagues would prefer to be presented with a choice rather than having to take the hatchet to a single Minister's programme.

The Chancellor feels that it would be better to go to Cabinet with just one programme to settle.

You will of course want to allow the Chancellor to have his say. But Lord Whitelaw and the Chief Secretary are much more closely in touch with the tactics. The balance seems to me to lie with them.

DN

DAVID NORGROVE

28 October 1985

LEBANON

SECRET



10 DOWNING STREET

Prime Minister

Brian Grogan has
asked to come to
this meeting. I
think he should.

Agree? → Yes no

N.L.W.

25.10

PRIME MINISTER

PUBLIC EXPENDITURE

You are meeting Lord Whitelaw on Monday at 1515 for 75 minutes to discuss progress on public expenditure. The Chief Secretary and Mr. Unwin will also be there. The papers are:-

- A Paper by Lord Whitelaw
- B Note by Sir Robert Armstrong
- C Minute from Mr. Younger
- D Comment by the Policy Unit on Mr. Younger's minute

I suggest you start by warmly congratulating the Star Chamber Members and Mr. Unwin. Morale could probably do with a boost, and they have made progress in difficult circumstances. They have held 21 meetings in 9 days, and the Treasury and Cabinet Office have produced 20 papers.

I suggest you then ask Lord Whitelaw to take you through his minute.

I can add nothing to the assessment. But on Scotland you might raise the Policy Unit's suggestion at Flag D so that this can be studied before you reply to Mr. Younger's minute.

DLW

DN

25 October, 1985.



cc NLW
 8
 A
 B
 G
 (2 return)

PRIME MINISTER

STAR CHAMBER

I have now completed a full first and second round of discussions in the Star Chamber with spending Ministers on whose programmes a significant dispute remained with the Chief Secretary. The purpose of this note is to give you my summary assessment of where matters now stand. I will supplement this orally when we meet on Monday.

2. As you know, the remit given to the Group by the Cabinet on 11 July was to hold the public expenditure planning totals to the following baseline levels in the three years covered by the 1985 Survey.

	£ billion		
	1986/87	1987/88	1988/89
	<u>139.1</u>	<u>143.9</u>	<u>148.2</u>

The difficulty of the task facing us is shown by the fact that after taking account of agreements reached bilaterally between the Treasury and departments, the net bids above baseline in the three years remained some £3.4 billion, £4.7 billion, and £5.7 billion respectively, even after allowing for the lower reserves and large additional asset sales proposed by the Chief Secretary in July.

3. Although the Chief Secretary was able to provide just a little more room for manoeuvre by further adjustments to the Reserve, asset sales and to the planning total in the last year (totalling £0.5 billion in the first year, and £1 billion in each of the two later years), and the recent revision of the economic assumptions in the light of the autumn forecast has reduced somewhat the massive social security bids, the "gap" remained very large and it was clear that, in order to hit the targets, the Group would need to press for settlements very much in the Chief Secretary's favour.



4. The task I set the Group was to achieve this. To the extent that we could not do so, my aim was to clarify and narrow down the areas of disagreement so that the parameters were clearly set for consideration by you and by the Cabinet.

Programmes under discussion

5. The Group have discussed the following programmes:

Defence

Aid (including ATP)

Housing

DOE Other

Education and Science

Health

Social Security

Scotland

Electricity (England and Wales) and fast reactor research

Water

They have not so far discussed coal and gas, in which large sums are at issue. The Chief Secretary is still pursuing these with Peter Walker.

6. This is a far heavier load than in any previous year, and the gap to be filled, and the positions taken by the spending Ministers concerned, has been correspondingly harder too.

7. My general approach has been to try to get programmes back to baseline; and, in order to make some room for bids of the highest political priority, in some cases to seek substantial reductions below baseline. The largest such reduction we sought was, as you would expect, in the defence programme where the Group have been guided by the view expressed at our Chequers discussion on priorities that, with the ending of the commitment to 3 per cent real annual growth, some reductions in the planning



totals for this large programme should be feasible. I am also seeking to scale down the very large bids on Norman Fowler's health and social security programmes (his bids on social security alone totalled over £2.5 billion for the three Survey years, even after the effect of the revised economic assumptions). There are difficulties here which relate to the social security review and our MISC 111 discussions which I should prefer to explain to you orally.

8. I have therefore put to each of our colleagues proposals that, if accepted, would deliver the planning total, or thereabouts, in each of the three years. Negotiations are continuing, but we are still short of our target. However, although I was very depressed earlier this week, we have made some limited progress in the last day or two; but, alas, we are still faced with grave difficulties on some of the major programmes.

9. The overall picture is summarised in the attached table (although a number of the figures are still subject to further clarification). This shows for each year the baseline total, the proposal put forward by the Star Chamber, and (in the last column) an assessment of the current position of the Minister concerned (ie incorporating the reductions in bids he has so far been willing to offer). You will see that the totals in the last column are still some £1.8 billion, £2.0 billion, and £2.7 billion above the baseline.

These are not a course forecast outcomes.

10. On individual major programmes, I am glad to say that we have been able to reach a satisfactory settlement with Peter Walker on electricity and with Keith Joseph on the Education and Science programme, although there is still one political aspect of this programme that I should like to discuss with you. We are also within possible sight of an agreement with Norman Fowler on at least the two earlier years on health and social

2 1 2



security - the third year of the latter will depend heavily on MISC 111. I am, however, still having difficulties with Geoffrey Howe on the aid programme and you and I may have to have a talk with him privately. I will, of course, explain the details to you. We have also been unable so far to resolve the problems on the following programmes.

Defence

11. As you will see from the attached table, Michael Heseltine is still seeking very large provisions above baseline. We thought it vital, however, to seek substantial reductions below baseline - although less than the Chief Secretary originally proposed - in order to provide some room for manoeuvre for higher priorities elsewhere. If the Group's proposals were accepted, real defence spending would still be over 20 per cent higher in 1988/89 than in 1978/79; and we think it entirely reasonable to look for rising defence output through increased efficiency. I must stress that the very strong feeling of the whole Group is that many of our difficulties would be substantially resolved if we could persuade Michael Heseltine to meet us. My strong recommendation to you at the moment is that decisions here should be brought to the whole Cabinet. I will explain to you why I take this view.

DOE Housing and other programmes

12. The main reason for the massive bids here - over £1100 million in the second year - is a claim for substantial extra resources for public sector housing renovation in response to the report commissioned by the Department from local authorities. As you know, this recommends a huge renovation programme of some £19 billion over the next ten years. We could not accept the case for this. The Government's record on public sector housing is a good one, and the case made in the report seems to us to be greatly overstated (as one would expect if the local authorities themselves are asked to state their own needs). However, we recognised the

Waka



need to respond constructively to the report and proposed to Kenneth Baker increases of £100, £200, £200 million on this part of his programme for the three survey years. This would be enough to finance a £15 billion renovation programme over 11 years. This was, however, on condition that substantial offsets were made elsewhere in his housing programme (for example, we felt that both public sector new building and improvement grants should take a lower priority, although very large sums would still be spent); and that he agreed to settle his other programmes, including provision for the water industry, on average somewhat below the baseline.

13. We accordingly made an offer to Kenneth on this basis. He has not so far felt able to accept it, and I think that he will want to put his own case to the Cabinet.

Health and Social Security

14. We have not yet completed our discussions with Norman Fowler and will be seeing him again next week. I have no need to explain at length the basic problems. The figures speak for themselves. There are huge bids in each year, and the Government's public expenditure objectives cannot be obtained unless substantial reductions are made.

15. Very briefly, on social security, we have sought to trim the bids substantially. After a thorough examination of the options, including accelerating measures covered by the review, Norman has made some further suggestions that would help considerably in the first two years. But we need to examine these with him further and, as indicated above, there is still likely to be a big problem in the last year.

140
10-30
1-15

III - Green Paper Proposals now serious



16. On health, Norman has, in discussion with us, reduced his bids by around £100 million in each year. While very helpful, this is not enough and I have asked him to consider the possibilities further so that we can discuss them with him again next week.

Scotland

— see flap C0D

17. The amounts at issue here are not as large, but I think I should draw this problem to your attention. Although George Younger has not sought any significant extra provision, the Chief Secretary thought it right to ask him to reduce his programme by £100 million in each year below the baseline. The Group fully endorsed this approach. They believe that Scotland is over provided in public expenditure and that the block formula agreed in 1978 is excessively generous.

18. I do not think that George Younger seriously disputes this. In view of the political situation in Scotland, however, he has made it absolutely clear that he cannot contemplate any visible cuts in his programme. We have explored various possibilities by which, for example, it might be possible for Scotland to contribute to some other relevant programmes. None of them has so far proved feasible or acceptable to George. And, although we are still considering the possibility of a reduction in baseline to reflect population shifts since the late 1970s, we have been unable to settle this programme.

19. I shall be glad of the opportunity to discuss the next steps with you when we meet on Monday. I am optimistic that some further progress can be made. But some of the major issues referred to above will undoubtedly need to be discussed by the Cabinet on 7 November, and I am anxious that we should define and circumscribe the issues as far as possible in advance. I



See page B

must particularly stress my view that the defence issue should be argued by the Cabinet. I understand that there is some question of Michael Heseltine not being available the week after next owing to the Trip to the Far East. I strongly recommend that you should require his attendance at Cabinet when these issues are discussed.

20. I am sending copies of this minute to the Chief Secretary and to Sir Robert Armstrong.

A handwritten signature in blue ink, appearing to read "J. MacNaught".

(Approved by the Lord President
and signed in his absence)

Privy Council Office
25 October 1985

SECRET AND PERSONAL - CMO

£ million

	1986-87			1987-88			1988-89		
	Baseline	MISC 120 Proposal	Departments' Present Position	Baseline	MISC 120 Proposal	Departments' Present Position	Baseline	MISC 120 Proposal	Departments' Present Position
TOTAL AGREED ϕ									
SO FAR	52,509	-1726	-1726	53,724	-616	-616	56,574	-1531	-1531
	<i>18,053</i>						<i>18,840</i>		
DEFENCE	18,560	-200	+171	18,859	-300	[+362]	19,033	-208	[+655]
ODA (Incl ATP)	1,296	0	[+15]	1,317	0	[+15]	1,350	0	[+20]
ENERGY (Departmental Programme)	294	+22	+27	293	+32	+37	300	+35	+40
HOUSING	2,424	+120	[+790]	2,526	+100	[+968]	2,589	+80	[+892]
DOE Other	848	-25	-10	860	-20	[0]	882	-15	[0]
EDUCATION AND SCIENCE	3,418	+80	+80	3,505	+75	+75	3,593	+60	+60
ARTS & LIBRARIES \pm	333	-1	+15	342	+5	+23	350	+10	+27
HEALTH	14,945	+200	+301	15,622	+250	+382	16,012	+450	+766
SOCIAL SECURITY	41,547	+857	+941	43,553	+140	+181	44,642	+644	+816
SCOTLAND	4,300	-100	-2	4,373	-100	-1	4,482	-100	-19
ELECTRICITY*	-1447	+90*	+90*	-1487	-94*	-94*	-1524	+309*	+309*
WATER	123	0	+33	15	0	0	15	-60	0
COAL \pm	382	+400	+508	392	+283	+333	402	+150	+198
GAS \pm	-470	+160	+272	-	-	-	-	-	-
Territorial Consequences	-	+80	+320	-	+100	+380	-	+155	+480
TOTAL	139,062	-43	+1825	143,894	-145	+2045	148,700	-51	+2713

ϕ Includes additions to asset sales, lower Reserves and increase in 1988-89 planning total

\pm Programmes not yet considered by MISC 120

*Agreed figures, but subject to further reductions to reflect assumed slippage of Sizewell.

NB: Figures in square brackets reflect secretariat's interpretation of current Departmental positions.

Ref. A085/2720

PRIME MINISTER

Cabinet Discussion of Public Expenditure

As you know, the main discussion of public expenditure is scheduled for Cabinet on 7 November. I understand from the Lord President's office that discussions in his Ministerial Group are on schedule, and it should be possible to cover the whole subject in Cabinet on that day, without need for a second discussion later.

2. On present plans, the Secretary of State for Defence will not be at Cabinet on that date (or on 14 November). He has a long-standing commitment to visit the Far East, beginning on 5 November, and could be present only by dint of cancelling entirely his visit to Malaysia, to which he attaches importance. The Malaysians are sensitive at the best of times, and the recent collapse of the International Tin Agreement, for which they may well seek to blame the United Kingdom in some degree, might make it a bad moment to give them further cause to take umbrage. Additionally he takes the view that he cannot absent himself from the Rome Ministerial meeting of the Western European Union.

3. On the other hand, the Lord President takes the view that he could not properly deal in Cabinet with the full range of public expenditure issues in the absence of the Secretary of State for Defence. In previous years the defence budget has usually been the subject of discussion in a separate meeting with yourself, the Lord President, the Chancellor of the Exchequer and the Secretary of State for Defence alone, and one of the Defence Secretary's arguments for not interfering with his touring plans is that he would expect the defence issues to be settled in a restricted quadrilateral discussion this time. But that course

could well not be appropriate on this occasion, given the real possibility that it will come down to a trade-off between the defence and one or more other budgets.

4. Your office's agreement, in a letter of 18 October, to Mr Heseltine's visit was of course subject to the usual qualification "Government and Parliamentary business allowing". You will want to consider whether the Secretary of State for Defence should be asked to reschedule his travel plans, if necessary cancelling his visit to Malaysia or his attendance at the WEU meeting, since even more important issues of Government policy are at stake in the public expenditure discussions, which neither the Lord President nor the Chancellor of the Exchequer would like to see delayed as late as 21 November. But I have been left in no doubt that he will be very reluctant indeed to do so.

ONS

ROBERT ARMSTRONG

*(Approved by Sir Robert
and signed in his absence)*

25 October 1985

PRIME MINISTER

25 October 1985

SCOTLAND: LOCAL AUTHORITY SPENDING

George Younger is trying his usual tactics. His argument is:

- the Treasury want savage reductions of grant to Scottish local authorities;
- he (GY) is willing to accept this;
- but there will be a political disaster;
- so, will you please take responsibility for it?

This is a question expecting the answer 'no' or, more precisely, the answer 'no, the Treasury must provide some more money instead'.

But the right answer is: 'if there will really be a political disaster, GY should find some extra money for the local authority grant from some less contentious part of the massive Scottish block-budget'. The Scots will not have much difficulty identifying such an item if they actually try; at present, their provision is about £900m higher than comparable English figures. Examples of feather-bedding include:

	<u>ENGLAND</u>	<u>SCOTLAND</u>
NHS beds per 1,000 people	7.5	11.3
Pupil/teacher ratios	18.5	*17.3
Proportion of road schemes which don't make a reasonable return	14%	28%
Proportion of housing lacking basic amenities	5%	2.8%
Average Council rents	£14.05	£9.84

And Scotland is no longer the poor relation. Admittedly it still has higher unemployment (14.6% as against 12.8% for Great Britain). But North Sea oil has brought prosperity. In 1972 GDP per head was only 93% of the national average. By 1981 it was up to 99% and was still rising.

We recommend that you should ask George Younger to use money from his own budget to fund extra local authority grant if he really believes that a 1.5% real terms expenditure reduction will cause a political disaster.



OLIVER LETWIN



7B

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

25 October 1985

Dear Lord President,

Thank you for your letter of 24 October.

HOUSING

On housing I reproach myself that I must have failed to convey to you and your colleagues the nature and extent of the Housing problems facing our country, and the inadequacy of the present public expenditure provision to deal with them. The plain fact is that much of the present stock is crumbling. The conditions in which we expect many of our people to live are, in my view, quite unacceptable. This is due to decades of unsatisfactory municipal building which we now have to put right. We cannot successfully privatise until it is in reasonable shape.

We fought the last election on the goal of "making Britain the best housed nation in Europe". At present that is no longer a credible claim. The state of the stock is getting worse. The issue before us is how as a Government we should respond to this. I simply do not believe that your offer is an adequate response to the growing crisis.

The attached Table shows the effect of your offer. There is no way in which I could present a steady year on year cash reduction in the gross housing capital programme, and a 25% reduction in allocations to local authorities next year, as a realistic response to the grave deterioration of our housing stock.

I hope colleagues have not ruled out private finance for the Housing Corporation. It seems to me to be an ideal way of introducing much-needed private sector resources into housing, and my offer to reduce my bid by £50 million stands.

PROGRAMME 8

In my meetings with John on Programme 8 I have moved very substantially from my original bid of some £150m above baseline, and I am now prepared to move further, to a cut of £10m below baseline in each year. But I cannot accommodate a reduction of £25m. I have inescapable obligations. As you proposed at our first meeting, the Urban Programme is left on one side, and should remain at baseline for the time being.

WATER

On Water, in view of our discussions, I am reviewing the possible combination of prices, investment levels, and returns on investment and I will come back to you.

I am sending a copy of this letter to those who received yours.

Yours sincerely,
Kenneth Baker

The Rt Hon the Viscount Whitelaw CH MC

KENNETH BAKER

(Approved by the Secretary of State)

SECRET

25.10.85.

=====

HOUSING PROGRAMME: OUTURN AND STAR CHAMBER PROPOSALS [fm]

=====

	1984-85 OUTTURN	1985-86 OUTTURN	1986-87 PROPOSAL	1987-88 PROPOSAL	1988-89 PROPOSAL
GROSS CAPITAL	3893	3284	3102	3083	2975
CAPITAL RECEIPTS	-1784	-1651	-1531	-1431	-1285
NET CAPITAL	2109	1633	1571	1652	1690
<hr/>					
CURRENT	962	1084	971	975	975

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NET PROGRAMME TOTAL

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	3071	2717	2542	2627	2665
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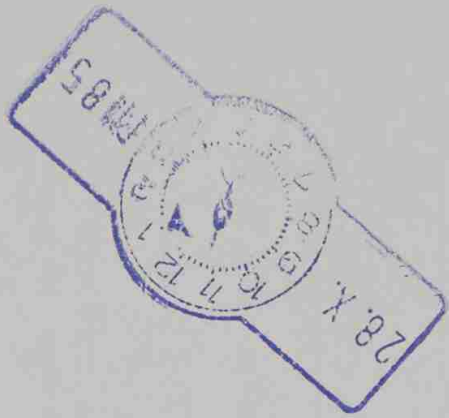
ALLOCATIONS

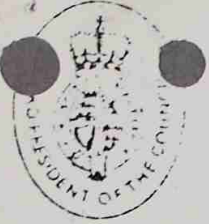
[Based on HMT calculation method]

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	1852	1600	@85% 1203
			@83% 1320

SECRET





7A

SECRET

MISC 120

CABINET OFFICE
A 8520
24 OCT 1985
FILING INSTRUCTION
FILE No.

PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

24 October 1985

cc - Mr Unwin
Mr Wiggins

Dear Secretary of State,

MISC 120: DOE PROGRAMMES

Following your meeting with the Group yesterday afternoon, I promised to write to you to set out the Group's proposals for settling the three programmes under discussion.

On housing, as the Group sought to make clear to you, we do recognise that higher priority must be attached to renovation of the public sector housing stock, and we therefore offered increases of £100 million, £200 million and £200 million on this part of the programme for the three survey years. But we felt that public sector new build had a lower priority, and accordingly proposed reductions in expenditure consistent with the maintenance of 30,000 starts in 1986/87 and 1987/88, and 28,000 in 1988/89; we assumed that, together with a £30 million reduction in improvement grants in 1987/88, a programme on this basis would give rise to reductions below baseline of £60 million, £195 million and £115 million. Taking account of the agreed irresistible bids, and your further savings (set out in the paper you gave the Group on 22 October) of £65 million, £60 million and £65 million, we proposed a net increase in the housing programme for the three years of £120 million, £100 million and £80 million.

You made clear that you did not consider this a sufficient response to the social needs created especially by the unsatisfactory condition of much public sector housing, although it appeared that - as you suggested at your first discussion with the Group - you could accept public sector housing starts of 30,000 a year. You insisted to the Group that you had to have an increase in gross capital expenditure above the forecast 1985/86 outturn, despite the £250 million overspend implied by that forecast; and you further urged the need for allocations of at least £1,600 million for 1986/87, as against some £1,230 million consistent with the Group's proposals. As we understand the position, agreeing to your proposal on allocations, even accepting your proposed change in methodology, would require an increase in the gross capital expenditure of at least £200 million above the figure contemplated in the settlement proposed by the Group.

The Rt Hon Kenneth Baker MP

SECRET

The Group have considered the position further following our conversation with you. They continue to believe that the proposal described above, which would permit a substantial increase in your priority programme of housing renovation, is the most reasonable offer they can make in the circumstances and they do not feel able to increase it. The proposal assumes that you would at the same time accept the Chief Secretary's proposal that the 'DOE other' programme would be settled on the basis of reductions below baseline of £25 million, £20 million and £15 million for the three years, after allowing you the benefit of additional new town receipts.

On water, we also assume that you will be able to provide for investment of at least £880 million in 1986/87 without any increase in external financing, and within an average increase in domestic water charges not exceeding 8 1/2 per cent; and that you will be able to accept a provision of £60 million below the baseline in 1988/89, although this will no doubt need to be considered again at a later stage in the light of a pre-privatisation review. We would equally be content if in 1986/87 you went for a slightly lower investment and a somewhat smaller price increase. You are also giving further consideration with the Chief Secretary to the rate of return.

I need not further labour the very great difficulties under which the Group are working. I feel that in making this offer we have gone as far as anyone could reasonably expect in giving higher priority to housing renovation. I very much hope, therefore, that you will be able to accept this offer; I do not see how the Group can improve it, and if you conclude that you should refuse it, I can give no undertaking that we shall not find ourselves obliged to propose something less favourable to your programmes when the Group's report is made to the Cabinet.

I am sending a copy of this letter to the members of MISC 120, to the Chief Whip, Commons, Mr Unwin in the Cabinet Office, and Sir Robert Armstrong.

Yours sincerely

Joan MacNaught
for VISCOUNT WHITELOW

Approved by the Lord President



B/F 4/11
C. B. ...
SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

PRIME MINISTER

LOCAL AUTHORITY EXPENDITURE: SCOTLAND: AGGREGATE
EXCHEQUER GRANT 1986-87

The Chief Secretary and I have been discussing since June the appropriate level of Aggregate Exchequer Grant (AEG) for Scotland for 1986-87.

My objectives are to ensure that:

- a. on a realistic forecast of expenditure the general level of rate increases in Scotland is not out of line with inflation after a very damaging year in 1985 (about which I warned colleagues) and bearing in mind that 1986 is a year of regional council elections.
- b. individual authorities which have co-operated with Government policy receive a satisfactory grant figure (you attached a particular importance to this).
- c. the total figure for AEG can be presented as fair in relation to England and Wales, given that grant penalties will remain in Scotland, reducing the initial grant figure by returning penalties to the Exchequer. In England, now that penalties have been abolished, the initial AEG figure will no longer be reduced by grant penalties; Scottish authorities are very aware of this.

The Chief Secretary has proposed an AEG figure of either £2000 million, or £2015 million with tougher penalties designed to yield an additional £15 million. In the interests of reaching a settlement, I have offered to accept an AEG figure of £2015 million with a guarantee that penalties can be increased if they do not bring in a minimum figure required by the Treasury. While I am prepared to settle on this basis I have to point out that I do not consider this enables me to meet fully my objectives and in particular the one to which you attach special importance. In view of your interest I would therefore not wish to settle on this basis without your approval.

I would like to describe what I see as the consequences of such a settlement. With an AEG of £2015 million, on my view of a realistic forecast of expenditure reduction next year (1.5% in real terms) the rating burden will increase by 6.5%. Nigel Lawson is forecasting inflation figures well below this.

It is impossible within the figure of £2015 million to ensure that there is a satisfactory result for all co-operative authorities. In particular, Bearsden and Milngavie District Council will find itself with a reduced grant figure again this year. I am also seriously concerned about the rate consequences of the settlement on Strathclyde Regional Council which accounts for half of the Scottish population and whose rates are the major component of the bills of ratepayers in co-operative authorities, such as

Eastwood. Heavy penalties this year and reduced grant next year will push up the Strathclyde rate by well over twice and possibly three times the rate of inflation.

To be fair in comparison with England, Scotland should have a cash standstill in AEG (£1962 million) plus an allowance for continuing penalties. This year penalties are reducing grant by £126 million. While this may come down to £60 million to £80 million at outturn, a figure of £2015 million with increased penalties does not compare with England on this basis.

Thus while I am prepared to settle at £2015 million it does not meet the objectives I have set out and in pushing up penalties still further in Scotland, when they have gone in England, will add further to feeling already created by this year's events, that Scotland has been unfairly treated. I feel that in these circumstances and in the light of the discussions we had earlier in the year, I could not proceed to settle on this basis without your approval.

A.Y.

October 1985

4 con pol - Public Expend Ac 33



SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

The Rt Hon John MacGregor OBE MP
Chief Secretary
HM Treasury
Treasury Chambers
Parliament Street
London
SW1P 3AG

24 October 1985

Dear Chief Secretary,

LOCAL AUTHORITY EXPENDITURE: SCOTLAND: AEG 1986-87

Thank you for your letter of 8 October in which you suggest an AEG figure equivalent to £2000 million with present penalties of £2015 million with tougher penalties.

I still consider that either of these figures would leave Scotland less well off than England, in terms of rate increases, for a similar degree of overspending. This is a dangerous situation after the crisis of revaluation and in view of the fact that Scottish rate increases overall were higher than England's this year for a similar degree of overspending, even after the special measures were taken. A settlement at either of these figures does not in my judgement enable me to meet fully the objectives set by the Prime Minister. In view of this I am minuting to the Prime Minister with a copy of this letter explaining the extent to which the settlement falls short and seeking her agreement to settle on this basis.

However, I am, in the interests of reaching a settlement, prepared to agree to a figure of £2015 million with tougher penalties. The present penalties are already applying a significant degree of pressure to authorities. Even if we leave the penalty tariff as it is, it will be come tougher in its effect because we are increasing the total provision for local authority expenditure by 3.9%, less than the rate of inflation. Thus if a major authority such as Strathclyde (which cut its spending this year by almost 1% in volume terms) cuts by a further 1% next year it will have a penalty of over £100 million under the present tariff, 60% above this year's penalty. It is against this background that the term 'tougher penalties' needs to be considered, especially since Scottish local authorities are now very well aware that penalties have been abolished in England but remain in Scotland. For penalties to remain and become tougher as a result of both a cut in provision and an increase in penalty tariff will be very difficult to defend. Authorities being asked to cut by more than 6% in real terms to avoid penalties cannot realistically be expected to do so and the result is that rates go up to pay for the inevitable penalties.

I would therefore, in agreeing to tougher penalties, want to set a cash limit on what these penalties would produce. I would like to propose that the limit on the yield of penalties at outturn should be £80 million and that the present penalty tariff would be toughened if necessary to bring in that figure but not to exceed it. This would in my view be a reasonable reflection of the allowance being made for penalties in arriving at the grant figure with an addition of that figure.

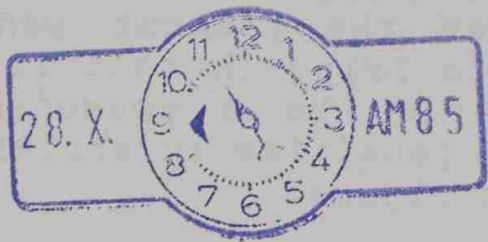
Copies of this letter to members of E(LA) and to the Prime Minister's Office.

Yours sincerely,

John S. Ambler

(Private Secretary)

Approved by the Secretary of State
and signed in his absence



PRIME MINISTER

18 October 1985

You held a good Seminar at Chequers before the Recess on controlling public spending. The main conclusions for reductions were:

Running Costs Treasury/Scotland obtained general agreement to a big drive for more value for money and tighter control.

Agriculture General agreement to cut subsidy in view of past CAP growth.

Defence General agreement to curb this programme, and to reduce R&D expenditure on defence.

DTI No more.

Law and Order General agreement to stop its growth.

The outcomes so far contrast starkly.

Running Costs Likely to rise by 7½% nominal, ie more than £1bn. Baseline envisaged 3.2% increase. So there is an overrun in excess of £550m.

Agriculture +£332m over baseline.
(inc. IBAP/AFF)

Defence Undecided (Treasury: -£300m; Dept: +£422m).

DTI (inc. ECGD) +£194m over baseline

Home Office +£43m

The argument over law and order has changed in view of the riots. However, on three of the four other programmes

singled out for reduction, we have an agreed overrun of around £1,100m! Defence is still to settle.

These results are all explicable - higher pay, higher interest charges, bigger food surpluses, etc. But they call into question whether there is any management control in any of these areas, and whether there has been sufficient search for offsetting savings.

Shouldn't you reopen the question of running costs, if nothing else, in view of this result? Options include:

- i. Implementing the £200m savings identified by scrutinies but not yet achieved.
- ii. Completing the present management targets exercise by April 1986 and ensuring delivery.
- iii. Converting staff inspections into running cost inspections, and bringing in outside consultants if departments still fail to meet these targets.
- iv. Suspending recruitment next year, saving c. ^{200m} ~~£500m~~ (except in Customs, Inland Revenue etc, where manpower brings in net revenue); and expanding Special Employment Measures, which will have the same employment effects as civil service recruitment at far lower cost.
- v. Setting tougher management targets for 1988.

You are meeting Robin Ibbs and Ian Beesley on 6 November, and could discuss these issues with them then. But to achieve real results you would need a meeting with senior Ministers soon.

PP JOHN REDWOOD

John Redwood

Public Ex. 7





Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

17 October 1985

David Norgrove Esq
10 Downing Street
London SW1

Dear David

The Prime Minister will wish to be aware of the economic assumptions that Treasury Ministers have agreed for use in the current round of public expenditure decisions; and, as appropriate, for publication over the next few months in the Autumn Statement, the Government Actuary's Annual Report, and the 1986 Public Expenditure White Paper.

The main assumptions are summarised below. They include financial year figures for unemployment (excluding school leavers), growth in average earnings, and the GDP deflator. The periods shown for the RPI are for the new uprating dates. In the past, up to and including the uprating in November of this year, social security upratings have been based on the May RPI figures for successive years. With the change in uprating dates from November to April, upratings are likely in future to be based on changes in the RPI between Septembers of successive years. A transitional uprating in July 1986 will be based on the change in the RPI between May 1985 and January 1986.

MAIN ECONOMIC ASSUMPTIONS

	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>	<u>1988-89</u>
Unemployment, GB excluding school leavers (millions)	3.05	3.0	2.95	2.9
Average earnings (per cent change)	8	7	6*	5½*
GDP Deflator (per cent change)	5	4½	3¾	3¼
RPI (per cent change)		1**	2¼**	3¼

* Not published at this time

** Actual change over period indicated: not annual rate



The unemployment, average earnings, and GDP deflator assumptions for 1985-86 and 1986-87 and the RPI change for January 1986 on May 1985 will be published in November (in the Autumn Statement and/or the Government Actuary's Annual Report). Unemployment, GDP deflator, and RPI assumptions relevant to the last two years of the Survey period have in the past only been published in the PEWP, not in the Autumn Statement. But if we publish three year projections of expenditure in the Autumn Statement we will need to consider publishing some of the assumptions for later years at the same time.

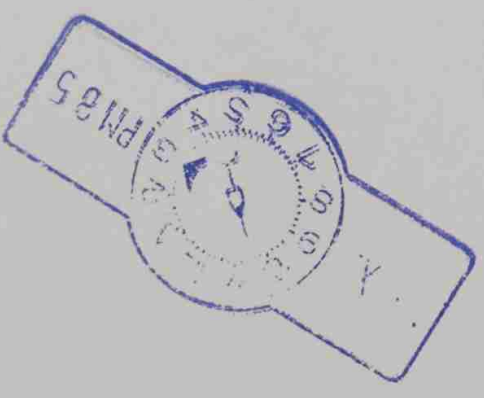
The assumptions show unemployment falling by 50,000 a year, broadly reflecting the expansion of the Community Programme and the extension of the Youth Training Scheme announced in the 1985 Budget. (GB unemployment excluding school leavers was 3.056 million in September). The assumption of 8 per cent average earnings growth in 1985-86 is half a point higher than that published in the Government Actuary's July Report, and reflects the Treasury's assessment of the implications of settlements over the last pay round, taking account of the recovery of earnings in the coal industry compared with their depressed level during the coal strike. The assumptions for the GDP deflator show the same figures for 1985-86 and 1986-87 as those published in 1985 Medium Term Financial Strategy, while the figures for 1987-88 and 1988-89 are a quarter of a point higher than the corresponding MTFs figures. The RPI figures are consistent with inflation close to 5 per cent by the end of 1985, and falling below 4 per cent in 1986.

*Yours ever
Rachel*

RACHEL LOMAX



1950 Jan



010

CONFIDENTIAL

CC Mr. Vassilov
CABINET



PRIVY COUNCIL OFFICE

WHITEHALL, LONDON SW1A 2AT

15 October 1985

CF in these letters to NO and
SS (without implying any
agreement).

JRM
15/10

Dear Richard,

ATTACHED

Thank you for your letter of 9 October
about press handling of the MISC 120
proceedings. I have discussed it with
the Lord President, who strongly agrees
with the Chief Secretary's approach. I
have told Bernard Ingham this, and am
copying this reply to him and to David
Norgrove.

Yours sincerely

Joan

Joan MacNaughton
Private Secretary to the
Lord President

Richard Broadbent, Esq.,
Private Secretary to the Chief Secretary,
Treasury Chambers,
Parliament Street.

CONFIDENTIAL



CONFIDENTIAL



*cc of the main
Cabinet Office.*

Treasury Chambers, Parliament Street, SW1P 3AG

9 October 1985

NBPT.

Ms Joan McNaughton
Private Secretary to the Lord President

Dear Joan

MISC 120: PRESS HANDLING

Attached

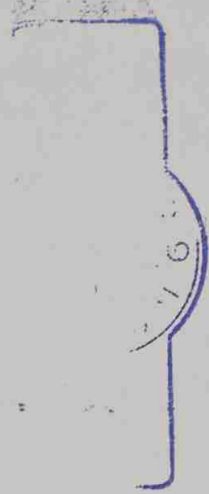
Following the Prime Minister's summing up at Cabinet on 3 October, the Chief Secretary has been considering whether there are steps which could usefully be taken to minimise Press speculation about the work of MISC 120. In this context, he thinks it is essential to ensure that no information is given to the Press in any circumstances about the subjects being discussed by MISC 120 or its timetable. Experience last year shows that once it is known which subjects are being discussed on which days Press speculation inevitably follows about the respective positions of the Ministers involved and the outcome of discussions. He has therefore instructed the Treasury Press Office to make sure that no such information is given, whether in response to questions or otherwise. He hopes that the Lord President will agree that this approach should be adopted generally.

I am copying this letter to David Norgrove and Bernard Ingham at No. 10.

*Yours sincerely
Richard Broadbent*

RICHARD BROADBENT

CONFIDENTIAL





Treasury Chambers, Parliament Street, SW1P 3AG

9 October 1985

David Norgrove Esq
10 Downing Street

Dear David

pa

MISC 120: POSITION PAPER

The Chief Secretary thought the Prime Minister would like to see how the position paper for MISC 120 (foreshadowed in paragraphs 8 and 9 of his minute of 24 September and his subsequent discussions with the Prime Minister) is shaping up. I enclose a copy of the latest draft which reflects the Chief Secretary's comments on earlier versions. He expects to finalise the draft, substantially in this form, in the next day or so. The intention is to circulate it tomorrow evening (10 October).

Yours

Richard

RICHARD BROADBENT

SECRET AND PERSONALDRAFT PAPER FROM CHIEF SECRETARY TO STAR CHAMBERPublic Expenditure Survey: Position Reached After Bilaterals
Memorandum by the Chief Secretary

1. This paper summarises the position reached after my bilateral meetings with colleagues. Separate papers discuss the position in each of the disputed programmes namely:

- | | |
|---------------------------|--|
| (i) Defence | (vi) Health |
| (ii) Aid (including ATP) | (vii) Social Security |
| (iii) Housing | (viii) Scotland |
| (iv) DOE Other | (ix) Electricity (England and Wales) fast reactor research, and gas. |
| (v) Education and Science | |
| (x) Water | |

Negotiations on the coal industry have not yet started pending the availability of data from the NCB.

2. The paper focusses on the **total expenditure provision** rather than **departmental running costs**. I hope it will be possible to avoid troubling the Group with issues about running costs and manpower, which I aim to settle bilaterally with colleagues within the framework of the Group's recommendations on total provision.

Background

3. In presenting our policy of firm control of public spending we have stressed the importance of holding to the **cash planning totals** once set.

SECRET AND PERSONAL

4. Cabinet on 11 July endorsed proposals to hold the planning totals to the **baseline levels** in the three years covered by the 1985 Survey:

	<u>£ billion</u>		
	1986-87	1987-88	1988-89
	139.1	143.9	148.2

5. For the first two years these baselines were the figures given in the 1985 Budget - ie the 1985 Public Expenditure White Paper figures plus the Budget additions for employment measures and the decision to add £2 billion to the Reserve - together with some minor adjustments. For 1988-89 - the new year of the 1985 Survey, for which there are no existing published plans - the figure provides an increase of 3% over 1987-88.

Progress So Far

6. I attach at Annex A a "scorecard" which shows the programmes where I have reached - or expect to reach - agreement bilaterally, and the opposing departmental and Treasury positions on the remainder. All figures are shown in terms of **changes from baseline**.

7. The key to using the scorecard is that, to achieve the aggregate planning total targets, we must get to an overall **zero change** from baseline. Increases on one line must be matched by reductions elsewhere.

8. The present totals at the foot of the "agreed" columns show changes of **minus** £1.3 billion, **plus** £0.3 billion and **minus** £0.6 billion respectively in the three years. This represents the net effect of:

- (i) the funds made available for allocation to programmes by my predecessor's proposal in July to increase the planned level of "**special sales of assets**" (line 39 of the table). These proceeds for privatisation score as an offset to public expenditure. The higher figures yield an extra £2¼ billion in 1986-87 and £1¼ billion

SECRET AND PERSONAL

in each of the later years, taking the total sales programme to £4½ billion, £3½ billion and £3½ billion respectively.

- (ii) similarly, my predecessor proposed that, as part of the normal rolling forward of the plans, the **Reserves** for 1986-87 and 1987-88 - initially set at £6 billion and £7 billion - could be reduced to £5 billion and £6 billion, so releasing £1 billion in each year to be allocated to programmes in 1988-89. (Line 40 of the table).
- (iii) for 1988-89 the initial baselines for individual programmes were set at 2½% above the 1987-88 levels. The July decision to increase the planning **total** by 3% provided £1.1 billion for allocation to programmes (line 41 of the table).
- (iv) decisions by E(LA) in July on provision for **local authority relevant current expenditure** in England, and subsequent decisions for the territorial departments, added £0.6 billion to expenditure in 1986-87 (line 30 of the table). I am in the process of seeking to agree figures for the later years with colleagues and the table shows my present assumptions on where those negotiations will end up. We also have to allow for the extra provision promised for **teachers' pay** if agreement is reached on the Government's current offer (line 31 of the table).
- (v) the various agreements I have reached bilaterally on **departmental programmes**. The increases I have been obliged to accept include IBAP and ECGD (lines 6 and 10), both unavoidable demand-led additions. Details of these and other settlements are given in Annex B.

Implications for Other Programmes

9. If the baseline targets are to be met increases in provision for the remaining programmes must be no greater than the net reductions

SECRET AND PERSONAL

already settled in the "agreed" lines (and for 1987-88, where net increases have been agreed so far, the remaining programmes must yield a reduction). That means the Group must hold net additions to provision for the remaining programmes to no more than £1.3 billion in 1986-87 and £0.6 billion in 1988-89; and achieve net savings of £0.3 billion in 1987-88.

10. The Group will wish to know how these targets relate both to Departments' bids on the disputed programmes, and to the proposals I have put forward. The details are in Annex A, but in aggregate (and in rounded figures) the position is as follows.

11. Departments' are bidding for

	<u>£ billion</u>		
	1986-87	1987-88	1988-89
	+4.5	+4.5	+6.4

which, compared with the sums available for these programmes of

+1.3	-0.3	+0.6
------	------	------

means their "excess bids" are

3.2	4.8	5.8
-----	-----	-----

12. My proposals for the outstanding programmes are:

+0.7	-0.9	-0.8
------	------	------

which means the "margin for manoeuvre" in my proposals (ie the amounts which can be conceded without exceeding the sums available set out above) is

0.5	0.5	1.4
-----	-----	-----

13. The Group will note that, while my proposals for these programmes are sufficient to yield the agreed targets, the available

SECRET AND PERSONAL

margin for manoeuvre is a great deal less than the excess bids from Departments. This means that to hit the targets the Group would need in aggregate to adjudicate about 80-90% in my favour.

14. As I shall make clear in the course of the Group's work, I believe my proposals for all the disputed programmes are justified. But I recognise that the above arithmetic gives the Group very little leeway in making its recommendations. I have therefore carefully considered if there is any way in which the margin for manoeuvre could be widened.

15. The two elements in the planning total **not** specific to departmental programmes are special sales of assets and the Reserve. As noted in paragraph 8 above my predecessor made proposals in July for allocating provision from these lines to programme spending. I have now looked again at these areas.

Asset Sales

16. In relation to **asset sales**, even as things stand we shall be severely criticised for publishing plans which, over the 3 years combined, increase the total disposals by £4¾ billion and finance extra programme spending with the proceeds. I am most reluctant **further** to relax the position on programme spending.

17. But, having looked again at the expected receipts from the sales now in prospect, I think I can raise the forecast by a further £0.25 billion, £1.0 billion and £0.5 billion respectively in the three years. This would bring the total programme to £4¾ billion in 1986-87, £4½ billion in 1987-88 and £4 billion in 1988-89. In terms of the likely proceeds from the sales we could not safely go higher; indeed if one of the major privatisations was to hit snags these figures would probably be unattainable. In presenting "unchanged" public expenditure plans containing a **doubling** of the sales receipts since the last White Paper, we shall face a barrage of accusations about "fudging" and "selling the family silver to pay the drinks bill". But given the difficulty of the Group's remit, I propose that these higher forecasts should now be adopted.

SECRET AND PERSONALThe Reserve

18. The position on the size of the Reserve also poses major difficulties. Present indications are that the £5 billion Reserve for the current year, 1985-86, will be at least fully spent, and that expectation will be revealed at the time of the Autumn Statement. To publish a figure significantly lower for 1986-87, with corresponding reductions in the later years, could raise major doubts about the credibility of the plans. In particular, we face the likelihood of continuing heavy - and possibly increased -current overspending by local authorities following the abolition of targets and the very worrying pressures on the pay front. It will do us no good at all to present revised plans that commentators - and perhaps more important the markets - do not believe can be delivered.

19. On the other hand, we would expect pressures on the Reserve this year caused by the "blip" in inflation and the follow-on costs from the coal strike to moderate in 1986-87. I have no great confidence that these helpful factors will outweigh the possible upwards pressures. ^{But} I think we could, with some degree of risk, justify trimming £0.5 billion a year from the Reserve, giving figures of £4.5 billion, £5.5 billion and £6.5 billion respectively for the 3 Survey years.

20. The combined effect of these adjustments to asset sales and the Reserve would add $\frac{3}{4}$ billion, $1\frac{1}{2}$ billion and £1 billion respectively to the room for manoeuvre in the three years.

The Planning Totals

21. The only other way in which the position could be eased would be to add to the **planning totals**. But for 1986-87 and 1987-88 the Prime Minister publicly re-affirmed in July our commitment to hold to the baseline totals which had already been raised by £2 billion in the Budget. Now to announce higher totals would be a clear admission of defeat, and would greatly harm the conduct of the Survey in future years. We should therefore rule out the option of changing

SECRET AND PERSONAL

the totals for 1986-87 and 1987-88.

22. For 1988-89 we have already during this Survey allowed for the planning total to rise by a further $\frac{1}{2}\%$ beyond the $2\frac{1}{2}\%$ built into programmes (paragraph 8 above). A further increase would be most unwelcome. But for 1988-89, unlike the earlier years, there are no existing published plans. Given the overall difficulties, I believe we could defend adding a further £0.5 billion to the 1988-89 planning total. This would produce a cash increase of 3.3% which, compared with a 1985 Budget inflation forecast of 3%, we could still justify as "broadly" constant in real terms. When added to the adjustments proposed above for asset sales and the Reserve, this would provide overall extra room for manoeuvre in 1988-89 of £ $1\frac{1}{2}$ billion.

The Revised Margin for Manoeuvre

23. I believe the various adjustments proposed above - totalling £ $\frac{3}{4}$ billion in 1986-87 and £ $1\frac{1}{2}$ billion in each of the following years - take us to the limit both of what is acceptable and can be presented within the framework of unchanged public expenditure policy. Adding these figures in to the arithmetic (paragraph 9) means that the total funds available for the disputed programmes would rise to £2.0 billion, £1.2 billion and £2.1 billion respectively.

24. On this basis Departments' bids of:

	+4.5	+4.5	+6.4
compared with the revised sums available of			
	+2.0	+1.2	+2.1
mean their excess bids become			
	2.5	3.3	4.3

25. By comparison my proposals of

	+0.7	-0.9	-0.8
compared with the revised sums available			
	+2.0	+1.2	+2.1
mean my margin for manoeuvre has become			
	1.3	2.0	2.9

SECRET AND PERSONAL

26. Although the margin for manoeuvre in my proposals is increased, it remains substantially less than Departments' excess bids. So hitting the revised targets still requires the Group to adjudicate on average much more in my favour than that of spending Ministers. While I consider them to be fully justified, I recognise that my proposals for the contested programmes involve some very difficult decisions. So even after the adjustments proposed in this paper, the target faced by the Group is a very tough one. The detailed position papers for the individual programmes spell out what is involved.

(JM)

SECRET AND PERSONAL

ANNEX A

MISC 120 SCORECARD

SECRET

[mark2-friday]

[DATE: 8 /10/85]

COMPOSITE SCORECARD:

£million

Survey baseline and proposed changes	1986-87				1987-88				1988-89			
	Baseline	TSY	AGREED	DEPT	Baseline	TSY	AGREED	DEPT	Baseline	TSY	AGREED	DEPT
1. MOD(1)	18,558	-278		422	18,861	-602		593	19,033	-708		897
2. FCO-ODA	1,296	-20		64	1,317	-20		83	1,350	-20		98
3. ATP				40				70				110
4. FCO-DTHER*	603		36		619		39		635		57	
5. EC*	640		10		830		320		850		100	
6. IBAP/AFF CAP*	1,277		324		1,304		345		1,337		346	
7. AFF domestic*	713		8		699		5		717		3	
8. FORESTRY*	53		0		54		0		56		0	
9. TRADE/INDUSTRY*	1,162		-13		980		12		1,004		-25	
10. ECGD*	78		207		-43		219		-44		126	
11. ENERGY	294	1		27	293	-21		37	300	-20		40
12. EMPLOYMENT*	3,704		-74		3,901		-207		3,999		-125	
13. TRANSPORT*	1,955		25		1,995		34		2,045		53	
14. DOE-HOUSING	2,424	-81		744	2,526	-312		1028	2,589	-418		957
15. DOE-PSA*	-120		7		-128		0		-131		0	
16. DOE-OTHER	848	-110		135	860	-99		130	882	-101		128
17. HOME OFFICE*	1,061		43		1,104		44		1,131		55	
18. LCD*	574		21		610		39		625		72	
19. DES	3,418	0		168	3,505	-11		182	3,593	-36		198
20. DAL*	333		6		342		13		350		18	
21. HEALTH & PSS	14,945	0		409	15,622			484	16,012			870
22. SOCIAL SEC.	41,547	931		1199	43,553	572		1144	44,642	636		1885
23. CIVIL SUPER*	1,114		65		1,226		86		1,257		147	
24. SCOTLAND	4,300	-93		7	4,373	-130		20	4,482	-188		12
25. WALES*	1,708		-1		1,735		-1		1,779		-4	
26. N. IRELAND*	4,464		53		4,603		76		4,717		105	
27. Territorial conseq.		-70		310		-130		410		-130		530
28. CHANCELLOR'S DEPT*	1,825		163		1,842		169		1,888		143	
29. OTHER DEPTS* (2)	366		68		396		64		406		68	
30. LA REL CUR(UK)(ELA)	26,032		601		26,301		760		26,959		360	
31. teachers pay			228				300				400	
NAT IND												
32. E(A)target ind settled*	1,495		-4		1,265		-77		1,299		-459	
33. Electricity E&W	-1,447	-100		189	-1,487	-350		-93	-1,524	150		379
34. Water E&W	123	0		34	15	0		103	15	-60		78
35. Coal	382	408		508	392	233		333	402	97		198
36. RMPS & SRPS*	309		194		318		-41		326		-50	
37. BGC.(3)	-470	152		272	-390		390		-400		400	
38. SPECIAL SALES OF ASSETS	-2,250		-2250		-2,250		-1250		-2,250		-1250	
39. RESERVE	6,000		-1000		7,000		-1000		7,000			
40. 3 per cent increase in 1988-89 total									1,127		-1127	
less double counting(4)	-252				-249				-258			
41. TOTALS	139,062	740	-1283	4528	143,894	-870	339	4524	148,200	-798	-587	6380
42. ROOM FOR MANOEUVRE		-543		3245		-531		4863		-1385		5793

* agreement reached or near agreement-forecast outcomes included for those not finally agreed.

(1) Officials have agreed a revised baseline switching £2m from 1987-88 to 1986-87.

(2) E(LA)figure for 1986-87 agreed. Figures for later years are forecast outcomes.

(3) When British Gas is privatised in 1986-87 the planning total loses the benefit of the negative EFL.

(4) DAFS and WOAD are in the baselines of both IBAP/AFF domestic and Scotland/Wales.

BRIEF NOTES ON AGREEMENTS REACHED IN BILATERALS

£ million

4.	<u>FCO Other</u>	+ 36	+ 39	+ 57
----	------------------	------	------	------

The settlement includes increased provision to offset increases in overseas costs, and for BBC external services. In the last year an extra £20m is included to compensate for the ending of loan repayments by Yugoslavia.

£ million

5.	<u>EC</u>	+ 10	+320	+100
----	-----------	------	------	------

The figures reflect higher forecast UK contributions to the European Communities.

£ million

6.	<u>IBAP/AFF CAP</u>	+324	+345	+346
----	---------------------	------	------	------

The net change largely reflects higher forecasts of intervention stocks due to agricultural surpluses in the CAP. The forecasting increases are offset by economy measures on support for beef and cereals in each year and a once and for all saving of £14m in 1986-87 achieved by delaying payments for intervened cereals.

£ million

7.	<u>AFF domestic</u>	+ 8	+ 5	+ 3
----	---------------------	-----	-----	-----

Domestic agriculture has been settled slightly above baseline partly as a result of volume changes in domestic demand led programmes.

£ million

13. Transport + 25 +34 + 53

The net change includes increases for national roads, local capital and gross running costs offset by savings from fees, other programmes and the introduction of EFL treatment for local authority transport companies (£40 million a year). The agreement on the programme as a whole is conditional on securing the legislation needed to introduce EFL treatment for local authority transport companies.

£ million

15. PSA + 7 0 0

In the first year increased provision has been agreed for maintenance, new works and the International Conference Centre. Increased allowance has also been made for Parliamentary building (scored against other departments).

£ million

17. Home Office + 43 + 44 + 55

A package deal was agreed with the Home Secretary reflecting his bids for the prison service, largely because of the growth in prisoners and the need to maintain the prison building programme. Other bids for drugs, civil defence and the passport and immigration departments will also be accommodated within the agreed figures. The figures imply worsening arrears on the criminal injuries compensation scheme and no addition to provision for fire service capital.

£ million

18. Lord Chancellor's Dept + 21 + 39 + 72

The agreed changes reflect the increased costs of legal aid and administration of legal aid by the Law Society. A confidential review of legal aid controls will be set up.

£ million

20. OAL + 6 + 13 + 18

The Treasury is attempting to reach a deal with OAL allowing some extra provision for the arts council, the British Library project and museums and galleries.

£ million

23. Civil Superannuation + 65 + 86 +147

The figures reflect higher forecasts of the cost of payments to civil service pensioners and their dependants.

£ million

25. Wales - 1 - 1 - 4

The Welsh block will be settled according to the usual formula. On other spending net reductions have been agreed for the Welsh Development Agency and the Development Board for Rural Wales. These savings are partially offset by increases for housing revenue account interest payments.

£ million

26. Northern Ireland + 53 + 76 +105

The Northern Ireland block will be settled on the basis of the normal block/formula arrangements. The agreed additions represent higher forecast costs of social security and housing revenue account interest payments.

£ million

28. Chancellor's Departments +163 +169 +143

Bids of around £35m a year have been conceded to cover the higher forecast costs of life assurance premium and mortgage interest reliefs. The main other increases are for Inland Revenue and Customs and Excise tax collection and enforcement costs. Additional provision is also made for HMSO supplies to Parliament.

£ million

29. Other Departments + 68 + 64 + 68

Most of the additional provision is to cover the cost of the Crown Prosecution Service. Other bids meet higher running costs of the House of Commons and House of Lords together with provision for PSA to continue security work on the Palace of Westminster. Extra provision has also been allowed for staff to speed up the Land Registry's work.

£ million

33. E(A) target industries settled - 4 - 77 -459

Agreement has been reached on EFLs for the Scottish Electricity Boards, BSC, Post Office, National Giro Bank, British Rail, Scottish Transport Group, British Shipbuilders (Merchant), Civil Aviation and London Regional Transport. Small savings were agreed for most industries.

The EA target (other than for Coal, Gas, Airports and Buses) is by comparison with baseline

£ million

86-87	87-88	88-89
0	-250	-150

Apart from Water and Electricity (England and Wales) all the industries within the target are settled contributing

- 4	- 77	-459
-----	------	------

If Departments bids for Water and Electricity were accepted the outcome would be

+219	- 67	- 1
------	------	-----

Giving a shortfall on target of

219	183	149
-----	-----	-----

£ million

37. RMPS & SRPS

+194

- 41

- 50

Extra provision has been made to cover the cost of the Redundant Mineworkers Pension Scheme. The figures for the Shipbuilding Redundancy Payments Scheme are little changed.

10 DOWNING STREET

6A

Prime Minister

This, for information, is the
Chief Secretary's paper referring to
the hood Whitehall's group what
the Treasury sees as its remit.

It is to be circulated on
Tuesday night.

JRS
9/10.



SECRET AND PERSONALDRAFT PAPER FROM CHIEF SECRETARY TO STAR CHAMBERPublic Expenditure Survey: Position Reached After Bilaterals
Memorandum by the Chief Secretary

1. This paper summarises the position reached after my bilateral meetings with colleagues. Separate papers discuss the position in each of the disputed programmes namely:

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|----------------------|-------|-----------------------|--------|---|
| <i>Not attached,</i> | (i) | Defence | (vi) | Health |
| | (ii) | Aid (including ATP) | (vii) | Social Security |
| | (iii) | Housing | (viii) | Scotland |
| | (iv) | DOE Other | (ix) | Electricity (England and Wales) fast reactor research, and gas. |
| | (v) | Education and Science | | |
- (x) Water

Negotiations on the coal industry have not yet started pending the availability of data from the NCB.

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SECRET AND PERSONAL

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- (ii) similarly, my predecessor proposed that, as part of the normal rolling forward of the plans, the Reserves for 1986-87 and 1987-88 - initially set at £6 billion and £7 billion - could be reduced to £5 billion and £6 billion, so releasing £1 billion in each year to be allocated to programmes in 1988-89. (Line 40 of the table).
- (iii) for 1988-89 the initial baselines for individual programmes were set at 2½% above the 1987-88 levels. The July decision to increase the planning total by 3% provided £1.1 billion for allocation to programmes (line 41 of the table).
- (iv) decisions by E(LA) in July on provision for local authority relevant current expenditure in England, and subsequent decisions for the territorial departments, added £0.6 billion to expenditure in 1986-87 (line 30 of the table). I am in the process of seeking to agree figures for the later years with colleagues and the table shows my present assumptions on where those negotiations will end up. We also have to allow for the extra provision promised for teachers' pay if agreement is reached on the Government's current offer (line 31 of the table).
- (v) the various agreements I have reached bilaterally on departmental programmes. The increases I have been obliged to accept include IBAP and ECGD (lines 6 and 10), both unavoidable demand-led additions. Details of these and other settlements are given in Annex B.

Implications for Other Programmes

9. If the baseline targets are to be met increases in provision for the remaining programmes must be no greater than the net reductions

SECRET AND PERSONAL

already settled in the "agreed" lines (and for 1987-88, where net increases have been agreed so far, the remaining programmes must yield a reduction). That means the Group must hold net additions to provision for the remaining programmes to no more than £1.3 billion in 1986-87 and £0.6 billion in 1988-89; and achieve net savings of £0.3 billion in 1987-88.

10. The Group will wish to know how these targets relate both to Departments' bids on the disputed programmes, and to the proposals I have put forward. The details are in Annex A, but in aggregate (and in rounded figures) the position is as follows.

11. Departments' are bidding for

£ billion

	1986-87	1987-88	1988-89
	+4.5	+4.5	+6.4

which, compared with the sums available for these programmes of

	+1.3	-0.3	+0.6
--	------	------	------

means their "excess bids" are

	3.2	4.8	5.8
--	-----	-----	-----

12. My proposals for the outstanding programmes are:

	+0.7	-0.9	-0.8
--	------	------	------

which means the "margin for manoeuvre" in my proposals (ie the amounts which can be conceded without exceeding the sums available set out above) is

	0.5	0.5	1.4
--	-----	-----	-----

13. The Group will note that, while my proposals for these programmes are sufficient to yield the agreed targets, the available

SECRET AND PERSONAL

margin for manoeuvre is a great deal less than the excess bids from Departments. This means that to hit the targets the Group would need in aggregate to adjudicate about 80-90% in my favour.

14. As I shall make clear in the course of the Group's work, I believe my proposals for all the disputed programmes are justified. But I recognise that the above arithmetic gives the Group very little leeway in making its recommendations. I have therefore carefully considered if there is any way in which the margin for manoeuvre could be widened.

15. The two elements in the planning total not specific to departmental programmes are special sales of assets and the Reserve. As noted in paragraph 8 above my predecessor made proposals in July for allocating provision from these lines to programme spending. I have now looked again at these areas.

Asset Sales

16. In relation to asset sales, even as things stand we shall be severely criticised for publishing plans which, over the 3 years combined, increase the total disposals by £4½ billion and finance extra programme spending with the proceeds. I am most reluctant further to relax the position on programme spending.

17. But, having looked again at the expected receipts from the sales now in prospect, I think I can raise the forecast by a further £0.25 billion, £1.0 billion and £0.5 billion respectively in the three years. This would bring the total programme to £4½ billion in 1986-87, £4½ billion in 1987-88 and £4 billion in 1988-89. In terms of the likely proceeds from the sales we could not safely go higher; indeed if one of the major privatisations was to hit snags these figures would probably be unattainable. In presenting "unchanged" public expenditure plans containing a doubling of the sales receipts since the last White Paper, we shall face a barrage of accusations about "fudging" and "selling the family silver to pay the drinks bill". But given the difficulty of the Group's remit, I propose that these higher forecasts should now be adopted.

SECRET AND PERSONALThe Reserve

18. The position on the size of the Reserve also poses major difficulties. Present indications are that the £5 billion Reserve for the current year, 1985-86, will be at least fully spent, and that expectation will be revealed at the time of the Autumn Statement. To publish a figure significantly lower for 1986-87, with corresponding reductions in the later years, could raise major doubts about the credibility of the plans. In particular, we face the likelihood of continuing heavy - and possibly increased -current overspending by local authorities following the abolition of targets and the very worrying pressures on the pay front. It will do us no good at all to present revised plans that commentators - and perhaps more important the markets - do not believe can be delivered.

19. On the other hand, we would expect pressures on the Reserve this year caused by the "blip" in inflation and the follow-on costs from the coal strike to moderate in 1986-87. I have no great confidence that these helpful factors will outweigh the possible upwards pressures. ^{But} I think we could, with some degree of risk, justify trimming £0.5 billion a year from the Reserve, giving figures of £4.5 billion, £5.5 billion and £6.5 billion respectively for the 3 Survey years.

20. The combined effect of these adjustments to asset sales and the Reserve would add $\frac{3}{4}$ billion, $1\frac{1}{2}$ billion and £1 billion respectively to the room for manoeuvre in the three years.

The Planning Totals

21. The only other way in which the position could be eased would be to add to the planning totals. But for 1986-87 and 1987-88 the Prime Minister publicly re-affirmed in July our commitment to hold to the baseline totals which had already been raised by £2 billion in the Budget. Now to announce higher totals would be a clear admission of defeat, and would greatly harm the conduct of the Survey in future years. We should therefore rule out the option of changing

SECRET AND PERSONAL

the totals for 1986-87 and 1987-88.

22. For 1988-89 we have already during this Survey allowed for the planning total to rise by a further $\frac{1}{2}\%$ beyond the $2\frac{1}{2}\%$ built into programmes (paragraph 8 above). A further increase would be most unwelcome. But for 1988-89, unlike the earlier years, there are no existing published plans. Given the overall difficulties, I believe we could defend adding a further £0.5 billion to the 1988-89 planning total. This would produce a cash increase of 3.3% which, compared with a 1985 Budget inflation forecast of 3%, we could still justify as "broadly" constant in real terms. When added to the adjustments proposed above for asset sales and the Reserve, this would provide overall extra room for manoeuvre in 1988-89 of £1½ billion.

The Revised Margin for Manoeuvre

This is a little less than the Treasury reported to you earlier. They are adamant that they have firmed their pockets out.

23. I believe the various adjustments proposed above - totalling £¾ billion in 1986-87 and £1½ billion in each of the following years - take us to the limit both of what is acceptable and can be presented within the framework of unchanged public expenditure policy. Adding these figures in to the arithmetic (paragraph 9) means that the total funds available for the disputed programmes would rise to £2.0 billion, £1.2 billion and £2.1 billion respectively.

24. On this basis Departments' bids of:

	+4.5	+4.5	+6.4
compared with the revised sums available of			
	+2.0	+1.2	+2.1
mean their excess bids become			
	2.5	3.3	4.3

25. By comparison my proposals of

	+0.7	-0.9	-0.8
compared with the revised sums available			
	+2.0	+1.2	+2.1
mean my margin for manoeuvre has become			
	1.3	2.0	2.9

SECRET AND PERSONAL

26. Although the margin for manoeuvre in my proposals is increased, it remains substantially less than Departments' excess bids. So hitting the revised targets still requires the Group to adjudicate on average much more in my favour than that of spending Ministers. While I consider them to be fully justified, I recognise that my proposals for the contested programmes involve some very difficult decisions. So even after the adjustments proposed in this paper, the target faced by the Group is a very tough one. The detailed position papers for the individual programmes spell out what is involved.

(JM)

SECRET AND PERSONAL

ANNEX A

MISC 120 SCORECARD

SECRET
.....

[mark2-friday]

[DATE: 8 /10/85]

COMPOSITE SCORECARD:

£million

Survey baseline and proposed changes	1986-87				1987-88				1988-89			
	Baseline	TSY	AGREED	DEPT	Baseline	TSY	AGREED	DEPT	Baseline	TSY	AGREED	DEPT
1. MOD(1)	18,558	-278		422	18,861	-602		593	19,033	-708		897
2. FCO-ODA	1,296	-20		64	1,317	-20		83	1,350	-20		98
3. ATP				40				70				110
4. FCO-OTHER*	603		36		619		39		635		57	
5. EC*	640		10		830		320		850		100	
6. IBAP/AFF CAP*	1,277		324		1,304		345		1,337		346	
7. AFF domestic*	713		8		699		5		717		3	
8. FORESTRY*	53		0		54		0		56		0	
9. TRADE/INDUSTRY*	1,162		-13		980		12		1,004		-25	
10. ECGD*	78		207		-43		219		-44		126	
11. ENERGY	294	1		27	293	-21		37	300	-20		40
12. EMPLOYMENT*	3,704		-74		3,901		-207		3,999		-125	
13. TRANSPORT*	1,955		25		1,995		34		2,045		53	
14. DOE-HOUSING	2,424	-81		744	2,526	-312		1028	2,589	-418		957
15. DOE-PSA*	-120		7		-128		0		-131		0	
16. DOE-OTHER	848	-110		135	860	-99		130	882	-101		128
17. HOME OFFICE*	1,061		43		1,104		44		1,131		55	
18. LCD*	574		21		610		39		625		72	
19. DES	3,418	0		168	3,505	-11		182	3,593	-36		198
20. OAL*	333		6		342		13		350		18	
21. HEALTH & PSS	14,945	0		409	15,622			484	16,012			870
22. SOCIAL SEC.	41,547	931		1199	43,553	572		1144	44,642	636		1885
23. CIVIL SUPER*	1,114		65		1,226		86		1,257		147	
24. SCOTLAND	4,300	-93		7	4,373	-130		20	4,482	-188		12
25. WALES*	1,708		-1		1,735		-1		1,779		-4	
26. N. IRELAND*	4,464		53		4,603		76		4,717		105	
27. Territorial conseq.		-70		310		-130		410		-130		530
28. CHANCELLOR'S DEPT*	1,825		163		1,842		169		1,888		143	
29. OTHER DEPTS*	366		68		396		64		406		68	
30. LA REL CUR(UK)(ELA)	26,032		601		26,301		760		26,959		360	
31. teachers pay			228				300				400	
NAT IND												
32. E(A)target ind settled*	1,495		-4		1,265		-77		1,299		-459	
33. Electricity E&W	-1,447	-100		189	-1,487	-350		-93	-1,524	150		379
34. Water E&W	123	0		34	15	0		103	15	-60		78
35. Coal	382	408		508	392	233		333	402	97		198
36. RAPS & SRPS*	309		194		318		-41		326		-50	
37. BGC.(3)	-470	152		272	-390		390		-400		400	
38. SPECIAL SALES OF ASSETS	-2,250		-2250		-2,250		-1250		-2,250		-1250	
39. RESERVE	6,000		-1000		7,000		-1000		7,000			
40. 3 per cent increase in 1988-89 total									1,127		-1127	
less double counting(4)	-252				-249				-258			
41. TOTALS	139,062	740	-1283	4528	143,894	-870	339	4524	148,200	-798	-587	6380
42. ROOM FOR MANOEUVRE		-543		3245		-531		4863		-1385		5793

* agreement reached or near agreement-forecast outcomes included for those not finally agreed.

(1) Officials have agreed a revised baseline switching £2m from 1987-88 to 1986-87.

(2) E(LA)figure for 1986-87 agreed. Figures for later years are forecast outcomes.

(3) When British Gas is privatised in 1986-87 the planning total loses the benefit of the negative EFL.

(4) DAFS and WOAD are in the baselines of both IBAP/AFF domestic and Scotland/Wales.

BRIEF NOTES ON AGREEMENTS REACHED IN BILATERALS

£ million

4. <u>FCO Other</u>	+ 36	+ 39	+ 57
---------------------	------	------	------

The settlement includes increased provision to offset increases in overseas costs, and for BBC external services. In the last year an extra £20m is included to compensate for the ending of loan repayments by Yugoslavia.

£ million

5. <u>EC</u>	+ 10	+320	+100
--------------	------	------	------

The figures reflect higher forecast UK contributions to the European Communities.

£ million

6. <u>IBAP/AFF CAP</u>	+324	+345	+346
------------------------	------	------	------

The net change largely reflects higher forecasts of intervention stocks due to agricultural surpluses in the CAP. The forecasting increases are offset by economy measures on support for beef and cereals in each year and a once and for all saving of £14m in 1986-87 achieved by delaying payments for intervened cereals.

£ million

7. <u>AFF domestic</u>	+ 8	+ 5	+ 3
------------------------	-----	-----	-----

Domestic agriculture has been settled slightly above baseline partly as a result of volume changes in domestic demand led programmes.

£ million

13. Transport + 25 +34 + 53

The net change includes increases for national roads, local capital and gross running costs offset by savings from fees, other programmes and the introduction of EFL treatment for local authority transport companies (£40 million a year). The agreement on the programme as a whole is conditional on securing the legislation needed to introduce EFL treatment for local authority transport companies.

£ million

15. PSA + 7 0 0

In the first year increased provision has been agreed for maintenance, new works and the International Conference Centre. Increased allowance has also been made for Parliamentary building (scored against other departments).

£ million

17. Home Office + 43 + 44 + 55

A package deal was agreed with the Home Secretary reflecting his bids for the prison service, largely because of the growth in prisoners and the need to maintain the prison building programme. Other bids for drugs, civil defence and the passport and immigration departments will also be accommodated within the agreed figures. The figures imply worsening arrears on the criminal injuries compensation scheme and no addition to provision for fire service capital.

£ million

18. Lord Chancellor's Dept + 21 + 39 + 72

The agreed changes reflect the increased costs of legal aid and administration of legal aid by the Law Society. A confidential review of legal aid controls will be set up.

£ million

20. OAL + 6 + 13 + 18

The Treasury is attempting to reach a deal with OAL allowing some extra provision for the arts council, the British Library project and museums and galleries.

£ million

23. Civil Superannuation + 65 + 86 +147

The figures reflect higher forecasts of the cost of payments to civil service pensioners and their dependants.

£ million

25. Wales - 1 - 1 - 4

The Welsh block will be settled according to the usual formula. On other spending net reductions have been agreed for the Welsh Development Agency and the Development Board for Rural Wales. These savings are partially offset by increases for housing revenue account interest payments.

£ million

26. Northern Ireland + 53 + 76 +105

The Northern Ireland block will be settled on the basis of the normal block/formula arrangements. The agreed additions represent higher forecast costs of social security and housing revenue account interest payments.

£ million

28. Chancellor's Departments +163 +169 +143

Bids of around £35m a year have been conceded to cover the higher forecast costs of life assurance premium and mortgage interest reliefs. The main other increases are for Inland Revenue and Customs and Excise tax collection and enforcement costs. Additional provision is also made for HMSO supplies to Parliament.

£ million

29. Other Departments + 68 + 64 + 68

Most of the additional provision is to cover the cost of the Crown Prosecution Service. Other bids meet higher running costs of the House of Commons and House of Lords together with provision for PSA to continue security work on the Palace of Westminster. Extra provision has also been allowed for staff to speed up the Land Registry's work.

£ million

33. E(A) target industries settled - 4 - 77 -459

Agreement has been reached on EFLs for the Scottish Electricity Boards, BSC, Post Office, National Giro Bank, British Rail, Scottish Transport Group, British Shipbuilders (Merchant), Civil Aviation and London Regional Transport. Small savings were agreed for most industries.

The EA target (other than for Coal, Gas, Airports and Buses) is by comparison with baseline

£ million

86-87	87-88	88-89
0	-250	-150

Apart from Water and Electricity (England and Wales) all the industries within the target are settled contributing

- 4 - 77 -459

If Departments bids for Water and Electricity were accepted the outcome would be

+219 - 67 - 1

Giving a shortfall on target of

219 183 149

£ million

37. RMPS & SRPS

+194

- 41

- 50

Extra provision has been made to cover the cost of the Redundant Mineworkers Pension Scheme. The figures for the Shipbuilding Redundancy Payments Scheme are little changed.

pa public expenditure

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D R Norgrove Esq
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Your reference

Our reference

Date

4 October 1985

*Dear David,*DEFENCE EXPENDITURE AS A PROPORTION OF GDP

I promised to let you have the figures for defence expenditure as a proportion of GDP in 1988-89 on the assumption of level real terms provision.

This is in the attached note (outcome D), which also refines the figures for other possible outcomes in the earlier DM note. The figures in the latter were more heavily rounded, and constrained to be close to those calculated by MOD (so that if the Chief Secretary and the Secretary of State for Defence had returned to the issue in the second bilateral, they would at least have been using the same figures). For the same reason, the earlier note used MOD's figures (published in evidence to HCDC) for the earlier years, including 1978-79. However, these were calculated last December: recalculating using the latest GDP estimates would produce a ratio of 4.34 for 1978-79.

That aside, the revised figures confirm that whatever the outcome the GDP ratio will be within a fairly narrow range and will have fallen quite markedly compared with the earlier years of this decade.

*Jams**Frank*

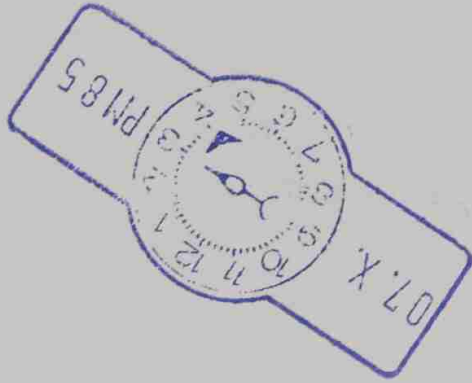
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CONFIDENTIAL

DEFENCE EXPENDITURE AS A PROPORTION OF GDP

Percentage of GDP at market prices	<u>1988-89</u>
Outcome A: Baseline plus Falklands costs	4.54
Outcome B: Baseline plus <u>all</u> MOD bids	4.71
Outcome C: Baseline plus Falklands costs less Treasury reductions (£600m)	4.40
Outcome D: Baseline plus Falklands costs plus Inflation adjustment (£464m) ¹	4.65

Note: ¹ Sufficient to provide level real terms provision after 1985-86



*Defense briefing, for public
expenditure file. RW 2/10*

if it were a fund built up from contributions made in the past; and since the past pensions paid under the PCSPS have already scored as public expenditure as a proxy for those contributions, it would be double counting to score the transfer payment itself as public expenditure.

5. The proper treatment of the PCSPS in public expenditure was discussed briefly in the Review of Public Expenditure Classifications (REPEC) but no firm conclusion was drawn and the issue is still being considered. It is argued by some, that where a scheme is non contributory (ie pay as you go) such as the PCSPS pensions actually paid under the PCSPS should score as public expenditure -as that reflects the reality of annual cash expenditure. However, such treatment would ignore the fact that pensions paid in any one year reflect liabilities built up in the past. For this reason, others argue that what should score as public expenditure is a proper actuarial estimate of the contributions that would be necessary, if the PCSPS were funded, to pay the future pensions of presently employed civil servants.

6. This argument is not yet resolved, and so we should follow the present treatment - which has the virtue of being consistent with past practice and with the national accounts. The attached note which has been prepared by GEP describes and defends this treatment. If you are content, I will send it to the TCSC.

RICHARD PRATT

UK DEFENCE EXPENDITURE AS A PROPORTION OF GDP

Mr Heseltine's line of argument at the 17 September bilateral was that, if the Treasury has its way (that is, if all Mr Heseltine's non-Falklands bids fail and if the Treasury reductions in the existing baseline are implemented), by 1988-89 UK defence expenditure would only be the same proportion of GDP as in 1978-79, the last year of the Labour Government. His argument was that this would be politically indefensible.

2. The attached table provides figures for defence expenditure as a proportion of GDP over the 1978-79 to 1988-89 period, with the figures for the Survey years on three alternative bases - A, present baseline plus Falklands costs 1988-89; B, baseline plus all MODs bids; and C, baseline plus Falklands costs but less Treasury option reductions. The figures confirm that Mr Heseltine's basic comparison is broadly correct; if C is the outcome of the Survey, defence expenditure in 1988-89 will be much the same proportion of GDP as in 1978-79 (when the ratio was the lowest in the post-war period).

3. But arguably the comparison is fairly meaningless. It ignores the substantial growth in defence expenditure in the period up to 1985-86, and the fact that the later decline in the GDP ratio primarily reflects the relatively healthy (2 per cent a year) GDP growth currently forecast. It is hardly a point of criticism that, defence expenditure having been raised to a much higher level in absolute terms, it falls as a proportion of GDP mainly because of the growth of the latter. This is leaving aside the fact that even a ratio of 4.5 per cent in 1988-89 would be likely to be significantly higher than those of our major European allies - France currently has a ratio of 3.4 per cent and Germany 3.3 per cent. In this context it might be noted that the commitment in the 1983 Labour Manifesto was:-

"Labour will reduce the proportion of the nation's resources devoted to defence so that the burden we

bear will be brought into line with that of other major European NATO countries..."

4. Nevertheless, Mr Heseltine's comparison touches on an important issue for defence in the Survey - the political presentation of the resulting totals. If the Treasury has its way the programme will be declining quite markedly in real terms over the Survey period - by 2 per cent in 1986-87 and 1987-88, and a further 1.5 per cent in 1988-89. This is likely to cause concern to some Government supporters and, arguably, to provide the Opposition with more ready ammunition than comparisons of GDP ratios. The following therefore attempts to provide counter-arguments to both potential lines of criticism.

Government planning to spend a lower proportion of national wealth on defence than did last Labour Government?

- We will be spending a lower proportion of our national wealth on defence because our national wealth will grow substantially;

- both in cash and after adjusting for inflation, during our term of office we have massively increased the resources devoted to defence - in 1985-86 defence spending is £18 billion, compared with the £7.5 million spent by the Labour Government in 1978-79. In real terms we have increased spending by nearly 30 per cent, adding nearly £4 billion a year to the defence budget;

- and we will continue to spend a much bigger proportion of our national wealth on defence than other major European countries.

Defence spending planned to fall in real terms?

- since Government took office, defence spending has increased by nearly 30 per cent in real terms. In cash terms, spending has more than doubled, from £7.5 billion in 1978-79 to £18 billion in 1985-86.

- this is a massive step increase in defence expenditure, the bulk of which will run on to future years. In 1988-89 defence spending will still be 18 per cent higher in real terms than in 1978-79 and the programme will still have some £2.8 billion more cash a year than if the 1978-79 level had been maintained level in real terms;

- the result is more men and women in the Forces, better paid and better equipped.

5. Finally it is worth noting that Mr Heseltine played this political card in the 1984 Survey. The No 10 letter of 1 November 1984 recording the outcome of the Prime Minister's meeting on defence expenditure includes the following:-

"The Secretary of State for Defence said that he was not arguing that Britain's defence needs could not adequately be met within the provision recommended.... The problem he faced was a political one...."

"The Secretary of State for Defence said that if he accepted the Group's offer on figures and words, it would be essential to present the Government's case to the defence constituency with greater vigour... The Prime Minister assured him that he would have the full support of colleagues in this."

ANNEX: DEFENCE EXPENDITURE AS A PROPORTION OF GDP

<u>Financial Year</u>	<u>Percentage of GDP at market prices</u>		
1978-79*		4.4	
1979-80		4.5	
1980-81		4.8	
1981-82		4.9	
1982-83		5.1	
1983-84		5.1	
1984-85		5.3	
1985-86		5.1	
	<u>1986-87</u>	<u>1987-88</u>	<u>1988-89</u>
Outcome A: Baseline plus Falklands costs 1988-89	4.9	4.7	4.6
Outcome B: Baseline plus <u>all</u> MOD bids	5.0	4.9	4.8
Outcome C: Baseline plus Falklands costs less Treasury reductions	4.8	4.6	4.5

* The lowest ratio in the post-war period. But throughout the 1970s defence expenditure was a comparatively low proportion of GDP, the highest ratio during that decade being 4.8 per cent.

UK DEFENCE EXPENDITURE: SOME FACTS AND FIGURES

How we compare

- In absolute terms, UK spends more on defence than any other European country - in 1984, \$22.7 billion compared to \$20.4 billion in Germany and \$20.1 billion in France;

- UK spends more as a proportion of GDP than these other major European countries - in 1984, 5.3 per cent, compared to 3.4 per cent for France and 3.3 per cent for Germany;

- and we also spend more per head than these countries - \$405 in 1984, compared to \$370 in France and \$330 in Germany;

- Moreover, the UK spends a higher proportion of its defence budget on equipment than any other NATO country, including the US.

The record since 1978-79

- over the 1978-79 to 1985-86 period defence spending has grown by 150 per cent in cash terms. This year the UK is spending £18 billion, compared with £7.5 billion in 1978-79:

- over this period, spending has increased by 29 per cent in real terms (using GDP deflators, not MOD's unreliable price indices);

- the result of this real growth is that the defence budget now has £4 billion more cash a year than if the 1978-79 provision had been maintained level in real terms. Even MOD admit to a £3 billion a year cash increment;

- spending on defence equipment has grown even more strongly. In 1985-86 it is £9.1 billion, compared with £3.3 billion in 1978-79:

- in real terms, equipment expenditure has grown by 48

per cent over this period, providing an annual cash addition of nearly £3 billion;

- and over the period defence spending has also taken on increased share of total public expenditure. In 1985-86 the defence budget is 13.7 per cent of total public expenditure, compared with 11.4 per cent in 1978-79.

What the money has bought

- More service personnel. In 1985, UK Regular forces total 326,000, compared with 315,000 in 1979. Reserve and Auxiliary forces total 203,000 compared with 180,000.

- the second largest navy in NATO, an air force almost as large as those of France and Germany and an all-professional army. All benefitting from a major and continuing re-equipment programme.

Manifesto commitments

The attached annex reproduces the commitments on defence in the 1979 and 1983 Conservative manifestoes.

ANNEX: EXTRACTS FROM CONSERVATIVE MANIFESTOES1979 Manifesto (page 29)

IMPROVING OUR DEFENCES

During the past five years the military threat to the West has grown steadily as the Communist bloc has established virtual parity in strategic nuclear weapons and a substantial superiority in conventional weapons. Yet Labour have cut down our forces, weakened our defences and reduced our contribution to NATO. And the Left are pressing for still more reductions.

We shall only be able to decide on the proper level of defence spending after consultation in government with the Chiefs of Staff and our allies. But it is already obvious that significant increases will be necessary. The SALT discussions increase the importance of ensuring the continuing effectiveness of Britain's nuclear deterrent.

In recent times our armed forces have had to deal with a wide variety of national emergencies. They have responded magnificently despite government neglect and a severe shortage of manpower and equipment. We will give our servicemen decent living conditions, bring their pay up to full comparability with their civilian counterparts immediately and keep it there. In addition, we must maintain the efficiency of our reserve forces. We will improve their equipment, too, and hope to increase their strength.

1983 Manifesto (page 43)

We have substantially increased our defence expenditure in real terms. We have honoured our promise to give our regular and reserve forces proper pay and conditions and the equipment they need to do the job.

There could be no greater testimony to the professional dedication and the quality of equipment of the British Armed Services than the brilliant recapture of the Falkland Islands in just 74 days. We take pride in their achievement.

Personal



David

We spoke. Briefs
for your use.

Ed we have a
word about one
or two general
issues later
today?

2/10

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PUBLIC EXPENDITURE CABINET: 3 OCTOBER

MINISTRY OF DEFENCE

	1986-87	1987-88	1988-89
Expenditure baseline (adjusted for £2m switch from 1987-88 to 1986-87)	18,560	18,859	19,033
MOD position	+ 422	+ 595	+ 897
Treasury position	- 300	- 600	- 708
[of which: option reductions	- 300	- 600	- 900
<u>less</u> bids conceded	-	-	+ 192]

(ii) Running Costs

MOD included in new scheme, but (following improved accounting capability within department) Armed Forces content reduced to some 60,000 Servicemen in support areas. Figures still to be agreed, but new coverage is expected to reduce MOD total by around £3.2 billion to approximately £4.2 billion for 1986-87.

(iii) Outstanding Issues

Treasury has accepted MOD's bid for Falklands costs in 1988-89 (£192m) and offered a maximum of £20m to meet the RO plc EFL in 1986-87 (MOD bid £42m). Treasury has rejected MOD's remaining bids - for inflation adjustment, extra costs of 1985 AFPRB award and Royal Dockyards. In addition, Treasury has requested reductions - through improved efficiency - of £300m, £600m and £900m.

(iv) Line to take

- Cannot accept remaining additional bids. In total, they would mean continued real growth in a programme which has already grown by nearly 30% since 1978-79.
- This real growth has meant a cash addition to the programme of nearly £4,000m a year.
- In view of this - and wide-ranging evidence of the scope for savings through improved efficiency - justified in asking for substantial reductions, to help achieve agreed planning total.
- Even after these savings, the defence budget would be considerably (18% in 1988-89) higher in real terms than when we took office.

FOREIGN AND COMMONWEALTH OFFICE - OVERSEAS DEVELOPMENT ADMINISTRATION

(i)

£ million

	1986-87	1987-88	1988-89			
<u>BASELINE</u>	1,296	1,317	1,350			
	<u>Department's position</u>			<u>Treasury position</u>		
<u>Additional Bids/ reductions sought</u>						
Net aid programme	+ 60.0	+ 80.0	+ 95.0	- 20.0	- 20.0	- 20.0
Overseas pensions	+ 3.4	+ 1.9	+ 1.9	-	-	-
Directorate of Overseas Surveys/ Ordnance Survey	+ 0.7	+ 0.7	+ 0.8	-	-	-
	<u>+ 64.1</u>	<u>+ 82.6</u>	<u>+ 97.7</u>	<u>- 20.0</u>	<u>- 20.0</u>	<u>- 20.0</u>
<u>Reduced Requirements</u>						
Compensation to Consolidated fund re Zimbabwe Grant	- 0.2	- 0.2	- 0.1	- 0.2	- 0.2	- 0.1
	<u>+ 63.9</u>	<u>+ 82.4</u>	<u>+ 97.6</u>	<u>- 20.2</u>	<u>- 20.2</u>	<u>- 20.1</u>

018/72

Aid and Trade Provision (ATP)

DTI proposal*
ODA, DE and ECGD
also involved

4.0 13.0 29.0 - - -

*Subject to Mr Brittan's approval and 1 October quadrilateral.

Running Costs

(ii) The Chief Secretary has agreed to accept an increase of 114 in ODA's manpower targets from 1 April 1987. This is conditional on the surrender of consequential running cost savings, estimated to be around £0.8m a year. (This is subject to the policy decision on taking back overseas pension administration from Crown Agents into ODA).

Outstanding Issues

(ii) The Foreign Secretary is holding firm to his bids of £60m, £80m and £95m for the aid programme. And, subject to outcome of the quadrilateral, there is the further bid for extra ATP spending.

Line to Take

(iv) Must continue to press for cuts of £20m a year in the aid programme. And extra spending on ATP should be absorbed in existing totals.

SECRETFOREIGN AND COMMONWEALTH OFFICE (Other)

(i)	1986-87	1987-88	1988-89
Baseline	603.1	619.2	634.6
Agreed settlement	+35.5	+39.2	+56.9

Running costs

(ii) Chief Secretary willing to accept FCO running costs figures (subject to final settlement at official level). Foreign Secretary has withdrawn his bids for additional staff.

Basis of settlement

(iii) Provides for additions for overseas price movements, asset recycling, BBC External Services and (1988-89 only) ending of Yugoslav loan repayments. Foreign Secretary has now withdrawn (or at least postponed until next year) bids for early retirement costs and security works.

EC CONTRIBUTIONS

D4

The projection of net payments to Community Institutions is as follows:

	<u>1986-87</u>	<u>1987-88</u>	<u>1988-89</u>	<u>£m</u>
Net payments to Community Institutions - current baseline	+640	+320	+100	
Additional bids - revised forecast of UK net contributions	+10	+320	+100	

2. The additional bids have been determined from the results of the latest projection of the UK's net payments to Community institutions. These bids have been seen but have not yet been finally approved by the Minister of State.

3. The projections are extremely uncertain. The forecast of UK gross contributions is dependent on, amongst other things, the exchange rate and changes in imports and import prices (particularly the prices of certain agricultural products), while the forecast of our gross receipts is dependent on future changes in the level and pattern of expenditure within the Community as a whole. Agricultural receipts are particularly difficult to predict accurately.

4. Net payments to the Community are demand-led. The UK is under a Treaty obligation to make the additional payments involved.

SECRET

IBAP AND OTHER CAP

	<u>£ million</u>		
	1986-87	1987-88	1988-89
Baseline	1277	1304	1337
Latest position	+337.6 ⁽¹⁾	+346.6	+345.6

(1) The Minister of Agriculture may accept a saving of £14 million in 1986-87.

Position on running costs

The Chief Secretary has accepted that IBAP's running costs bid is inescapable, due to the demand-led nature of its workload.

Line to take

Extra provision is unavoidable and reflects under provision in last year's Survey and larger intervention stocks due to agricultural surpluses in the European Community. [But still discussing scope for offsetting economies]. Government still pressing for reform of the CAP.

SECRET

DOMESTIC AGRICULTURE, FISHERIES AND FOOD

	<u>£ million</u>		
	1986-87	1987-88	1988-89
Baseline (excluding LA relevant current)	713	699	717
Adjustment for agricultural support	+2.7	+1.7	+0.5
Revised baseline	729.7	714.7	731.5
Departments' position	+6	+5	+4
Treasury position	+5	0	+2
<u>Position on running costs</u>			
Target	211.4	217.8	223.2
MAFF bid	212.2	217.6	225.4
Difference	+0.8	-0.2	+2.2

Main outstanding issues

The Chief Secretary has agreed to increase above the baseline of £5 million in 1986-87 for capital expenditure on fisheries protection, following Ministerial decisions, and £2 million in 1988-89 for Food from Britain. The Minister of Agriculture is seeking further small increases.

Line to take

Have agreed to increases which I consider are inescapable. Consider that other increases in expenditure should be contained within baseline.

SECRET

D7

FORESTRY COMMISSION

	<u>£ million</u>		
	1986-87	1987-88	1988-89
Baseline	53	54	56
Department's position	+2.3	+2.2	+1.3
Treasury position	0	0	0

Main outstanding issues

The Forestry Commission is seeking increases to provide for a larger new planting programme, increased forest maintenance, work on conservation and additional forest recreation facilities. Treasury consider that this expenditure should be contained within the baseline.

Line to take

Consider that it would be possible to reduce provision below the baseline, eg by increasing timber sales.

SECRET

DEPARTMENT OF TRADE AND INDUSTRY (Central Programmes)

		<u>£ million</u>		
		1986-87	1987-88	1988-89
(i)	Expenditure baseline	1,162	980	1,004
	Agreed settlement	-13	+12	-25

(ii) Running costs have been accepted on the basis of 4 per cent growth between 1985-86 and 1986-87, a reduction of 0.3 per cent in 1987-88, and growth of 3.9 per cent in 1988-89. If the 1987-88 total comes under pressure during the year, the Department will be allowed to transfer programme provision on to running cost items.

(iii) The general basis of the settlement is that the Department will slightly reduce its baseline after having made substantial additional bids which were only partly offset by reduced requirements. Apart from the irresistible bids (aircraft and aeroengine projects, shipbuilding and steel, Insolvency Service and EIEC), all the other bids will be dropped.

The settlement is only acceptable if the regional savings, which balance the books, are secured.

(iv) Line to take: the remaining task is to achieve the regional savings.

SECRET

09

ECGD

	<u>£ million</u>		
	1986-87	1987-88	1988-89
Expenditure baseline	78	-43	-44
Agreed position	+207	+219	+126

Basis of settlement

Bids for increased interest support and cost escalation have been reluctantly accepted as irresistible, though modest offsetting savings are to be sought through negotiating a reduction in banks' margins on new sterling lending and greater use of capital market funding. The mixed matching facility is to remain in return for ECGD foregoing its additional bid for the tender to contract facility and so retaining it on its trading account.

Running costs

ECGD's running costs (which are a charge to its trading account and not public expenditure) are forecast to rise by over 14 per cent in 1986-87 largely on account of costs related to the uprating and expansion of its computing capacity. The return should come in reduced manpower and running costs in later years. On this basis the 1986-87 figure has been agreed.

Line to take

No outstanding issues.

Complication

These figures do not include the net effect on ECGD of the soft loans package; see brief on ODA.

PES : Department of Energy

D10

	fm cash		
	1986-87	1987-88	1988-89
Baseline	294	293	300
<u>Agreed changes:</u>			
reduced requirement	-0.5	-0.5	-
AEA review consequentials	26.5	29.0	30.3
<u>Departmental position</u>			
coal firing scheme	0	+8	+9
<u>Treasury position</u>			
coal firing scheme	0	0	-7
fast reactor)	-25	-50	-50
fallback)	- 5	-10	-10
<u>Running costs</u>			
Agreed reduction of 8 staff by 1989.			
Resultant path:	+ 4%	+ 3%	+ 2.3%

Agreed changes

AEA review consequentials still under discussion with DEn. Actual requirement may turn out slightly lower than shown. Though PES planning total rises, interest payments by AEA to NLF when AEA becomes a trading fund (in 1986) means PSBR savings overall.

Outstanding issues

Coal firing scheme: paper by Mr Walker bids for extension to end June 1987.

Treasury case for immediate ending because need to stimulate coal demand weak given low coal stocks; scheme doubtfully efficient at delivery genuinely additional consumption.

Fast reactor: despite personal doubts, Mr Walker reluctant to attack £100m a year spending, allegedly because of international collaboration. Treasury case for halving spend (protecting Dounreay) given imprecise international commitments and ACARD criticism that fast reactor expensive insurance. Fallback would just trim.

Line to take

Coal firing scheme: defer for discussion with NCB IFR and corporate plan. Hope for early end to unnecessary and unconvincing scheme.

Fast reactor: room for debate about scale of substantial expenditure required by European agreement. Merits of research poor - payback, if any, very long term. Should cut research to Dounreay and no more, adjusting participation in European programme accordingly.

DEPARTMENT OF EMPLOYMENT PES 1985

OUTCOME

	86-87	87-88	88-89
Baseline	3704	3901	3999
Outcome agreed 26/9/85	-74	-207	-125
New baseline	3630	3694	3874

RUNNING COSTS

Agreement between CST and Lord Young didn't include specific running cost figure. DE will offer their proposal soon. Meanwhile we've agreed with DE a ceiling for running costs for 1986-87 which represents an increase over 85-86 of 7.4%, or fractionally under 4% excluding the 1985 Budget volume changes and extra fraud staff. Implied pay settlement factor: 5%.

OUTSTANDING ISSUES

E(A) meet 3 October to discuss DE's paper recommending abolition of rebates to employers from redundancy fund. Separate briefing provided. Major part of DE savings. PES outcome will need to be reviewed if E(A) do not agree redundancy savings. Lord Young will have to find alternative savings if savings fall through later. No commitment to reduction in NICs in 1986-87.

Expansion of Enterprise Allowance Scheme to be provided for within agreed totals.

LINE TO TAKE

Satisfactory deal. Grateful to Lord Young for making it possible to settle with £400m reductions in total over 3 years. Abolition of redundancy rebates a valuable part of set of positive policies for new jobs and new businesses. Outcome provides room for significant increase in fraud staff and in Enterprise Allowance Scheme.

TRANSPORT - DEPARTMENTAL PROGRAMME

D12

(i)				
Baseline	1995	1995	2045	
Agreed change	+25	+34	+53	

A settlement has been reached subject to the Secretary of State coming back with a proposal to shift one or two million between 1986-87 and 1987-88.

(ii) Running Costs

Running costs have been agreed:-

	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>	<u>1988-89</u>
baseline fm	267	275	280	287
bid fm		13	17	15
baseline plus bid fm		288	297	302
year on year percentage increase		7.9	3.1	1.7

Overspending of about £2 million is expected for 1985-86. So agreed provision for 1986-87 is about 7 per cent increase. Fee earning staff, mainly driving examiners, have been increased with a consequential 13 per cent increase in gross running costs. 1 per cent of the 5.5 per cent increase in gross running costs for non fee earning staff will be funded by savings on programmes.

(iii) Basis of Settlement

Apart from running costs, the settlement includes:-

national roads and local capital	71	88	113
----------------------------------	----	----	-----

in recognition of the need to improve the road network. This addition is offset by savings of:-

income from fees	-9	-12	-11
savings on programmes	-10	-19	-24
EFL treatment for la transport companies	-40	-40	-40

The majority of the savings on programmes were secured against a sympathetic hearing to any claim on the Reserve for Ports, arising from policies agreed in E(A). Agreement on the programme as a whole is conditional on securing colleagues' agreement to the legislation needed to introduce EFL treatment for local authority transport companies.

(iv) Line to take

Important to agree LA legislation in order to validate the bilateral settlement.

DEPARTMENT OF THE ENVIRONMENT - HOUSING

Figures

	1986-87	1987-88	1988-89
Baseline	2424	2526	2589
Department's position	+ 744	+1028	+ 957
Treasury position (*)	- 225	- 470	- 475
(*) increases in housing benefit expenditure borne on social security programme	+ 35	+ 50	+ 65

Running Costs

Running costs are part of the DOE - Other programme.

Outstanding issues

The Secretary of State seeks a substantial increase in provision for renovation of the local authority housing stock and some increase for provision of additional rented accommodation through the Housing Corporation. The Chief Secretary seeks a reduction mainly in provision for additional public sector rented accommodation but also for home improvement grants and subsidies. Officials are still considering the implications of various rent increase options (which affect subsidies) and the Secretary of State has offered a limited reduction in provision for home improvement grants (£30 million in 1987-88).

Resolution also depends on agreement on translation of provision into capital allocations.

Line to Take

1. Housing must make a contribution to the overall Survey strategy.
2. The extent of the need for additional expenditure on local authority renovation is questionable and must be met by cutting back on lower priority items - principally expanding the public sector rented stock.

PROPERTY SERVICES AGENCY

		<u>£ million</u>		
		1986-87	1987-88	1988-89
(i)	Expenditure baseline	-120.3	-128.2	-131.4
	Agreed settlement	+7.2	0	0

(ii) Running costs

To be agreed at official level in the light of the outcome on the Department's bids.

(iii) Basis of settlement

The Chief Secretary has offered a total of £8.0 million. This includes £0.8 million for Parliamentary security works. The addition to the PSA's own programme is therefore £7.2 million.

(iv) Line to take

Agreement allows some increase for maintenance and International Conference Centre in 1986-87. No question of ICC being a continuing cash drain for later years.

SECRET

DIS

DEPARTMENT OF THE ENVIRONMENT - OTHERFigures

	<u>£ million</u>		
	1986-87	1987-88	1988-89
Baseline	848	860	882
Department's position:			
(i) formal position as in Cabinet paper	+135	+130	+128
(ii) latest negotiating position	+90	+100	+120
Treasury position	-65	-50	-50

Running Costs

Agreed at official level, except bid for 8 additional revenue-gathering staff at Tower of London which remains to be resolved at official level.

Outstanding Issues

Mr Baker has proposed increases over baseline other than in Local Environmental Services (LES) of £20 million in 1986-87 and provision "held in real terms" for later years. On LES he is seeking capital allocations in 1986-87 of £320 million in 1986-87, which implies an increase in provision of about £70 million. Pending resolution of LES issue, no agreement reached on proposal by officials of -10, 0, 0 for DOE Other excluding LES.

Line to Take

Mr Baker must surrender additional LES bid. Local authorities have been overspending in past years. Provisions can't be fudged by spuriously derived allocations. Otherwise Treasury must press full options for reductions.

SECRET

D16

HOME OFFICE£ million

	1986-87	1987-88	1988-89
Baseline	1061	1104	1131
Department's position	+86	+77	+94
Treasury position	+8	-2	-7

Running costs

- HO position implies increases over previous year's baseline of			
	8.7%	4.0%	4.5%
- Still in dispute is:			
	17.1	29.2	31.4
- to offset the pay squeeze, and			
	11.0	11.0	11.0
- for realism, taken by HO as 5%.			

HO now wish to regard pay realism as a further additional bid, and it is treated as such in the table above.

Issues outstanding

Further reductions provisionally offered at and since the second bilateral were insufficient to secure a deal and so were withdrawn.

At issue are:-

- bids for pay squeeze and pay realism (above).			
- bid for prison building programme and the option for a rephasing of the programme while alternative sentencing policies are reviewed	+35.6	+36.1	+64.6
	-10.1	-25.9	-15.8
- bid for fire service capital in excess of allocation			
	+15	+15	+15
- need for contribution to costs of 24 hour Duty Solicitor Scheme			

Line to take

1. Surge in prison population makes it impossible to end overcrowding by end of decade.
2. Poor project control already leads to big changes in prison building schedule.
3. So need serious internal review now of sentencing policy and alternative sentences; with re-phasing of prisons programme to deliver some savings now on account.
4. Running costs increase too high, although acknowledge high running costs content of prisons programmes.
5. Pay increases absorbed in baseline this year should now be reinstated as extra bids next year.
6. HO have made no PES contribution to costs of their 24 hour Duty Solicitor Scheme, which is carried on LCD programme.

SECRETLORD CHANCELLOR'S DEPARTMENT

			<u>£ million</u>
	1986-87	1987-88	1988-89
Baseline	574	610	625
Assumed response:	+21	+39	+72
LCD Ministerial letter awaited			
Treasury position	+19	+37	+70

Running Costs

Original LCD proposal: £196.0m (+9.4%) in 1986-87. LCD now prepared to accept £189.5m (+5.9%) but with serious reservations about the factors assumed for the following 2 years. Given the higher than average proportion of PRS, the need to staff additional Crown courts and the effect of the TSRB settlement on judicial officers, this can be regarded as a satisfactory outcome from a Treasury point of view.

Issues outstanding

Any settlement must be subject to agreement by the Lord Chancellor that there should be a quick review by the Efficiency Unit of the operation and administration of the legal aid scheme. Provided he does so, the Department's position could be accepted. But it will be necessary to insist that LCD keep Treasury in touch with their thinking on how the cuts are to be achieved, since not all of the savings offered are clearly identified.

Line to take

Agreement is conditional upon an urgent review of the operation of the legal aid scheme, and of the value for money obtained from the payments made.

DEPARTMENT OF EDUCATION AND SCIENCE

	1986-87	1987-88	1988-89	£m
Expenditure baseline	3418	3505	3593	
DES position	+168.0	+182.2	+197.5	
Treasury position	- 0.5	-10.5	- 36.0	

Running costs

Letter awaited from Secretary of State on manpower and running costs; may seek small increase in running costs targets discussed by officials.

Main outstanding issues

- On universities Sir K Joseph is considering how best to put to colleagues joint proposals for savings on student awards but is otherwise standing firm on his bids.
- He is prepared to reduce the expenditure of one of the Research Councils (ESRC) by £1 million; but this is in the context of a substantial science budget bid (£85 million over the three years).
- He wants £46 million a year for local authority capital to permit allocations at 1985-86 levels plus £25 million to allow faster removal of surplus school places. On voluntary schools repairs DES have agreed to offsetting savings of £2 million in 1986-87 but stand by the remainder of their bid.

Line to takeUniversities

Agreement to bids would slacken drive for efficiency in universities. Also a mistake to add to university expenditure when demographic factors indicate a reduction in the medium term.

Science

Science budget has grown 6 per cent in real terms since 1981-82. Considerable scope for research councils to look harder at priorities and at value for money.

Local authority capital

Need to take steps to curb present overspending. That is what Treasury proposals on handling this expenditure would do. Not convinced that present levels of spending are essential to progress with surplus school place removal or necessary school building.

SECRET

D19

OFFICE OF ARTS AND LIBRARIES

	1986-87	1987-88	1988-89	£m
Expenditure baseline	332	342	351	
OAL's position	+15	+22.5	+27	
Treasury position	-1.1	+5.4	+9.9	
<u>Running costs</u>				
Revised OAL proposal <u>agreed</u>	1.200	1.242	1.279	
	-4.2%	+3.5%	+3.0%	

Main outstanding issues

OAL maintain their full £15 million pa bid for the Arts Council, part of which relates to replacing GLC/MCC funding after abolition. They have reduced their inflation adjustment and museums and galleries bids.

Line to take

Have already offered £5.8 million pa for the Arts Council in recognition of post-abolition problems, on top of £34 million extra central funding agreed last year. Wrong to provide centrally for purely local activities. Other bids should be covered by efficiency savings.

1985 PES: HEALTH

1. The latest position is:

	£ million		
	1986-87	1987-88	1988-89
Baseline	14945	15622	16012
DHSS bids (revised)	409	484	870
Treasury position	0	0	0

2. The main issues are:

i. HCHS Current (DHSS bids £m 238/295/493). Mr Fowler is prepared to set cost improvement programme ("efficiency savings") target at 1.7/2/2 per cent cumulative. You are seeking his agreement to 2½/3/3½ per cent (with a fallback of 2/2½/3); and diversion of proceeds of cost improvement programmes to meet essential requirements only and not to finance optional service improvements;

ii. HCHS Capital (DHSS bids £m 54/56/60). You wish Mr Fowler to absorb these on account of likely prospects for receipts from sale of surplus residential accommodation and land;

iii. FPS Contractors (DHSS bids £m 98/111/280). You are looking for policy changes to produce offsetting savings which Mr Fowler is not prepared to offer.

In addition, there are small disagreed bids for centrally financed services and FPS administration (DHSS bids £m 19/22/37).

3. Your line to take should be:

i. DHSS bids of 409/484/870 very large given general public expenditure position. Despite Mr Fowler's political difficulties, he must find a way of reducing them to affordable levels;

ii. Main problem with HCHS current is level of efficiency savings. Cumulative savings of 1.7/2/2 per cent too small: Griffiths general manager revolution, moves to clinical budgeting, appointment of NHS procurement director must be expected to yield more - otherwise we should ask serious questions. My suggestion of 2½/3/3½ per cent is below the sort of savings private industry is having to make. NHS managers must learn that growth in future will come only from improved efficiency, not from extra Government money.

iii. On HCHS capital, reasonable prospects of income from sales of surplus land and residential accommodation. Given this and difficult overall situation, Mr Fowler must be asked to drop his bids altogether;

iv. FPS Contractors is difficult to cut given its demand-determined nature. We have in previous Surveys squeezed a lot out through higher charges, lower drug company profits and the selected list. I accept that new charges eg for sight tests would be difficult politically. But amounts spent go on rising: difficult choices must still be made. In particular, I think we must make further savings through increases in existing charges and from the drug companies to offset at least part of the extra bids.

SOCIAL SECURITY (all figures £m)

(i) <u>Table</u>	1986-87	1987-88	1988-89
baseline (incl pay and administration, excl l.a. current)	41547	43553	44642
department's position (Mr Fowler's letter of 24 September)	+ 1203	+ 1579	+ 1771
Treasury position	+ 935	+ 744	+ 642

(ii) running costs

(a) Treasury has accepted bids as follows:

57.0	75.5	85.6
------	------	------

These leave totals within the guideline "GDP deflator - 1/2%". Agreement without prejudice to savings expected in 1988-89 once Review measures in place.

(b) DHSS expected to come forward with substantial further bids (which will be difficult to resist) as a temporary addition to meet staff costs of implementing reviews.

(iii) main outstanding issues

Mr Fowler wrongly scoring savings from changed uprating timing; from certain 1984 PESC measures (already in baseline) and 1984 PESC "excess savings" in 1986-87 towards his Review target savings. Net cost of Family Credit scheme has also risen and needs to be offset.

Further running costs bids needed as soon as possible.

(iv) Line to take

- Essential to make more inroads into massive demand - determined bids.
- First step is to get Review savings up to previously agreed levels.
- Then must bite bullet on option savings eg. deferment of abolition of pensioner's earnings rule.
- And must get manpower and running costs bids sorted out quickly.

SECRETSCOTLAND

		<u>£ million</u>			
		1986-87	1987-88	1988-89	
(i)	Baseline:	4,300	4,373	4,482	
	Department's position:	+10	+18	+12)	plus formula
)	consequential
	Treasury position:	-93	-130	-188)	in all years*

* On basis of other departments' bids these would be: +170 +230 +300

(ii) State of play on **running costs**:

Wider policy on pay assumption has been questioned by Secretary of State. Until that is resolved, running cost targets cannot be set; but on a 5% pay assumption the implied first year increase would be about 6%.

(iii) Options for reductions agreed for **development agencies** -7,-17,-15.5. But more than offset by effect of **higher interest rate assumptions** on housing revenue account.

(iv) **Main outstanding issue**: your proposed cuts on the block of -100,-150,-200.

(v) **Line to take**: still discussing size of budget with Secretary of State.

SECRETWALES£ million

	1986-87	1987-88	1988-89	
(i) Baseline:	1,708	1,735	1,779	
Department's position:	-1	-1	-4)	plus formula
)	consequential
Treasury position:	-1	-1	-4)	in all years*

* On basis of other departments'

bids these would be: +75 +100 +125

(ii) State of play on **running costs**:

Settled on basis of annual increases of 5%, 3%, 2.5%.

(iii) Options for reductions for **development agencies** -3.8, -4.5, -5.0 agreed between officials. Partly offset by effect of **higher interest rate assumptions** on housing revenue account.

(iv) **Basis of settlement**: normal formula consequential arrangements will apply for block budget.

SECRET

D24

NORTHERN IRELAND

		<u>£ million</u>			
		1986-87	1987-88	1988-89	
(i)	Baseline	4,464	4,603	4,717	
	Department's position	+53	+76	+105)	plus formula
)	consequential
	Treasury position:	+53	+76	+105)	in all years*

* On the basis of other Departments'

bids these would be: +55 +70 +95

(ii) State of play on **running costs:**

These are not formally your concern, but that of the Northern Ireland Secretary who is responsible for the NI Civil Service. His running cost targets are still under negotiation.

(iii) Agreed increases reflect higher social security costs and effect of higher interest rate assumptions on housing revenue account.

(iv) **Basis of settlement:** normal formula consequential arrangements will apply for block budget.

CHANCELLOR'S DEPARTMENTS AND OTHER DEPARTMENTS

Only the most important bids are shown for each of these Departments, although total bids for each group of departments are also shown.

CHANCELLOR'S DEPARTMENTS	27	28	30
(excluding Customs & Excise and Inland Revenue)			
Rating of Government Property			
Department	28	31	33
of which (Reassessment of PRS occupation			
receipts	21	22	23
Rates increase	6	9	10

The bid for reassessment of PRS occupation receipts arises from an overestimate in the 1984 Survey of receipts from PRS departments which partly offset the rates paid by RGPD on premises occupied by foreign governments for diplomatic purposes, and by most Government Departments. The mistake, discovered at the time of the 1985-86 Estimates, necessitated a claim on the Reserve of £21.1m this year, and has led to the above bid to correct the position for future Survey years.

The bid for increases in rates arises because rates are forecast to rise by more than the PES uplift factor which affects RGPD's baseline. The bid is equivalent to the differences between the expected increase in rates and the rise in the baseline.

OTHER DEPARTMENTS	56	46	51
House of Commons	6	6	7

The main bids are made for MPs pay and allowances, and for ERNIC-related increases to the cost of staff in the House of Commons Commission. The House of Commons Estimate is presented to Parliament by the Speaker, and is thus beyond Treasury control.

Crown Prosecution Service	29	16	16
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The bid is for the net cost of transferring to the Crown Prosecution Service the conduct of criminal proceedings initiated by police in England and Wales. This is net of transfers from relevant Departments and expected transfers from relevant local authorities.

Palace of Westminster	1	1	1
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The bid arises from additional security work undertaken by PSA. This bid was discussed at the PSA bilateral, and accounted for in the arithmetic for that bilateral, but is technically a small Departments bid.

NATIONALISED INDUSTRIES

E(A)(85)14 meeting agreed targets for all industries except NCB (discussions should take place with view to minimising large additional bid) and those industries which may be privatised during 1986-87 - British Gas, National Bus Company and British Airports Authority (to be considered separately). Provisional settlements have now been reached for all the industries covered by formal E(A) target except Electricity (England and Wales) and Water.

	£million		
<u>E(A) target industries</u>	1986-87	1987-88	1988-89
baseline	171	-207	-210
E(A) target (compared to baseline)	0	-250	-150
*Settlements (compared to baseline)	-9	-82	-464
*Possible outcome against baseline if Treasury fallback achieved for water and electricity	-94	-362	-274
Water and electricity revised bids (compared to baseline)	+322	+152	+822
*Treasury FALLBACK for water and electricity (compared to baseline)	-85	-280	+190

*Not for disclosure to Mr Baker or Mr Walker

Mr Walker's offer on electricity falls well short of the Treasury fallback position (by £260 million; £204 million, and £129 million in each of the years).

On water Mr Baker is continuing to hold out for significantly increased provision.

SECRET

Coal

	1986-87	1987-88	1988-89
baseline	382	392	402
NCB bid (compared to baseline)	+508	+333	+198
Treasury TARGET (compared to baseline)	+408	+233	+97
RMPS* bid (compared to baseline)	+183	-44	-50

* Redundant Mineworkers Payments Scheme, not included in main NCB bid and unlikely to offer scope for savings.

Department of Energy have not taken position on bid and are awaiting further detailed information from NCB. Possible this may be accompanied by revised bid. Intention to discuss with PM rather than in Star Chamber.

Industries to be Privatised

BAA and NBC provisionally settled at combined £2 million above baseline for 1986-87. Figures for BGC still awaited. Department have so far suggested work on planning assumption of £270 million above 1986-87 baseline of -£470 million. This assumes sale in autumn 1986 and because of cash flow pattern in the year largely explains the additional bid. Extent to which savings possible eg through January 1986 price increase, unclear until have more detailed information. Closely involved with privatisation decision. Need decision in October but does not have to go to Star Chamber.

LINE TO TAKE

On E(A) target industries need major savings on water and electricity bids if targets to be achieved in any year. Have more or less reached satisfactory position on other industries: now up to electricity and water to deliver.

NB: Mr Baker and Mr Walker should not be told how we stand against EA target for other industries.

On coal, essential detailed information is made quickly available so negotiation can begin. Want to avoid situation of having "unreal" EFL which has subsequently to be increased with consequent claims on reserve.

On gas, again essential that have detailed information promised in bilateral as soon as possible.

SECRET

DISPOSAL OF SURPLUS LAND AND EMPTY HOUSING

The latest figures show that receipts from the disposal of surplus land and empty housing are likely to amount to around £134.0m in 1986-87, £122.0m in 1987-88 and £100.0m in 1988-89. The estimates are in some instances very approximate, for example much of the MOD's housing surplus to be disposed of has not been valued and a rule of thumb figure of £20,000 a house has been used.

2. The figures are dominated by MOD, PSA and Home Office, who are expected to account for about 90% of the receipts. The MOD's share *of* the total is expected to be rather more than half in 1986-87, 1988-89 and about half in 1987-88.

3. In some cases, for instance PSA, officials will continue to press for improved figures as future surpluses are identified.

DISPOSAL OF SURPLUS LAND AND EMPTY HOUSING

	<u>1986-87</u>	<u>1987-88</u>	<u>1988-89</u>	<u>Comments</u>
Northern Ireland Office	6.074	6.241	3.165	To be agreed officially
D.En	0.100	0.200	0.300	Endorsed by CST during bilateral
MAFF	-	-	-	position still being reviewed, minimal receipts expected
MSC	0.040	0.250	0.300	To be agreed officially. But IAE propose to pursue after Survey
Welsh Office	1.000	0.500	0.500	To be agreed officially
Scottish Office	0.200	0.300	0.200	Targets accepted by Chief Secretary
Home Office	25.300	25.100	20.100	CST recommended to endorse line agreed by officials
DTP	8.000	6.500	6.000	Accepted.
PSA	18.500	22.000	16.000	Accepted. But PSA pressed to do better.
MOD	{54.449} {20.000}	{40.970} {20.000}	{34.026} {20.000}	Targets agreed at official level The first line represents receipts for properties valued. The second is a guesstimate of receipts from housing yet to be valued.
	<u>133.663</u>	<u>122.061</u>	<u>100.591</u>	

K

PRIME MINISTER

2 October 1985

PUBLIC EXPENDITURE CABINET

You might find it useful to have some figures on public expenditure for Cabinet tomorrow.

Public Expenditure Growth

In cash terms, spending has more than doubled from £65.8 billion in 1978-79 to £134.2 billion this year. Measured in constant prices, public spending has also increased every year.

	<u>£bn (Cost Terms, 1984-85 Prices)</u>		
1978-79	117.1
1979-80	117.3
1980-81	119.1
1981-82	122.2
1982-83	123.9
1983-84	125.5
1984-85	129.4
1985-86	127.8 (assuming no overshoot)
1986-87	126.8 (the current baseline)

By comparison, in 1976 the Labour Government achieved real cuts in public expenditure of 6%.

Public Expenditure as a Percentage of GDP

Between 1979 and 1981, public expenditure as a percentage of GDP rose rapidly because of the recession. But despite the economic recovery, we haven't fully reversed the increase. Even if we stick to the Survey baseline for next year, public expenditure will be around 42% of GDP, compared with 39% in 1978-79. Is this rolling back the frontiers of the state?

The Burden of Taxation

Meanwhile, the tax burden rises. Excluding North Sea revenues, tax has risen as a percentage of non-oil GDP from 34% in 1978-79 to 38% in 1984-85. That's a £15 billion increase, with a further £12 billion of increased North Sea oil revenues.

David Willetts

DAVID WILLETTS

PRIME MINISTER

PUBLIC EXPENDITURE

Andrew Turnbull, Treasury, has discussed the line to take after Cabinet tomorrow and you in turn have considered this with the Chancellor.

I would merely make the point that we need to get over that:

- i. the objective of the exercise is to contain public expenditure within the planned and published path;
- ii. it follows from this that the objective is NOT to cut expenditure;
- iii. instead, the exercise is concerned with dealing with bids by Departments to spend more and how they can be reconciled with the overall objective of containing public expenditure within planned totals.

The Lord President, Chancellor of the Duchy and the Chief Whip and I have discussed the problem of presentation and we are anxious to deal with the "cuts" point, in the manner set out above.

But it would be helpful if tomorrow you also reminded Ministers that the Government has consistently shot itself in the foot by playing out the public expenditure exercise in the press. This is very damaging and a self-denying ordinance would not come amiss.

Ind

BERNARD INGHAM
2 October 1985

*Prime Minister
Also worth making
the point - Unless we
contain public expenditure,
we will not be able
to reduce tax (so much).
N.L.W. 2-10*

LIST OF PAPERS

- A Cabinet Office brief
- B Minutes of July Cabinet
- C Chief Secretary's paper
- D Speaking note to open the discussion
- E Speaking note to close the discussion
- F Brief on running costs control (positive and defensive points)
- G Chief Secretary's minute on running costs
- H Mr. Younger's minute on running costs
- I Press handling
- J Composition of the Star Chamber
- K Public expenditure and tax in the UK
- L Other countries' policies

SECRET

CC BVP.
5

Treasury Chambers, Parliament Street, SW1P 3AG

David Norgrove Esq
Private Secretary
10 Downing Street
London
SW1

Dear David

2 October 1985

3 OCTOBER CABINET

... I enclose, as discussed at various points earlier today, an opening speaking note for the Prime Minister's use tomorrow; a note on press handling arrangements; and a summary brief on running costs. The Chief Secretary has seen and is content with all this material.

Lawrence
Richard

R J BROADBENT
Private Secretary

SECRET

To open the discussion

SPEAKING NOTE FOR THE PRIME MINISTER

Restraint of public expenditure is an essential part of our strategy for a more enterprising society and a more productive economy. By holding back expenditure in a growing economy we will be able to reduce the burden of taxation. By lowering taxes we can stimulate initiative, ease the poverty and unemployment traps, reduce the cost of employing labour and moderate pay demands. In short, a low tax economy will work better and generate more jobs.

2. Frankly our record in restraining public expenditure is unsatisfactory. It has increased steadily in real terms and this year will be about 9% higher than when we took office. It will be about 3% higher as a proportion of GDP. Given that in our first Parliament we had to give priority to bringing public borrowing under control the result has been that taxes as a proportion of GDP have risen since we took office (from 33.9% to 39.1% in 1984-85).

3. Last July we set ourselves planning totals which would hold public expenditure broadly constant in real terms. We must stick to that objective if we are to deliver lower taxes. We must also demonstrate that this Government is capable of setting itself a budget and taking the decisions necessary to live within it.

014/112

I must remind you that the planning totals were raised by £2 billion in the last Budget. We cannot allow that to happen again.

4 Although the Chief Secretary has scrutinised all departmental programmes with great care, it is extremely disappointing that there are additional bids still outstanding of £3 billion in 1986-87, rising to over £5 billion in 1988-89. We must be prepared to exercise priorities. I hope, therefore, that any Ministers who have not yet reached agreement will look again at their programmes to see whether their bids can be dropped or scaled down, and to identify what offsetting savings can be found. Investigations into Defence Procurement and the health service and the findings of the Audit Commission and the Efficiency Unit have all shown that the scope for greater efficiency savings is enormous.

I

PRESS HANDLING AFTER PUBLIC EXPENDITURE CABINET

Objectives

- (i) To reaffirm the Government's determination to stick to its objectives on public expenditure.
- (ii) To counter the view that the state of the Survey is worse than previously experience at this stage.
- (iii) To discourage the speculation that the gaps are huge and unbridgeable, or that massive cuts in programmes are in prospect.
- (iv) To set out the procedure for the next stage of the Survey.

Normally after the Public Expenditure Cabinet, Bernard Ingham has released a statement to the press. There are no Lobby meetings (they are in Bournemouth) but he is likely to be questioned at subsequent Lobby meetings and it is important that he should not be drawn into discussion of the outstanding issues. A possible form of words is set out below together with responses to likely questions.

Press Statement

"The Cabinet discussed the Chief Secretary's report on the Public Expenditure Survey. The importance of holding to the Government's objectives for public expenditure and taxation was reaffirmed and it was agreed that programmes should be settled at levels which were consistent with those objectives. As in previous years, a smaller group of Ministers under the chairmanship of the Lord President is being established to examine outstanding differences on programmes and to make recommendations on how they should be resolved."

Q and A Briefing

(i) Is there still a gap of several £ billion?

Not going to be drawn into detailed discussion on Survey. There will always be reports of a large gap at this stage. These simply represent the additional bids departments are making rather than a realistic projection of the level at which they expect their programmes to be settled.

(ii) Can the planning totals still be achieved?

The Government remains determined not only to set the public expenditure totals at levels which can be afforded, as it did last July, but to take the decisions necessary to achieve those objectives.

(iii) Will the Treasury increase asset sales or reduce the Reserve to bridge the gap?

Cannot provide details on the arithmetic of the Public Expenditure Survey. Wait for the Autumn Statement.

(iv) Which programmes will go to the Star Chamber?

This is not finally settled. On a number of programmes discussions are continuing and agreement may be reached before the Star Chamber starts work after the Party Conference.

(v) Massive cuts in prospect?

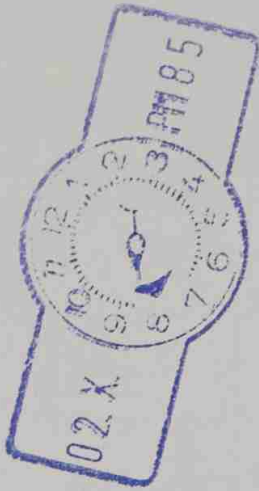
No. The Government has set out a path for public expenditure broadly constant in real terms. The purpose of the Survey is not to cut expenditure in aggregate but to decide the allocation of resources between programmes. For the most part so-called cuts represent no more than the rejection of departments' additional bids.

(vi) Who is on Star Chamber?

Not yet settled.

(vii) When will the Autumn Statement be published?

Probably around the middle of November.



Ref. A085/2516

PRIME MINISTER

Public Expenditure Survey 1985

(C(85) 23)

BACKGROUND

This year's White Paper on the Government's Expenditure Plans (Cmnd 9428) gave planning totals of £136.7 billion for 1986-87 and £141.5 billion for 1987-88; after the increases announced in the 1985 Budget in provision for employment and training schemes, and taking into account the £2 billion additions to the Reserve for these years announced at the same time, the baseline figures for the 1985 Public Expenditure Survey were £139 billion and £143.9 billion respectively. The baseline figure for 1988-89 was £147.1 billion; this was derived from the 1987-88 baseline by uplifting all programmes, with the exception of expenditure on the Falkland Islands, by 2½ per cent.

2. At the beginning of July the Chief Secretary, Treasury reported to the Cabinet, in his memorandum C(85) 18, that bids from Departments, net of reduced requirements, exceeded the baseline figures by £4.4 billion in 1986-87, £5.4 billion in 1987-88, and £6.6 billion in 1988-89. He proposed that the baseline figures for 1986-87 and 1987-88 should be maintained; and that the baseline for 1988-89 should be increased to £148.2 billion. This figure resulted from using an uplift factor of 3 per cent rather than 2½ per cent. The Chief Secretary also proposed that the Reserve should be £5 billion in 1986-87, £6 billion in 1987-88 and £7 billion in 1988-89.

3. The Cabinet approved these proposals; invited the Chief Secretary to pursue bilateral discussions of expenditure programmes with the Ministers responsible; and invited him to report again when he had completed those discussions (CC(85) 24th *Flag A* - Conclusions, Minute 4).

Flag B - 4. In his memorandum C(85) 23 the Chief Secretary reports on the current position. Although the detailed figures have not yet settled down, the general picture is clear enough. Even on the assumption that the objective agreed by E(A) on 17 July (E(A)(85) 14th Meeting) of keeping nationalised industry External Financing Limits at baseline for 1986-87, and reducing them below baseline by £250 million and £150 million in the two following years, is achieved - and the Chief Secretary says that he is still some way from this - agreed changes and outstanding bids from Departments amount to about £3 billion in 1986-87, £4.9 billion in 1987-88, and £5.3 billion in 1988-89. Although a number of substantial programmes have been agreed, there remain outstanding particularly large additional bids for defence, housing, health, and social security. In addition to these programmes where major policy issues are at stake, substantial increased bids have had to be accepted on a number of programmes where spending is determined by the prospect for inflation, interest rates and agricultural prices - the principal such programmes are social security, export credits and agricultural support.

5. The Chief Secretary proposes that a small Ministerial Group, on the lines of the Ministerial Group on Public Expenditure (MISC 106) last year, should be established with a remit to eliminate as much as possible of the excesses.

6. A particular question which arises on this year's Survey concerns the control of "running costs". Expenditure on the Civil Service has hitherto been controlled by means of manpower ceilings, and the provision in annual Estimates has been set by the application of a "pay factor" applied to agreed manpower

numbers. The resulting figures have not, however, constituted firm cash limits. Departments have been able in effect to transfer money from programme expenditure to meet the additional costs resulting from the fact that annual pay settlements have generally exceeded the pay factor by 1-2 per cent. It is now intended that in future - in accordance with the spirit of the FMI - Civil Service running costs should be controlled by means of overall cash limits, with Departments no longer held to specific manpower targets (although the existing targets up to 1988 would remain in force). There would no longer be any generally prescribed pay factor, and each Department's running costs total would operate as a separate limit. Departments would not normally be permitted to transfer money from their programmes to meet excess running costs.

7. Although this form of running costs control was generally agreed by Cabinet in July, some Ministers have subsequently expressed doubts about its operation (see for example the minute to you of 16 September from the Secretary of State for Scotland). Concern has been expressed that different Departments might make different assumptions about future pay increases for the Civil Service, which could prove embarrassing given the fact that pay is centrally negotiated by the Treasury. Treasury Ministers' line is that it is better to avoid specifying a single pay factor; sticking to last year's 3 per cent would hardly be consistent with a world in which the Government were seen to be promising the Civil Service a pay settlement not lower than the lower quartile of private sector settlements (as agreed by MISC 66 on 27 September) - but any higher figure would give quite the wrong signals about the Government's overall objectives for further reducing the rate of inflation, as well as serving as a target which union negotiators would seek to beat. The only alternative would be to go back to the present system, and reinstate both a low pay factor (ie 3 per cent) and rigid manpower controls; and spending Ministers would have at the same

Flag C

time to accept lower figures for running costs than they have agreed in their recent bilateral discussions with the Chief Secretary.

MAIN ISSUES

8. The issues requiring resolution at this stage are:

(i) the arrangements for securing decisions in this year's Public Expenditure Survey; and

(ii) the control of running costs.

Decisions on programmes

9. It will be at least as difficult as in previous years to secure decisions on the individual programmes consistent with the previously announced totals. The task of Lord Whitelaw's Group (which you discussed with him and Treasury Ministers on 30 September) will therefore once more be very difficult. But the excesses are comparable with those with which the Government has had to deal in previous years, and once the scope for reductions has been exhausted, there presumably remains the possibility of securing some additional receipts from the sale of public sector assets, as well as some scope for further allocation to programmes of funds from the Reserve. Treasury Ministers will not, however, wish to give any hint of such possibilities at this stage, especially since the figures for sales of assets are already at the top end of the range and the Reserve was increased by £2 billion in each year in the 1985 Budget.

10. On this occasion, therefore, any extended discussion of the totals or of the figures for the individual programmes would not be helpful. You have already agreed the establishment of Lord Whitelaw's Group (Mr Norgrove's minute of 1 October recording its

composition is attached for ease of reference), and those involved have already been approached informally. It would also be preferable (and consistent with past practice) to avoid telling the Cabinet who are to be the members, as this is your decision and not theirs.

Running costs

11. The background to the decision has been summarised above. The Chief Secretary will not seek any extended discussion of this subject, although he will be ready to respond if arguments are made in favour of a common pay factor, or for the maintenance of the current position. The Chief Secretary appears to have accepted that it will not be possible to avoid some overall increase in Civil Service running costs, as compared with the 1985-86 Estimates provision, of 6½-7 per cent. This seems a disappointingly high figure. But some ½ per cent is due to increases in staff numbers in areas where extra revenue secured or public expenditure saved can be expected to outweigh the costs of the additional staff employed (an example is firmer control of claims for unemployment benefit); and a further 1 per cent of the increase is accounted for by the fact that the 1985 pay settlement at 4.9 per cent could only be financed by the transfer of funds from programme expenditures. Thus the overall running costs increase allows on average for a pay settlement next year of the order of 4½-5 per cent, the minimum realistic allowance within a binding total for a pay settlement not below the lower quartile of private sector settlements. The new form of the controls will mean that somewhat less detail is given to Parliament in the Estimates, in that sub-heads confined to pay expenditures will no longer be given; Treasury Ministers are sounding out the Chairman of the Treasury Select Committee on these new arrangements. Despite the fears of the Secretary of State for Scotland, it should in practice be possible for spending Ministers to refuse to answer questions about pay assumptions, on the basis that there are a number of variables

also to be considered - including staff numbers, grading, and a whole range of other housekeeping expenditures, each of which could be varied to some degree even in the short run depending on the outcome of next year's pay negotiations.

HANDLING

12. You will wish to make clear at the start that this is not the occasion for any extended discussion of the overall public expenditure totals, or of the figures for individual programmes. You might then invite the Chief Secretary, Treasury briefly to report whether there are any last-minute developments since his memorandum, and its attached table, was prepared. He could at the same time refer briefly to the question of running costs, although without specifically inviting substantive discussion. Once the position on running costs has been clarified, you might announce your decision to set up a Ministerial Group under the chairmanship of the Lord President of the Council. You will wish to emphasise to your colleagues the importance of sticking to the public expenditure totals agreed in July, and of doing their utmost to assist the work of the Lord President's Group, which will necessarily take a very tough line on the unresolved issues referred to it. A speaking note on these lines is attached to this brief.

CONCLUSIONS

13. You will wish the Cabinet to record conclusions:

- (i) reaffirming their July decision to move to a system of running costs control of expenditure on the Civil Service, and

(ii) endorsing the establishment of Lord Whitelaw's Group to review outstanding differences between the Treasury and spending Departments and to make recommendations on how they should be resolved.

RA

ROBERT ARMSTRONG

2 October 1985

To close the
discussion

SECRET

SPEAKING NOTE ON SETTING UP THE "STAR CHAMBER"

In the light of the Chief Secretary's Report, and of our discussion, I have again decided to invite the Lord President to be the Chairman of a small Group of Ministers to consider and report to the Cabinet on the outstanding expenditure issues arising from the Survey.

2. This follows the practice of last year and previous years. But I am sure that colleagues will appreciate that, given the size of the outstanding problems, the Group will this year need to consider individual programmes with the utmost rigour and severity to ensure that they are brought into line with the overall expenditure totals which we have collectively agreed and to which we are publicly committed. It is vitally important to the Government to show that we are keeping public expenditure under firm control. So we must be prepared to take the decisions needed to stick to our cash plans.

3. I earnestly hope, therefore, that colleagues whose programmes have not yet been agreed will rigorously reappraise their bids so that they are settled in the Group in a manner consistent with the overall public expenditure decisions we have already taken.

4. There has, of course, already been extensive speculation in the press about the establishment of a "Star Chamber". I see no objection to confirming, in response to any enquiries, that, as in the course of previous public expenditure surveys, a small group of Ministers has been set up to consider and report to the Cabinet on issues arising from this year's Survey. But it is most important that no further information on our discussions to date, or on the subsequent discussions in the Ministerial Group, should be given to the media. Previous experience shows how damaging and divisive such leaks can be. It is also particularly important that no details should be disclosed at next week's Party Conference and no commitments entered into that would in any way prejudice our public expenditure discussions.

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10 DOWNING STREET

From the Private Secretary

SIR ROBERT ARMSTRONG

STAR CHAMBER

The Prime Minister has discussed with the Lord President, the Chancellor and the Chief Secretary the composition of the small group of Ministers which, as you know, is to be constituted after Cabinet on Thursday to discuss outstanding Survey issues. The proposed members are as follows:

- Lord President of the Council (Chairman)
- Secretary of State for Trade and Industry
- Lord Privy Seal
- Chancellor of the Duchy of Lancaster
- Secretary of State for Wales
- Chief Secretary

The Chief Whip should also be sent the papers and attend meetings as necessary.

The Prime Minister is content for you to approach members of the group informally before Thursday so that an early start can be made on timetabling their work.

DAVID NORGROVE

1 October 1985

CST

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L CC PC
NO ②
Prime Minister
Useful background
for Cabinet discussion

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

of public expenditure.

CDP 2/x 1

1 October 1985

① Charles Powell Esq
10 Downing Street
LONDON SW1

② O. Noyce

Sean Charles,

FISCAL POLICIES IN OTHER MAJOR COUNTRIES

The Prime Minister may be interested in a brief round up of the latest budget plans in the major industrialised countries whose governments are following policies of fiscal restraint. The last couple of months have seen some important policy statements from the US, Japan, Germany, France and the Netherlands.

A key feature is continuing expenditure restraint in an effort to curb budget deficits further and, particularly in Europe, to make room for tax cuts. The tight fiscal stance continues in Japan despite considerable pressure for some relaxation.

The budget resolution for 1986 agreed by the US Congress over the summer cuts planned expenditure by about \$55 billion to produce an estimated Federal deficit of \$178 billion in fiscal 1986 (4¾ per cent of GNP) compared to this year's deficit of \$211 billion (5½ per cent). There are no major tax increases. Congress is now considering the Appropriation Bills needed to implement the Resolution and it remains to be seen whether all the proposed cuts will be achieved. Jim Baker's best guess is that they will end up with \$40 - \$45 billion of genuine cuts, of which some \$30 billion will be in the defence budget.

The Administration's projections of a sharply declining Federal deficit in the next few years (2 per cent of GNP by 1988) depend on their optimistic assumptions of future output growth and on achieving further expenditure cuts. It is thus far from clear that the Federal deficit is yet firmly established on a downward path.



The 1986 German budget continues the government's commitment to budgetary consolidation by holding the cash increase in expenditure to 2½ per cent. Capital expenditure and subsidies to industry are to be cut. Public expenditure will fall slightly as a proportion of GNP. The budget deficit is to be held at last year's level of DM 25 billion. Past success in reducing the deficit is seen as allowing scope for some income tax cuts worth around ½ per cent of GNP next year.

Japan's draft fiscal 1986 budget continues the tight fiscal stance adopted in recent years. At this stage it seeks cash cuts of 10 per cent in most areas of expenditure except defence and overseas aid. These initial budget intentions are usually revised considerably but the scale of reduction can be taken as a broad indication of the government's determination to lower the budget deficit further as a percentage of GNP. There remains a risk that this determination may undo the other measures which they promised in the G5 communique.

The French draft central government budget for 1986 seeks to contain the increase in expenditure to under 4 per cent, compared with the government's highly optimistic inflation assumption of 3½ per cent for next year, in order to maintain the central government deficit at 3 per cent of GDP, while providing room for some FF 10 billion of tax cuts (just under £1 billion). Spending on defence, research and education is to increase slightly in real terms but this is offset by cuts in subsidies, particularly to nationalised firms and in the state's contribution to social security costs. The latter, however, reduces the deficit of the central government but not that of the government sector as a whole.

After a period of marked fiscal retrenchment the Dutch 1986 budget plans further but more moderate expenditure restraint. The freeze in money terms of social security benefits, family allowances and public service salaries is to continue. But employee and employer social security contributions are to be cut and corporate taxes reduced slightly. Forthcoming elections in May next year have led the government to pause in its efforts to reduce the budget deficit as a proportion of GNP though further restraint seems probable thereafter.

I am copying this to Len Appleyard (FCO).

*Yours ever
Rachel*

RACHEL LOMAX
Principal Private Secretary

10 DOWNING STREET

Prime Minister

The Chief Secretary will be coming with the Chancellor to talk about the approach to public expenditure at Cabinet on Thursday and to bring you up to date on particular issues.

Briefs will follow tomorrow night in the usual way.

JRS

1/10.

DN 010

SECRET

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pa

MR UNWIN

The Lord President has seen and approved the draft speaking note for the Prime Minister's use attached to your minute to me of today's date.

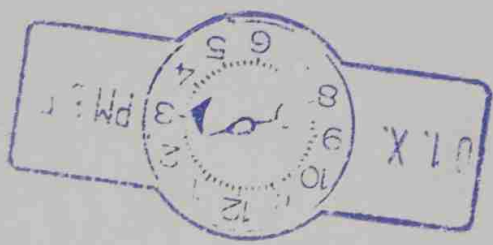
I am copying this note to David Norgrove and Richard Broadbent.

A handwritten signature in cursive script, appearing to read "Joan Macnaughton".

JOAN MACNAUGHTON
Private Secretary

1 October 1985.

SECRET





CABINET OFFICE

With the compliments of

J. B. UNWIN

70 Whitehall, London SW1A 2AS
Telephone 01 233



SECRET

cc. B. J. P.
1

pa

CONF FOR

P 01695

From: J B UNWIN
1 October 1985

cc Mr Norgrove - No 10
Mr Broadbent - Tsy

MISS MacNAUGHTON

I enclose, as discussed at the end of the Prime Minister's meeting yesterday, a short speaking note for the Prime Minister to use at Cabinet on Thursday on the setting up of the Star Chamber.

2. It would be most helpful to know, by this evening if possible, if the Lord President has any comments on it.

3. I am copying it to David Norgrove at No 10 and Richard Broadbent in the Chief Secretary's Office and should similarly be grateful to know by this evening whether they have any comments.

J B UNWIN



SECRET

DRAFT

SPEAKING NOTE FOR THE PRIME MINISTER

In the light of the Chief Secretary's Report, and of our discussion, I have decided to invite the Lord President, as last year, to be the Chairman of a small Group of Ministers to consider and report to the Cabinet on the outstanding expenditure issues arising from the Survey.

2. This follows the practice of last year and previous years. But I am sure that colleagues will appreciate that, given the size of the outstanding problems, the Group will need this year to consider individual programmes with the utmost rigour and severity to ensure that they are brought into line with the overall expenditure totals which we have collectively agreed and to which we are publicly committed. There is no sense or credit to the Government in setting totals which are not then achieved.

3. I earnestly hope, therefore, that colleagues with outstanding problems will rigorously reappraise them so that they are settled in the Group in a manner consistent with the overall public expenditure decisions we have already taken.

4. There has, of course, already been extensive speculation in the press about the establishment of a 'Star Chamber'. I see no objection to confirming, in response to any enquiries, that, as in the course of previous public expenditure surveys a small group of Ministers has been set up to consider and report to the Cabinet on issues arising from this year's Survey. But it is most important that no further information on our discussion to date, or on the subsequent discussions in the Ministerial Group, should be given to the press. Previous experience shows how damaging and divisive such leaks can be. It is also particularly important that no details should be disclosed at next week's Party Conference and no commitments entered into that would in any way

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prejudice our public expenditure discussions.

hll
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SM



10 DOWNING STREET

From the Private Secretary

1 October 1985

1985 SURVEY: DRAFT PAPER FOR CABINET

The Prime Minister has seen the draft paper for Cabinet attached to your letter to me of 30 September. She agrees that it may now be circulated.

DN

(David Norgrove)

Richard Broadbent, Esq.,
Chief Secretary's Office,
HM Treasury

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cc Mr Wicks
Chancellor of the Duchy
of Lancaster
Chief Whip
Mr Sherbourne

10 DOWNING STREET

From the Private Secretary

LORD PRESIDENT

PUBLIC EXPENDITURE

I promised an early note on the problem of presenting public expenditure.

As I said at the meeting, we have not succeeded in presenting the exercise positively in the previous six years for a variety of reasons:

- first, the entire public expenditure exercise presents only one (negative) half of the picture and is divorced from the potentially positive half - the Budget
- second, the handling of the whole issue is organised for maximum dramatic effect which keeps the media going for months - Departmental bids; total overbids and size of problem; bilaterals; Star Chamber; November Statement (followed 4-5 months later by the Budget)
- third, the combative nature of the exercise is meat and drink to the media; who is giving to or is getting a black eye from the Treasury
- fourth, Ministers and Departments insist on playing to the public gallery partly because they know their pressure groups know that they are not fighting against a cut in their allocation but for an increase
- fifth, the atmosphere in which the exercise is conducted is nonetheless one of cuts; for six years the Government has managed to present itself as cutting public expenditure even though that public expenditure has consistently risen; the issue has never been whether public expenditure should be reduced, but by how much, if at all, it should rise over and above the planned increase
- sixth, the catch-as-catch-can nature of the exercise means that it has been almost guaranteed to produce a bananaskin or two at a late stage - eg student grants; how to ensure no hostages to political fortune are given in bilaterals is an important aspect of the detail of the exercise.

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To meet this formidable catalogue of potential negatives we have over the years:

- considered whether the outcome of the public expenditure round could be brought together with the Budget; (no luck)
- tried to get Departments and Treasury to leak less (with no discernible effect; indeed it seems to get worse)
- tried to get over the point to the media that we are not dealing with "cuts" at all but how to keep within the planned spending increase (with scarcely any discernible effect, even in the quality newspapers for whose simplistic reporting there is no excuse)
- tried to focus on the positive point of outputs - ie the country is in fact getting better value for its money (with not a great deal of joy).

Indeed, I regard the public expenditure round as one large unadulterated mess, relieved only intermittently by success in persuading one of the more intelligent journalists to write about the Government's formidable success in all the circumstances in keeping a tight hold on the spending of tax payers' money.

It is superficially attractive to argue that what the Government does each year is decide how, within a modestly increasing total of spending, to allocate where the additional money goes. But the media will not be diverted from its main task of recording punch and counter punch in the game of indentifying who has won and who has lost, even though one who is classed as a loser may have actually increased his budget.

The whole affair is a presentational nonsense and nightmare. And the biggest nonsense is the way Ministers and Departments conspire to inflict collective damage. Since they won't shut up, whatever "disinterested" or "uninvolved" Ministers, or officials like me, say positively to the media has about the same effect as spitting in the wind.

This does not mean we should not keep trying. But it does mean that unless we can find a better way of conducting Government business we shall see limited results.



BERNARD INGHAM
1 October 1985

PART 32 **ends:-**

PS/CST to DN 30.9.85

PART 33 **begins:-**

B.1. to LPC 1.10.85

