PREM 19/2103

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PART 36

50.06

SECRET

CONFIDENTIAL FILING

PUBLIC EXPENDITURE AND CASH LIMITS

ECONOMIC POLICY

PART 1: MAY 1979

PART 36: OCT 1986

PREM 19/2103

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
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Dd 8398366 2M 11/83 JET

PART 36 ends:-

Welsh Office to HMT 16.1.87

PART 37 begins:-

CJT to PM 5.2.87

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
CC(86)35th Conclusions, Minute 1	30.10.86
CC(86)36th Conclusions, Minute 5	06.11.86

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed R Wayland Date 8 September 2015

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FROM THE PRIVATE SECRETARY
TO THE SECRETARY OF STATE
FOR WALES

NBPM. 16 January 1987

Dear Alex

My Secretary of State promised to let the Chancellor of the Exchequor have some background briefing on the Welsh economy in advance of next Tuesday's ... debate. I am enclosing with this letter:-

- A summary of 'bull points'
- Estimates of new jobs created in Wales following acceptance of Regional Selective Assistance and Regional Development Grants
- A note on change in situations vacant advertisements in Wales newspapers 1985-86.

... In addition I am enclosing a copy of a speech that Mr Kinnock made to the Wales CBI in Cardiff on October 31 1986 which my Secretary of State also promised to provide.

/ I am copy this letter together with Mr Kinnock's speech to David Norgrove at No 10.

Yours sincerely

Jon Shortridge

J D SHORTRIDGE

Alex Allan Esq
Private Secretary to the
Chancellor of the Exchequour
HM Treasury
Parliament Street
LONDON
SW1P 3AG

EXTRACT FROM SPEECH GIVEN TO WALES CBI, CARDIFF, OCTOBER 31, 1986, BY RT HON NEIL KINNOCK MP, LEADER OF THE OPPOSITION

When a Government is faced by the alternatives of using resources for investment or denying itself resources by making tax cuts I believe that the priority must, wherever possible, be the tangible, targettable, measurable maximum employment and production course of investment rather than the speculative course of hoping that the tax concessions will be spent on British industry and services, generating British jobs.

Certainly, that priority of investment must apply when we are faced by the need for major infrastructural improvement both in the physical environment and in human skills. Such an investment programme, plainly necessary now to my Party, to your organisation, and to the DTI will sadly and obviously not be enough to set Britain on the long road back to industrial recovery.

Especially when the length and steepness of that road was shown all too vividly in last week's balance of payments figures. For the second month running the current account, including trade in services, was in deficit. We are now heading for a deficit this year taken as a whole, and embedded in those dreadful figures last week was the most ominous figure of all - we already have a £4 billion deficit in manufactured trade so far this year and there is still a quarter of the year to go.

The question that therefore faces all who work for recovery is how we are to pay our way in the world as oil revenues decline with falling prices and falling production unless we have a competitive manufacturing industry.

And, as you know only too well, the only true measure of competitiveness is performance in the market place at home and abroad.

And on that true measure of competitiveness our manufacturing industry, after seven years of monetarist squeeze, is far less competitive than it was in 1979.

In that seven years our share of the world market for manufactured exports has fallen by 23% and import penetration of our markets in Britain has risen by 22%.

/Cont..

And the outcome of these persistent trends is that, unless something is done now, British industry will be once again squeezed in the vice of recurrent balance of payments crises.

The £55 billion of oil revenues could of course have been used to lay the foundations in infrastructure, industrial capacity, research and development and education and training, so that a truly competitive manufacturing industry could take over when the oil was gone.

It wasn't and now its gone. That means that we have to resort to systematic policies for the consistent building of the industrial base, the improvement and spread of skills, the containment of costs, the dependability of demand and the advance of competitiveness.

For those purposes I have set down a three-stage programme for my Party to foster recovery in the British economy.

First, there will be a two-year emergency programme of investment in infrastructure and in training to lay the foundations for industrial growth and in the process generate jobs.

Second, there will be a five year medium-term employment strategy, at the core of which will be our commitment to the expansion of manufacturing industry - for only if manufacturing recovers its lost markets will the two year expansion in employment be sustained.

Third, our industrial development strategy will be formulated within a ten year planning horizon. We must break out of the obsession with the short term which afflicts far too much British finance, British industry, and, in these days, the economic policy of the British Government.

These three elements form an inter-dependent programme for industrial recovery.

Our situation is now so serious, the dangers so pressing, that we cannot leave industrial recovery to chance. We cannot rely on market forces alone to allocate our scarce resources efficiently - simply because markets respond to the relatively short-run and our national need is for agreed medium and long-term objectives and continuity in the effort to reach them. Government must, therefore, join with industry to formulate a clear strategy for investment and recovery. The central criterion by which that strategy must be guided must be the need to secure a trend improvement in the trade performance of our industry at home and abroad.

/Cont..

13:24 HC LIBRARY ORIEL ROOM P04

At the centre of our industrial strategy will stand a completely revamped DTI and its associated Welsh, Scottish and regional activities.

Today the DTI devotes itself to the support of industry.

We want a DTI whose objective is to maintain that role but to be involved also in the CREATION of industry.

We have to learn the lessons taught by the success of the active entrepreneurial ministries which have guided and fostered industrial success in France and, most notably, in Japan.

And we can learn too from the success of the industrial development banks which have played such important roles in the modernisation of the French, German and Japanese economies.

That is why we shall establish a British Investment Bank as a first step towards developing a financial sector which is committed to and knowledgeable about the LONG-TERM modernisation and growth of British industry.

I am well aware that business people often complain that changes in the party of government have led to sharp changes in economic policy and that the uncertainty associated with these changes of direction has damaged the planning and prospects of British companies. They are not making a partisan point, they are complaining about the problems of working when someone keeps jogging your elbow or shifting the bench.

May I make what I believe to be an equally non-partisan point by saying that I believe that the failure of British Governments to place industrial policy at the very core of their economic strategy has been fundamental to that problem of discontinuity.

That is why industrial policy will be at the very centre of attention in the next Labour Government. The other components of economic policy will complement the requirements of production, rather than the other way round. That, in my view, is a matter of national priority, indeed a matter of national, industrial advance, and therefore, national economic survival.

That survival does not of course just depend upon our industry-conscious government being willing to provide new infrastructural and industrial investment, new forms of access to commerical funds and new backing for new enterprise. They are only tools. Unless they are utilised properly by people of skill and experience in concerted action they will be under-used and under-productive.

/Cont..

That is why co-operation, joint-determination, is essential if we are to see those tools used by the right people in the right places at the right times.

Commercial experience and intelligence, the capabilities of science and technology, the participation of labour, are all vital ingredients in that task.

Private and public enterprises that subscribe to that effort must be consulted and supported if we are to get the advanced performance and the improving trade balance in manufactures that is the key to securing the future prosperity of our country.

This does not mean that we or anyone else can expect a vast job increase in manufacturing industry itself. Expansion does mean more jobs, of course, but to be efficient and competitive, modern manufacturing must plainly increase its labour and capital productivity. That stability or reduction in marginal unit costs obviously means better use of better machines rather than substantial recruitment. The effectiveness of manufacturing operation is, however, fundamental to the production of wealth that is essential if jobs are to be persistently created elsewhere in the economy.

And that, of course, must be the central part of all objectives.

When UK unemployment is in excess of 3.25 million and costing £22 billion to sustain we cannot as a society tolerate such a burden of poverty and waste or as an economy afford such a useless expense.

Reducing those massive costs and disabilities is a purpose directly and inextricably linked to advancing the producing and selling performance of our country.

I am committed to those tasks by action in concert between government, employers and trade unions. I would welcome your participation. We will not always agree about means or methods, we must surely concur on the purpose of gaining vitality and success for our country and our people.

ENDS

CONFIDENTIAL

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

14 January 1987

REGIONAL DEVELOPMENT GRANT

Your letter of 13 January to Jill Rutter refers.

The Prime Minister has seen the draft answer, and suggests that she would prefer the following alternative:

> "The present Public Expenditure Provision for Regional Incentives in 1987-88 is £419 million, an increase of 9% ie £x m on the provision contained in last year's Public Expenditure White Paper. Within this increased provision, it has been decided that payment of grant on new applications under RDG II will be made two months after a claim has been approved. This will help to ensure that expenditure on regional incentives stays within 1987-88 public expenditure plans. Grants under the old RDG scheme, RDG I, will continue to be paid four months after claims have been approved."

As I explained on the telephone, David Norgrove will probably be in touch later in the day to suggest some amendments to the question and answer briefing.

I am sending a copy of this letter to Robert Gordon (Scottish Office), Colin Williams (Welsh Office) and Murdo Maclean (Chief Whip's Office).

(P. A. BEARPARK)

Michael Gilbertson, Esq.,
Department of Trade and Industry.

CONFIDENTIAL

PRIME MINISTER

REGIONAL DEVELOPMENT GRANT

The proposed PQ announcing the two month delay in payments of RDG II is attached to the letter below.

I am not sure it is quite right and suggest as an alternative:

> "The present Public Expenditure Provision for Regional Incentives in 1987-88 is £419 million, an increase of 9% on the provision contained in last year's Public Expenditure White Paper. Within this increased provision, it has been decided that payment of grant on new applications under RDG II will be made two months after a claim has been approved. This will help to ensure that expenditure on regional incentives stays within 1987-88 public expenditure plans. Grants under the old RDG scheme, RDG I, will continue to be paid four months after ~~schemes~~ claims have been approved."

Are you content with this alternative version? Any other changes you would wish to suggest?

The Q & A brief could also do with improvement and I shall make some suggestions on this. In particular, some of the material you have on the north/south divide could usefully be carried into the last page of the briefing.

Vanessa

I much prefer your answer. Could we not have the 9% in absolute figures as well.

DAVID NORGROVE

13 January 1987

VC4ALK

010

CQBG

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
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Secretary of State for Trade and Industry

PS/

CONFIDENTIAL

13 January 1987

Jill Rutter
Private Secretary to the
Chief Secretary to the Treasury
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Dear Jill,

RDGs

As you know, the subject for the Opposition Day Debate tomorrow has now been changed. It will therefore not be possible for the Chancellor to announce the two months delay in payment under the RDG II Scheme as previously planned.

... My Secretary of State will therefore make the announcement my means of a written PQ. I attach a copy of the Answer he intends to give tomorrow. This has been cleared with Treasury officials: if you or other copy recipients have any comments please let me know as soon as possible tomorrow morning.

... I also attach Question and Answer briefing for use following the announcement.

I am copying this letter and attachments to David Norgrove (No.10), Robert Gordon (Scottish Office), Colin Williams (Welsh Office), and Murdo MacLean (Chief Whip's office)

Yours ever,
Michael

MICHAEL GILBERTSON
Private Secretary

JF2ABH

999-1

Q. WHAT ARE THE GOVERNMENT'S PLANS FOR EXPENDITURE ON INCENTIVES TO INDUSTRY IN THE ASSISTED AREAS IN 1987/88?

A. The present Public Expenditure Provision for Regional Incentives in 1987-88 is £419m, an increase of 9 per cent on the provision contained in last year's Public Expenditure White Paper. As a result of a greater than expected transitional bulge in payments of RDG produced by the overlap of the old RDG I and new RDG II Schemes, it has been decided to spread out the flow of payments under RDG II. Payment of grant on new applications will be made two months after a claim has been approved. This will help to ensure that expenditure on regional incentives is contained within 1987-88 public expenditure plans.

There will be no change to the arrangements for grants under the old RDG scheme, which will continue to be paid four months after claims have been approved.

JF2ABI

RDG: WAITING PERIOD ON PAYMENTS

QUESTION AND ANSWER BRIEF

1. 2 month Waiting Period

Q1 How much will be saved by the 2 month waiting period for RDG II payments?

A1 Around £10-£12m will be deferred from 1987-88 into 1988-89 as a result of this measure. [If pressed These are GB figures. They are made up of £5-6m for DTI, £4m from the Scottish Office and £2m for the Welsh Office. But the estimates cannot be precise.]

Q2 How long will delay in payments last?

A2 No decision made yet. Depends on public expenditure position. The situation will be kept under regular review.

Q3 Is delay in payments simply stoking up problems for the future?

A3 No. It is true that this measure will only defer expenditure, not reduce it absolutely. But it is intended to deal with the temporary problem of the bulge in total RDG payments as the old RDG scheme runs down.

Q4 Will the waiting period apply to all applicants?

A4 It will not apply to existing applications or to claims on projects which have been wholly carried out.

Q5 Will the waiting period for RDG II payments not damage small firms particularly?

A5 There is little evidence of hardship having been caused by the existing 4 month waiting period for payments of old RDGs. The modest 2 month waiting period for new RDGs is unlikely to cause problems, particularly as firms should continue to be able to borrow from their banks against a letter from HMG approving a claim.

Q6 How will the delay in payments operate?

A6 Claims will be dealt with in the normal way until the relevant Department (DTI, Scottish Office, Welsh Office) has decided that grant is payable. The Department will then advise the claimant in writing that payment will be made two months later. Full details will be sent out in a Notice for Applicants.

2. **PROVISION FOR REGIONAL INCENTIVES**

Q7 Already a big reduction in spending on regional incentives?

A7 Provision in 1987-88 is lower than in recent years because of our 1984 changes which were designed to make regional incentives much more cost effective in creating jobs. Very large sums have been spent on the old RDG scheme which was solely linked with capital expenditure. But provision for regional incentives in 1987-88 is 9% up on previous plans and it is intended to maintain expenditure at this level for the next three years.

Q8 Very sharp reduction in provision for regional incentives in 1987-88 compared with the current year?

A8 The Government has accommodated a large increase in expenditure on regional incentives in the current year resulting from the bulge in claims for old RDG under the transitional arrangements from the old to the new scheme. Though the bulge will continue into 1987-88, payments under the old scheme are now running down: future expenditure will be mainly on the new RDG scheme and on Regional Selective Assistance, both of which are more cost effective in generating jobs.

3. **ERDF/NORTH/SOUTH DIVIDE**

Q9 Regional Development Programme (ERDF Report) an indictment of the Government's record in the Regions.

A9 Report given impressive list of Government policies - industrial, regional, employment, infrastructure - which demonstrate the Government commitment to combatting problems of the regions. Report makes clear that the problems it describes are long standing and reflect past decline. ERDF receipts (a total of £1.4 billion since 1979) make substantial contribution and help Government find room in plans for worthwhile projects.

Q10 North/South Divide. Government's regional policy inadequate given current levels of unemployment and differences between north and south.

A10 1984 review of regional policy took full account of employment patterns throughout the country. Current Regional Assistance map for Great Britain shows assisted areas as being overwhelmingly concentrated in the North and West of England, Scotland and Wales. Important also to remember that the regional policy is just one of a range of Government programmes which help generate employment and tackle problems of dereliction and industrial decline eg

* the Urban Development Grant (since 1982 grant has been paid to 200 projects; £423 million private funds have been levered for £100 million of public funding; and 22,800 jobs have been supported).

* the Urban Development Corporations (2 at present and 5 more planned): intended to emulate the success fo the London Docklands Corporation (which in 6 years of existence has levered £1,466 million of private funds - 6.4 times the public input to its work, and has created 8,000 permanent and 500-2,000 temporary jobs and preserved 1,400 jobs);

* 25 enterprise zones and 6 freeports.

016/2769

CLBG (letter only)

CONFIDENTIAL

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

David Norgove Esq
Private Secretary
10 Downing Street
London
SW1

13 January 1987

Dear David

1987 PUBLIC EXPENDITURE WHITE PAPER

As you know, the 1987 Public Expenditure White Paper is due to be published at noon tomorrow. The Chief Secretary thought that it would be helpful for the Prime Minister and other Cabinet colleagues to have advance copies before publication. I am therefore enclosing a confidential final revise copy.

I am also sending this letter and copies of the White Paper to the Private Secretaries of members of Cabinet, the Minister for the Arts, and to Sir Robert Armstrong.

Yours,

Jill

JILL RUTTER
Private Secretary

psl/54A

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

13 January 1987

M Gilbertson Esq
PS/Secretary of State
Department of Trade and Industry
1 Victoria Street
LONDON
SW1

Dear Mike, NRBPM.

RDGs

As you know, in his speech tomorrow the Chancellor will be announcing the introduction of the two months delay in payment of RDGs under the new system.

I attach a draft passage on this, and would be grateful for any comments as soon as possible.

I am copying this letter to David Norgrove (10 Downing Street), Robert Gordon (Scottish Office), Colin Williams (Welsh Office), and Chris Copella (Paymaster General's Office).

Yours.
Alex.

A C S ALLAN
Principal Private Secretary

psl/53A

RDGs

Public expenditure provision for regional incentives in 1987-88 has been set at £418 million, an increase of 9 per cent on the provision in last year's Public Expenditure White Paper. This demonstrates the Government's continued commitment to cost-effective and carefully targeted regional incentives.

2. We are currently in a period of transition between two systems of regional development grants, following the changes introduced in 1984. The old system perversely encouraged firms to set up capital intensive plants in areas where unemployment was high; the new system provides an explicitly job-related structure of incentives and concentrates assistance where it is most needed. However, during the transition between the two systems, there has been a larger than expected bulge in payments. In order to keep expenditure within even the enlarged public expenditure provision we have agreed, it will be necessary to spread out the flow of payments under the new system, so that from now on grants will be paid two months after an application has been approved. There will be no change to the arrangements for the remaining grants under the old system, which will continue to be paid four months after applications have been approved.

Personal + Confidential

CHIEF SECRETARY TO THE TREASURY

MR NORCROVE

I enclose extracts from the mega-brief for the Public Expenditure White Paper. This is, as always, for your personal use to use as you see fit. We (or Departments) can of course supply any additional defensive material for Questions on Thursday. I will let you know on Monday if any changes to the "lines to take" the CST/Chancellor may propose. (If you have any comments on presentation let me know).

Jim Ruth

9.1.87.

file DT

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

9 January 1987

EDUCATION, SCIENCE AND ARTS COMMITTEE (ASAC)
REPORT ON PUBLIC EXPENDITURE

Thank you for your letter to Andy Bearpark here of 24 December. This is to confirm that the Prime Minister has agreed that the response to the Committee's report should be published as a White Paper on Monday.

M E ADDISON

Ms Alison Kennedy,
Department of Education and Science

CH

PRIME MINISTER

1987 PUBLIC EXPENDITURE WHITE PAPER

Mr. Rifkind's minute below draws colleagues' attention to the fact that the Public Expenditure White Paper includes an announcement of a four-month moratorium on payment of the new Regional Development Grant (The moratorium is a delay of four months in any given payment - so the effect is on cash flow.) He points out that the current pre-occupation about north-south is not a good background for this. His minute is in effect a request to you to overturn the moratorium. The cost for England, Scotland and Wales together would be some £25 million.

The timing of the announcement clearly is very awkward. It will come in the middle of the Lords' debate on north-south and the Commons' debate on the economy, for which the motion includes a reference to a divided nation.

It would clearly be wrong to go back on the decision. I have investigated whether the announcement could be postponed. This would not however be possible without embarrassment: the press conference following publication has already been arranged and knowledge of any postponement would in any case leak.

I suggest you note the difficulty of the announcement and say that clearly the closest possible attention will need to be paid to its presentation. (You may like to see the brief for use by Treasury Ministers, attached.)

I'm afraid we shall have to reconsider. It is not possible to present this decision. The only way I can think of - as it is job creation - is to see if we can divert some other money from M.S.C. MT

DRN

DAVID NORGROVE
SLHAEI
9 January 1987

CC/G

CONFIDENTIAL

Prime Minister

PUBLICATION OF 1987 PUBLIC EXPENDITURE WHITE PAPER

I have seen the letters of 5 January from the Chief Secretary's Private Secretary and the reply of 6 January from your Private Secretary.

I entirely agree that the plans should be presented actively and positively. I am conscious, however, that a particularly difficult issue presentationally will be the introduction of the 4 month moratorium on payment of new Regional Development Grant. We decided, during the 1985 PES round, that such a moratorium was likely to be necessary and the decision was reluctantly confirmed during the last round even though we recognised that its introduction would cause difficulties for the cash flow of grant recipients in the assisted areas 95% of whom in Scotland are likely to be small firms. The grant supports job creation.

As colleagues will appreciate, the publicity this week about job losses in the regions creates an atmosphere in which the announcement next week of the new moratorium will be very badly received in the assisted areas.

I am copying this minute to Cabinet colleagues and to Sir Robert Armstrong.

MR

9 January 1987

RDG2 MORATORIUM

White Paper says

"The transitional bulge in total RDG awards resulting from the overlap of the 2 schemes [RDGI and RDGII] have proved to be of a greater magnitude and extending over a greater period than anticipated. In order to spread this expenditure, further moratoria have been imposed on payments of RDG, to cover new RDG as well as old."

Facts

A four month moratorium on payments of RDGI has been in force since 1985. A four month moratorium on payments of RDGII will come into force immediately after Mr Channon's announcement of it in a written reply to a PQ on the afternoon of 14 January. The new moratorium is expected to yield savings of £20-25m in 1987-88.

Line to Take

- New moratorium does not signal any change in Government's commitment to an effective regional policy.

- Provision for Regional Assistance expenditure by DTI/SO/WO in 1987-88 some £36m up on previous plans (£419m as agaisnt £383m). But transitional bulge in total RDG awards larger than anticipated; and moratorium intended to help spread payments.

- (If pressed) Secretary of State for Trade and Industry will announce details later today (14 January).

- (Regional Assistance inadequate given current levels of unemployment and differences between North and South). 1984 review of regional policy took full account of the employment patterns. As a result of the review, assistance is now more clearly linked to job creation producing a higher number of

jobs for given level of spend. But targetting has allowed reduction in overall level of regional assistance expenditure over past 2 years. Now plan to maintain in real terms between 1987-88 and 1989-90. Important to remember that this is just one of range of Government programmes which help generate employment.

CC B I

(84)

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

6 January 1987

PUBLICATION OF 1987 PUBLIC EXPENDITURE WHITE PAPER

The Prime Minister has seen your letter to me of 5 January and is content for the Public Expenditure White Paper to be published on Wednesday 14 January.

The Prime Minister endorses most strongly the Chief Secretary's wish for the Public Expenditure plans to be presented actively and positively.

I am copying this letter to the Private Secretaries to members of Cabinet, the Chief Whip and Sir Robert Armstrong and to Mr. Bernard Ingham.

DAVID NORGROVE

Ms. Jill Rutter,
Chief Secretary's Office

6

002/2984

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Prime Minister!

Agree to publication on ~~8~~ 14 January, subject to colleagues, and to endose warmly the suggestion that the plans should be presented actively and positively?

D Norgrove Esq
Private Secretary
10 Downing Street
London
SW1

5 January 1987

DRN
5/1

Dear David,

PUBLICATION OF 1987 PUBLIC EXPENDITURE WHITE PAPER

The text of the 1987 Public Expenditure White Paper was cleared in correspondence before Christmas. We now need to settle arrangements for publication.

The White Paper is on schedule for publication in the second half of the week beginning 12 January. The Chief Secretary proposes it should be published at 12 noon on Wednesday, 14 January. There could be advantage in having the document available before the Opposition debate scheduled for that afternoon. Informal consultations have not identified any other major publication or announcement with which that would clash.

Established practice is for there to be no Oral Statement on publication of the White Paper. Instead, there is usually a debate in the House on the White Paper a few weeks after publication. Past practice is also to inform Parliament of the date and time of publication in a Written Answer beforehand, and then place copies in the Vote Office on publication day. The Chief Secretary proposes the publication details should be announced in a Written Answer on Tuesday, 13 January.

As in the past, the Chief Secretary will be holding an on-the-record briefing for the press. As the White Paper is a long and complex document, we envisage, in line with past practice, issuing embargoed Confidential Final Revises on the day before publication.

The Chief Secretary wishes the public expenditure plans to be presented actively and positively. Although some departments issued their own press notices at the time the summary figures were announced

in the 1986 Autumn Statement, the Chief Secretary hopes that departments generally will hold press conferences or issue press notices commenting on and explaining their figures in the White Paper.

I am copying this letter to the Private Secretaries to members of Cabinet, the Chief Whip and Sir Robert Armstrong, and to Mr Bernard Ingham.

Yours sincerely,

JILL RUTTER
Private Secretary

SP

Prime Minister

cc BG

This has been cleared by L. Pres & 'H'. Content ?

AB 8/1

DEPARTMENT OF EDUCATION AND SCIENCE
ELIZABETH HOUSE YORK ROAD LONDON SE1 7PH
TELEPHONE 01-934 9000

FROM THE SECRETARY OF STATE

P A Bearpark Esq
Private Secretary
10 Downing Street
LONDON SW1A 2AA

24 December 1986

Dear Andy

EDUCATION, SCIENCE AND ARTS COMMITTEE (ESAC) REPORT ON PUBLIC EXPENDITURE

I attach a draft response to the Education, Science and the Arts Select Committee's report on DES expenditure plans. We understand that the draft has been agreed by H Committee and that the Lord President will be writing to confirm this early in the New Year.

We plan to publish the response as a White Paper, and need to do so before this year's Public Expenditure White Paper is published. We therefore propose to publish the response on Monday 12 January. May I ask for your clearance to go ahead on this date?

I am copying this letter to the Private Secretaries to members of H Committee, to Bernard Ingham and to Sir Robert Armstrong.

Yours sincerely

Alison Kennedy

ALISON KENNEDY
Private Office

DEPARTMENT OF EDUCATION AND SCIENCE EXPENDITURE PLANS 1986-87 TO 1988-89 (CMND 9702) AND SUPPLY ESTIMATES 1986-87: GOVERNMENT RESPONSE TO THE SECOND REPORT FROM THE EDUCATION, SCIENCE AND ARTS COMMITTEE, SESSION 1985-86

Introduction

1. The Government welcomes this first report from the Education, Science and Arts Committee on DES expenditure plans and supply estimates, and looks forward to the Committee's future work in this area.

2. The Committee make seven recommendations in the Report: this response sets out and comments on each recommendation in turn. The response insofar as it relates to DES responsibilities for local education authority matters, refers to the position in England.

Current Expenditure

We therefore recommend that the Government should in future publish plans for local authority current expenditure - including those for education - which represent the Government's best estimate of what local authorities are likely to spend in the following three years. (paragraph 9)

3. The Government shares the Committee's view of the desirability of providing local authorities with planning figures for expenditure in the two later years of the Public Expenditure Survey. The particular uncertainties about future spending by local authorities which underlay the decision to restrict firm planning figures in Cmnd 9702 to the first year were set out in HM Treasury's Observations on the Third Report from the Treasury and Civil Service Committee on the Public Expenditure White Paper 1986. The 1987 PEWP will carry firm planning figures for three forward years. The distribution between services of total planned expenditure will be subject to review in the light of demographic trends, local authority budgets and other factors

including the Government's commitments and priorities. But local authorities will have a clear indication of the level of local authority spending for which the Government has allowed in its plans for future years.

4. The Committee will recognise, however, that decisions on what is actually spent rest with the local education authorities. In planning their expenditure they will have regard to local circumstances and their own policies for the service, as well as Government views. The Government promulgates longer-term policies for the property and manpower of the education service, as well as the annual expenditure plans. For example, this year the Department set targets for the number of surplus school places to be taken out of use nationally in each year up to 1992. The aim of achieving a student to staff ratio (SSR) of 12:1 in advanced further education is well established, and our plans for 1987-88 and later years imply a significant tightening of SSRs in the non-advanced sector, as part of a longer term efficiency target. The development of policies for the staffing of schools is under discussion with the local education authorities.

Capital Expenditure

The Department of Education and Science should take steps to assess the real, long-term changes in spending on maintenance of assets and to analyse the quality of the capital stock. Where there is evidence of poor maintenance, capital allocations should be revised so as to encourage additional improvements in areas with particularly poor capital stock. In addition, we would favour a more general shift in the balance of public expenditure so as to increase the real level of education capital expenditure. We recommend accordingly. (paragraph 24)

5. The Government acknowledges the desirability of a well-maintained capital stock for the education service. Maintenance of assets is a current expenditure item. It is for local education authorities themselves to decide how much to devote to maintenance within their total current expenditure. Studies of the trends in local authority expenditure on maintenance have

been conducted and will continue. A sample survey of school building improvement needs has recently been launched. It is designed to give a reasonably reliable national picture of the work which local education authorities consider necessary to bring school buildings, other than aided schools, up to defined standards of functional and educational adequacy and of physical and environmental condition for 1991 pupil numbers. The Department will inform Parliament of the outcome of the survey.

6. The methodology for distributing local authority capital provision to individual authorities incorporates the use of an indicator of physical state and educational suitability of school buildings derived from information supplied by local authorities. The methodology is regularly reviewed. How the local authorities spend their capital allocations is at their discretion. Allocations are not tied to specific services.

7. The resources which can be devoted to capital expenditure depend on the merits of the proposed categories of expenditure and the many claims on public expenditure as a whole: the Government notes the Committee's views on the priority which capital expenditure should receive, and has announced in the Autumn Statement increases over previous plans for capital provision for local education authorities and voluntary schools. In addition to these allocations, significant spending power is available to local authorities from capital receipts.

Presentation

It is in our view important that capital spending within central government should be identified in total, separate from current expenditure. We recommend that this should be done in future White Papers. (paragraph 24)

8. The Government will take into account comments made by the Committee, and by the Treasury and Civil Service Committee in its Third Report in the 1985-86 Session, on the presentation of its expenditure plans. It is intended to publish the information requested by the Committee on total central government capital

spending on education in the 1987 Public Expenditure White Paper.

Student Awards

We recommend that the DES immediately consider the equity of continued reductions in the basic student award following a period in which the figures produced by the DES show that there has been a cut in real terms. (paragraph 33)

9. The student support review is considering the financial support of students studying at first degree level in Great Britain. In reaching its conclusions it will take account of the recent changes in the value of the student award and of the Government's aim as expressed in the White Paper "Reform of Social Security" (Cmnd 9691), of removing students from dependence upon social security benefits. It will also take account of the Committee's recommendation.

10. The Government's expenditure plans published in the Public Expenditure White Paper cover three years only. The 1986 White Paper does not cover 1989-90 or subsequent years. Public expenditure is reviewed annually and final decisions on the level of students awards expenditure in the forthcoming year are taken in the light of that review.

Specific Grants

We therefore recommend that the DES, in conjunction with the Department of Employment, takes immediate steps to research the effects (both intended and unintended) of all centrally-funded initiatives and specific grants which affect education and training and that the results of such research should be made public. (paragraph 41)

11. The Committee's report expresses concern that the introduction of the Youth Training Scheme appears to have affected the proportion of young people taking A levels in schools. This point is discussed fully in the DES note of evidence to the

Committee (reproduced as Appendix 5 to the Report). The note drew attention to the Youth Cohort Study which has been designed to provide information on the education, training and employment of young people including the factors which influence the staying on rate. The first report of some preliminary findings was published in July 1986.

12. The Government's policy for 16-19 year olds is that they should be encouraged to continue with their education and training in whatever form is most appropriate to their needs, abilities and aspirations. The small drop in the A level participation rate and the possibility that some young people have opted for YTS who might otherwise have taken A levels is not in itself a cause for concern. The Government has no reason to believe that significant numbers of young people who would derive more benefit from taking A levels are opting for YTS instead.

13. Arrangements to monitor the effects of centrally-funded initiatives on education and training already exist and will be improved and developed. These are:

(a) Each activity within the Education Support Grant programme is evaluated as shown in Annex 2 to the Committee's report;

(b) TVEI projects are monitored and evaluated at both national and local level. The results of the evaluations are widely disseminated;

(c) Contributions from MSC towards work-related NAFE are subject to the acceptance of an LEA's three-year plan and a specific programme for the first year. The responsibility for monitoring provision lies with LEAs. Research continues into evaluation and the establishment of performance indicators.

14. The Committee also mentions the industrial language training service. That service is in the midst of a major review. A consultative document on the scheme was published in April 1986 and any decisions for the future will be made public.

Volume Terms Expenditure Measures

We therefore recommend the introduction of volume measures of past education expenditure in a table presented in the same way as Table 3.12 in the 1986 White Paper to complement the existing cash figures. (paragraph 45)

15. The Government has no plans to introduce volume measures of education spending. Such measures would be inconsistent with the basis of cash planning. Rather than examining the volume of inputs consumed, the Government will continue to encourage the development of performance indicators in education.

Objectives and Performance Measures

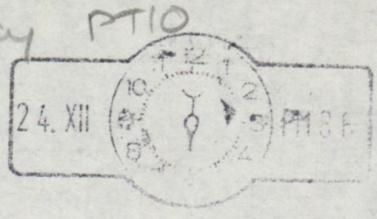
It is crucial that consideration be given by the DES to the detail of aims and objectives for the education service and to how the achievement of such aims may be demonstrated. We recommend accordingly. (paragraph 49)

16. The Government is concerned, as is the Committee, that improvements are made in setting objectives for the education service and measuring its performance. The Government's objectives for education are kept under review. Various Government publications have set out detailed objectives for specific parts of the education service; such objectives have been published in "Better Schools" (Cmnd 9469), "The Development of Higher Education into the 1990s" (Cmnd 9524), and more recently, "Working Together - Education and Training" (Cmnd 9823) and in the Public Expenditure White Paper.

17. The Government is encouraging the development of performance indicators for different sectors of the education service within the limits set by the availability of data. It is important that any such measures are consistent, easily understood and workable. In that context the Audit Commission has identified opportunities worth between £0.75 and 1 billion to improve value for money in current expenditure on local authority education, including most recently £500-700 million a year by 1990 from rationalising

provision in response to falling secondary school rolls. The Government believes that if these and other opportunities were seized, LEAs could make good progress with national and local policies for improving quality of education at a substantially lower level of expenditure.

Education; Policy PT10



005/2769

CCBS

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Andrew Lansley Esq
Private Secretary to the Chancellor of the Duchy of Lancaster
Cabinet Office
Whitehall
London
SW1

19 December 1986

Dear Andrew,

NBPM.

1987 PUBLIC EXPENDITURE WHITE PAPER

Thank you for your letter of 16 December.

The Chief Secretary agrees it would be helpful to add to the "main points" on the lines proposed by the Chancellor of the Duchy, But he feels the drafting could be made rather more positive, and he proposes the new section should read:

> "In other areas, most notably defence, the level of provision takes into account the substantial increases made in previous years. In these areas, as in all other programmes, the continuing search for efficiency will lead to further improvements in the level of service and output."

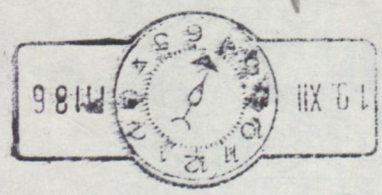
I am sending copies of this letter to David Norgrove, to the Private Secretaries to other members of Cabinet and to Trevor Woolley.

Yours,

Jill

JILL RUTTER
Private Secretary

Public Expenditure; Econ
Pol. 436.



cc BG

MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1
Telephone 01-930 7022

MO 8E

18th December 1986

NBH

Dear Max,

1987 PUBLIC EXPENDITURE WHITE PAPER

Your letter of 10th December and Jill Rutter's of 12th December circulated the draft 1987 Public Expenditure White Paper.

Mr Younger is generally content with the draft. He has noted, however, that there are a number of editorial amendments which should be incorporated; these are attached.

In addition, Mr Younger has recently endorsed revised totals for future civilian and Service manpower, which we would like to incorporate in the PEWP to make it consistent with the 1987 Statement on Defence Estimates. These are also shown in the attachment, together with a list of the references which need to be changed. I would be grateful if you would ensure that these amendments are incorporated.

Finally, Mr Younger has noted the addition to the "main points" section suggested by the Chancellor of the Duchy of Lancaster (Andrew Lansley's letter of 16th December), as amended by the Chief Secretary. He would prefer not to refer to "smaller increases", but to say 'In other areas, most notably defence, provision takes into account the substantial increases made in earlier years'.

I am copying this letter to those to whom you copied yours.

Yours ever,

J F Howe

(J F HOWE)
Private Secretary

M C Felstead Esq
Private Secretary to the Chief Secretary
HM Treasury

DETAILED AMENDMENTS

Part 1

Paragraph 18, line 4: Delete "to" insert "with".

Paragraph 90: Civil Service Manpower: This paragraph may need amendment to reflect the reductions in MOD civilian manpower numbers indicated below.

Paragraph 92: Armed Forces: Delete "329,700", insert "325,500". Delete the second sentence in toto, and insert "This reflects the Government's aim of making more efficient use of the manpower needed to support the defence programme."

Part 2

Paragraph 54: Armed Forces

Delete "3%", insert "2.5%".

Delete "329,700", insert "325,500".

Delete final sentence, insert "This reflects the Government's aim of making more efficient use of the manpower needed to support the defence programme."

Table 2.14: Public Sector Manpower

Amend MOD manpower numbers as follows:

		1.4.87	1.4.88	1.4.89	1.4.90
Civilians	Delete		150.0	149.0	149.0
	Insert		148.0	147.0	147.0
Armed Forces	Delete	330.5	329.7		
	Insert	329.6	325.5		

Part 3

Table 3.1.1; footnote 2: After "defence capital spending", add "plus capital expenditure of RP plc".

Paragraph 9, lines 7/8: Delete "have now been extended", substitute "were extended in 1985".

Paragraph 12, line 3: Delete it is estimated that". Start sentence "Since 1979 ...."

Paragraph 12, line 5: Delete "£28 million", substitute "£30 million".

Table 3.1.4: Personnel figure for 1984-85 should be 34.9, not 35.0.

/Paragraph 17 ...

Paragraph 17, lines 5,6: Delete "research, development and production and repair and into systems expenditure", substitute "various categories".

Table 3.1.5: the figure of 14.2 in the 1979-80 column should be centred between research and development.

Table 3.1.6: Air Force General Purpose Forces for 1985-86 should be 20.5, not 20.4.

Paragraph 24, line 2: Delete "this year", substitute "last year".

Table 3.1.9: Armed Forces Manpower

		1.4.87	1.4.88
Regular Forces			
UK Based	Delete	320.9	320.1
	Insert	320.0	315.9
Total	Delete	330.5	329.7
	Insert	329.6	325.5

Table 3.1.10: Nuclear Strategic Forces for 1984-85 should be 2.1 not 2.3.

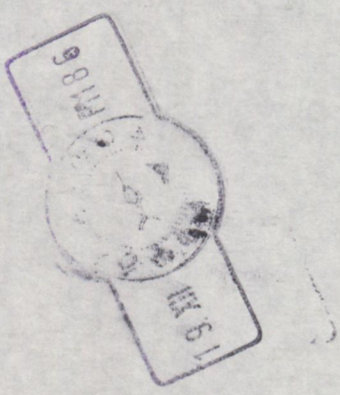
Other Army Combat Forces for 1984-85 should be 101.2, not 101.3.

Table 3.1.11: UK Based Civilian Manpower strengths

	1988	1989	1990
Delete	150	149	149
Insert	148	147	147

Paragraph 30, line 6: Delete "the contractor", substitute "the Dockyards". Final sentence; dlete "and overdue".

ECON. POL: Public expenditure: Part 36.



CC BS

Ministry of Agriculture, Fisheries and Food
Whitehall Place London SW1A 2HH

From the Minister's Private Office

Miss Jill Rutter
Private Secretary to the
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
London
SW1P 3AG

18 December 1986

Dear Jill

cc RBM

1987 PUBLIC EXPENDITURE WHITE PAPER

Thank you for circulating a copy of the 1987 White Paper with your letter of 10 December

Chart 1.5 should have a footnote to explain that the percentage change for Agriculture, Fisheries and Food is high as one-off sales of cereals to Spain and of beef to Brazil have resulted in an unusually low estimated outturn for the base year, 1986-87.

The text of the Agriculture chapter has been agreed by officials, and the Minister is content for it to be published .

I am copying this letter to the Private Secretaries to members of Cabinet and to Sir Robert Armstrong.

Yours ever

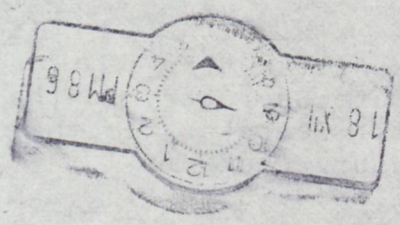
CIL

C I LLEWELYN
Private Secretary

Econ Pol

Public Expenditure

PT3C



GCB 9

CONFIDENTIAL

CABINET OFFICE,
WHITEHALL, LONDON SW1A 2AS

Chancellor of the Duchy of Lancaster

Tel No: 233 3299
7471

16 December 1986

Jill Rutter
Principal Private Secretary to
the Chief Secretary to the
Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

J BRN

Dear Jill,

1987 PUBLIC EXPENDITURE WHITE PAPER

WITHDRAWN.

Thank you for sending me a copy of your letter of 10 December to David Norgrove.

The Chancellor of the Duchy would suggest an addition to the first section of "main points". Following the third paragraph, a further section be added to read:

> "In other areas, most notably defence, the level of provision shows a smaller increase, but follows several years in which substantial increases in provision have taken place. In these areas, and in all programmes, the search for efficiency will yield savings. These, although not reflected in the expenditure inputs, will lead to improvements in the level of service or output from the programme".

This will very slightly pre-empt the last paragraph in this section, but might usefully reinforce the theme, and respond directly to the renewed emphasis on the level of defence expenditure.

I am sending a copy of this letter to David Norgrove, to the private secretaries to other members of Cabinet and to Trevor Woolley.

Yours Sincerely,

A. Lansley

ANDREW LANSLEY
Private Secretary

018/3294

COVERING CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG

David Norgrove Esq
Private Secretary
10 Downing Street
London
SW1

12 December 1986

Dear David,

WBIN

filed in separate box.

1987 PUBLIC EXPENDITURE WHITE PAPER

As foreshadowed in my letter of 9 December, I now enclose a copy of Volume II of the 1987 Public Expenditure White Paper.

I should point out that the health warning about the figures in our letter of 9 December also applies to this draft, although at this stage we are only envisaging minor further amendments.

As with Volume I, the Chief Secretary would be grateful for any comments by midday on Friday, 19 December at the latest.

I am copying this letter to the Private Secretaries to members of the Cabinet, to Michael Stark (Mr Luce's office) and to Trevor Woolley (Cabinet Office).

Yours sincerely,

Jill Rutter

JILL RUTTER
Private Secretary

011/3294

CONFIDENTIAL

Prime Minister 4
You may like to glance at this.
DHN 11/12

Treasury Chambers, Parliament Street, SW1P 3AG

David Norgrove Esq
Private Secretary
10 Downing Street
London
SW1

10 December 1986

Dear David.

1987 PUBLIC EXPENDITURE WHITE PAPER

The Autumn Statement gave a summary of the results of the 1986 Public Expenditure Survey. The next stage in the annual cycle will be the publication of the 1987 Public Expenditure White Paper.

This year the White Paper was published on 16 January. I envisage a broadly similar timetable for 1987, with publication during the week beginning 12 January; I will, however, write round separately later about the detailed publication arrangements.

This year the Chief Secretary is anxious that colleagues should be given rather more time than they have had in previous years to consider the White Paper in draft and make their final comments on it. Accordingly, I now enclose the draft of the summary Volume I, parts of which have already been discussed with departments at official level. The more detailed Volume II - including the departmental chapters already agreed at official level - will be circulated separately before the end of the week.

One implication of "circulating" the draft earlier than in previous years is that there is still uncertainty about the precise figures in some areas, such as the estimated outturn for 1986-87. (The deadline for departmental comments on figures is today.) The tables and charts will therefore be finalised once the exercise to establish the new database has been completed. But the Chief Secretary felt that his colleagues would prefer to have longer to consider a near-final draft of the document.

To meet the publication timetable it will be necessary to finalise the White Paper before the Christmas break.

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The Chief Secretary would therefore be grateful for any final comments by midday on Friday 19 December at the latest.

I am copying this letter to the Private Secretaries to members of Cabinet and Sir Robert Armstrong.

Yours sincerely

M C Felstead

M C FELSTEAD
Private Secretary

4276/1

MAIN POINTS FROM THIS WHITE PAPER

Public spending in 1987-88 and 1988-89 is planned to be £148.6 billion and £154.2 billion respectively. A new planning total of £161.5 has been set for 1989-90.

These plans mean that public spending is expected to fall as a proportion of the nation's income over the next four years By 1989-90, the proportion is expected to be back to the levels of the early seventies. In real terms, public spending is expected to increase by an average of 1 per cent a year, significantly less than the expected growth of the nation's income.

Compared with the last White Paper, extra funds have again been allocated to priority services; these include education, health and law and order. Further provision, around £1 billion in 1987-88, has also been made for capital spending, including substantial increases for housing, schools and roads. Estimated costs of some demand led programmes, such as social security, have also risen.

The privatisation programme is moving forward strongly.

The Government is giving high priority to improving value for money in all programmes. This White Paper further expands the information about what is being achieved and planned by departments.

The overall spending plans

Introduction

1. The Autumn Statement, published in November 1986, gave the broad results of the annual public spending review. This White Paper fills in the detail of the plans for the next three years; and provides the basis for the Supply Estimates, cash limits and other spending controls for 1987-88. Revised projections of government receipts, spending and borrowing over the medium term will be given in the next Financial Statement and Budget Report (FSBR), to be published on Budget Day.

2. This Volume of the White Paper gives a summary of the new plans. Volume II goes into more detail. It provides further analyses of historical trends in public spending, and detailed accounts of the spending plans, outputs and performance of all parts of the public sector. The contents of Volume II are summarised on page [ ] of this Volume.

Aims and objectives

3. The plans set out in this White Paper should ensure that public spending continues to fall as a percentage of GDP, as it has done over the last four years.

4. The Government's plans for public spending are an integral part of its Medium Term Financial Strategy (MTFS). When he announced the latest public expenditure plans in the House of Commons on 6 November 1986, the Chancellor of the Exchequer reaffirmed the Government's commitment to the fiscal stance set out in the MTFS published in the FSBR at the time of the 1986 Budget. He said that there would be no relaxation of that stance and that the public sector borrowing requirement (PSBR) in 1987-88 would be held to the MTFS figure of 1¾ per cent of national income (gross domestic product or GDP).

5. Within the cash resources available, the Government continues to attach importance to getting better value for money from public spending every year. The annual review of public spending looks not just at the money to be spent, but also at the outputs and the efficiency with which they are achieved.

1986-87 outturn

6. The estimated outturn for the planning total in 1986-87 is [£140.4] billion. This is [the same as] that published in the Autumn Statement (AS), and about [1]

per cent above the plans set out in the last White Paper (Cmnd 9702). The additions made to programmes during the year have been [£5.8] billion compared with a Reserve of [£4.5] billion at the beginning of the year. The main increases have been in local authority current and capital spending ([£2.7] billion and [£0.5] billion respectively) and in demand-led programmes, notably social security, which is projected to be [£1.6] billion higher.

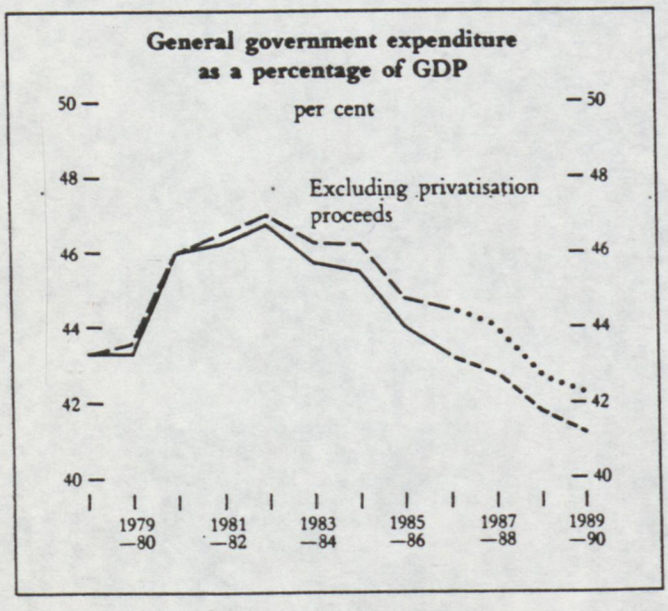
Public spending totals

7. The public expenditure planning totals for 1987-88 and 1988-89 are £148.6 billion and £154.2 billion respectively. This compares with £143.9 billion and £148.7 billion in the last White Paper. A planning total has now been set for 1989-90, at £161.5 billion. These totals include substantial Reserves not allocated to programmes. These Reserves are larger, both absolutely and as a percentage of the planning total, than in any White Paper except 1986 (see paragraph 56).

Public spending and national income

8. General government expenditure has been falling steadily as a percentage of GDP, with a decline of 2½ percentage points between 1982-83 and 1986-87. With money GDP growing as in the MTFS, the new plans will allow for a further decline of 2 percentage points (see Chart 1.1 below), bringing the ratio below that inherited by the Government in 1979 and back to the levels of the early seventies.

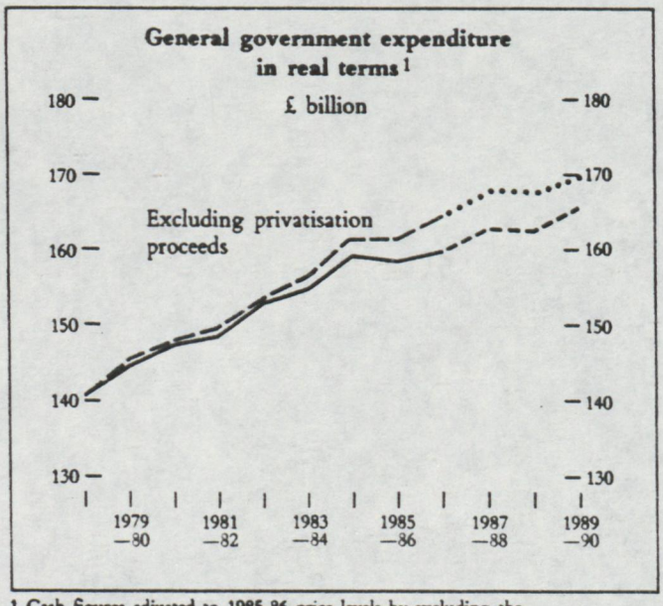
Chart 1.1 Public expenditure as a percentage of GDP



Public spending in real terms

9. The new plans should ensure a continued deceleration in the growth of public spending. In real terms, the average growth in general government expenditure, (excluding privatisation proceeds in order to show the underlying trend), is expected to be just over 1 per cent between 1986-87 and 1989-90 (see Chart 1.2) (1¼ per cent for the planning total). This compares with growth averaging almost 3 per cent in the decade up to 1978-79, around 2¼ per cent in the period 1978-79 to 1982-83, and around 1¾ per cent in the period 1982-83 to 1986-87.

Chart 1.2 General government expenditure in real terms



1 Cash figures adjusted to 1985-86 price levels by excluding the effect of general inflation as measured by the GDP deflator.

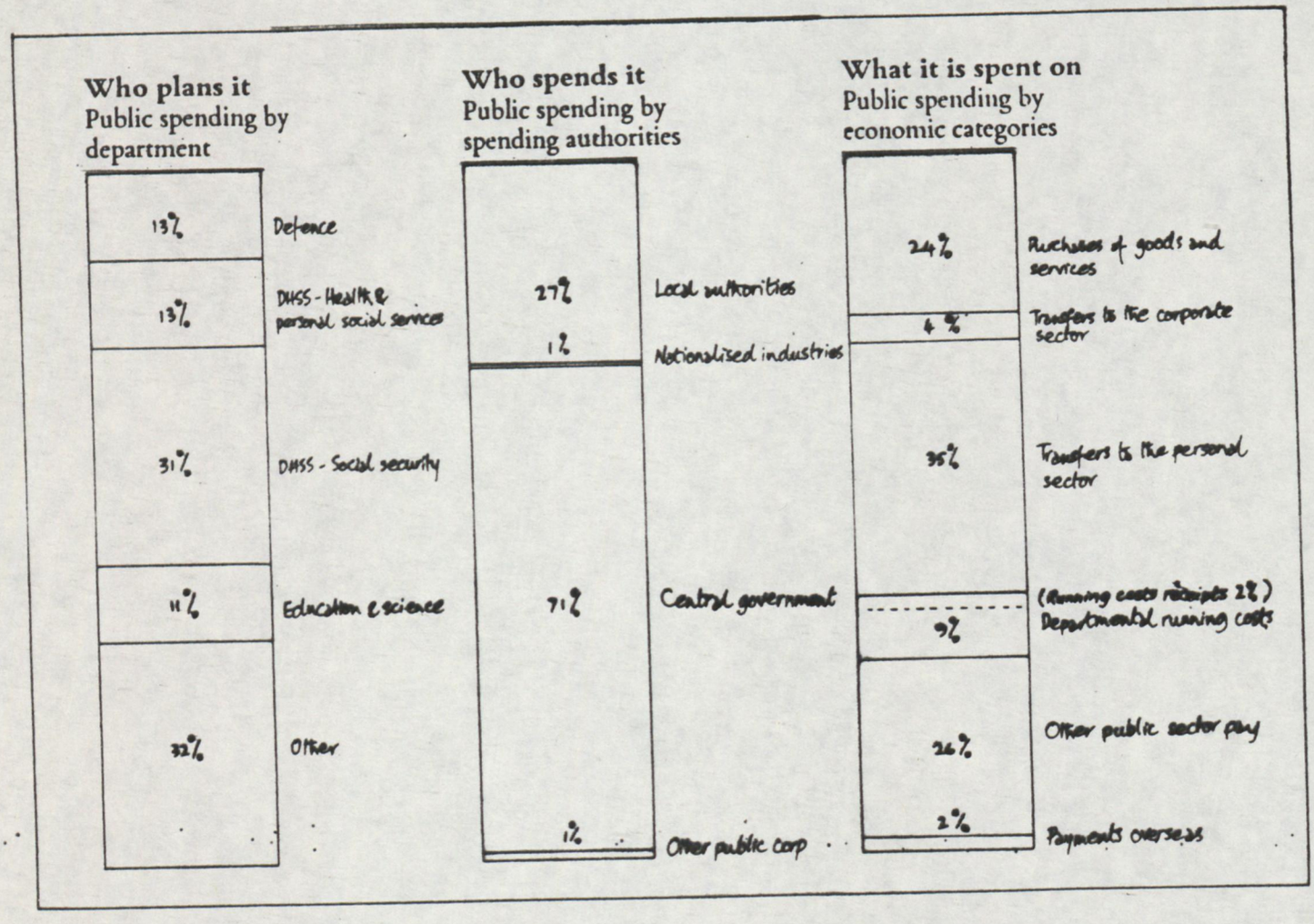
Public spending concepts

10. There are different ways of analysing total public spending, and different spending aggregates are relevant for different purposes. General government expenditure (the combined spending of central and local government including debt interest but excluding public corporations) is a comprehensive measure of public spending. It is useful for analysing overall trends in public spending, and in the formulation of macro-economic policy. Thus it is the measure used in determining the MTFS at Budget time. But for the purposes of the detailed public spending review, attention is focussed on the public expenditure planning total, which forms the basis for the control totals used each year(1).

11. Information on the planning total can be shown in a number of different ways. An analysis of public spending by departments, covering all expenditure policies for which each Secretary of State is responsible, provides an answer to the question "Who plans it?". A breakdown of how the money is spent by central government, local authorities and public corporations answers the question "Who spends it?". Similarly a breakdown by economic category answers the question "What is it spent on?"

These different approaches are illustrated in Chart 1.3 below.

Chart 1.3 Public spending analysed



(1) The main difference between general government expenditure and the planning total is general government gross debt interest, some £18 billion in 1986-87. Full details of the relationship between GGE and the planning total are given in Part 2 of this White Paper.

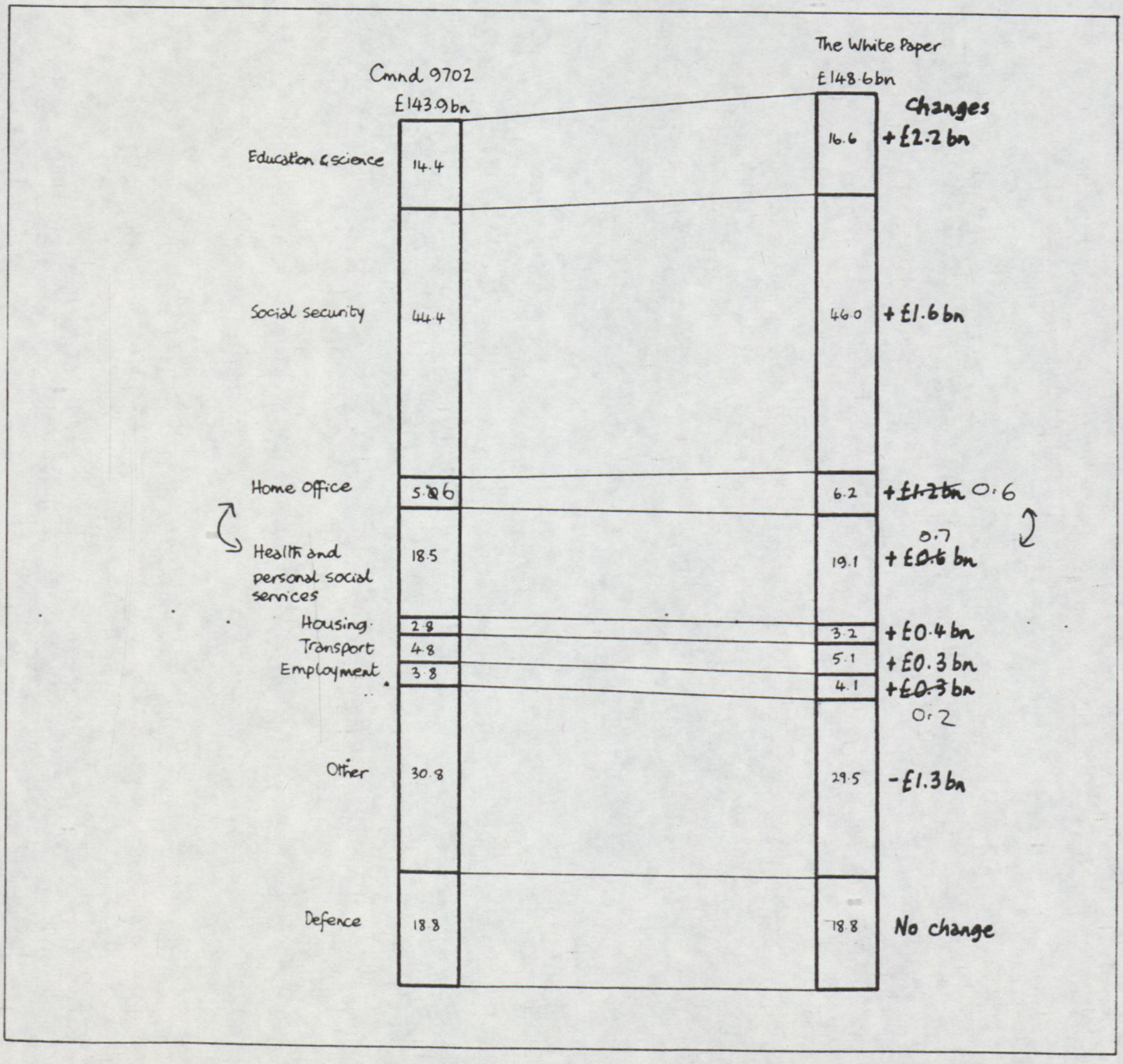
Who plans it - public spending by department

Priorities

12. The Government's review of the development of its spending priorities is carried out in the context of the annual Public Expenditure Survey.

13. Chart 1.4 below summarises the main adjustments to departmental spending plans for 1987-88. Substantial extra provision has been made available for education, health and law and order; and estimated costs of pensions and social security benefits have increased significantly. Extra provision of some £1 billion for capital spending is included in the revised plans for schools, housing and roads.

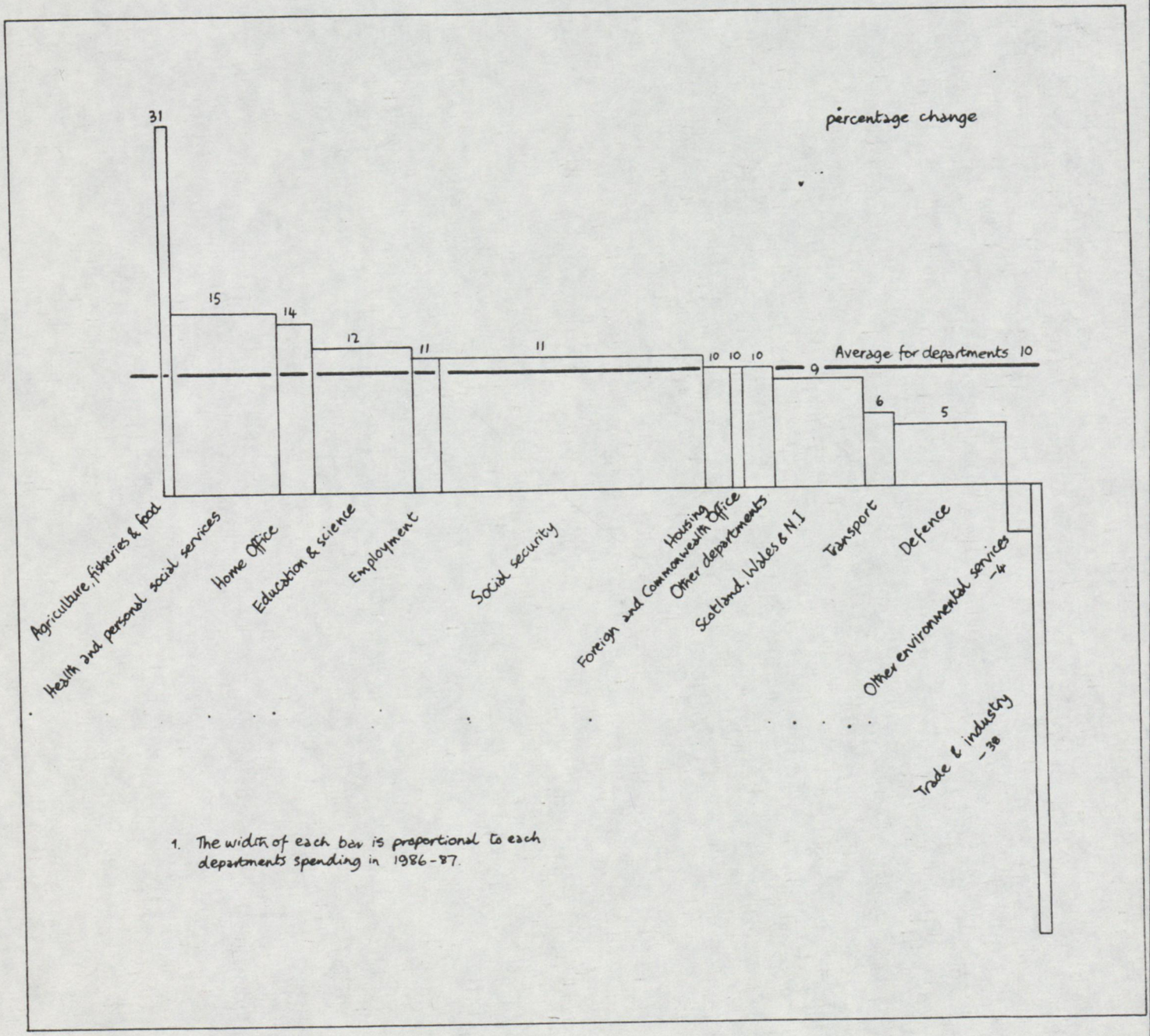
Chart 1.4 Changes in 1987-88 cash spending between 1986 and 1987 public expenditure White Papers



departmental

14. Chart 1.5 illustrates the percentage increases now planned for each of the main / programmes between 1986-87 and 1989-90. It shows how expenditure has been allocated; to the main priority areas including education, health, employment and the Home Office, and to cover higher estimated costs of social security payments and agricultural support.

Chart 1.5 Percentage change in cash provision for departments in between 1986-87 and 1989-90



1. The width of each bar is proportional to each departments spending in 1986-87.

15. But simply looking at increases in provision does not give a full picture of priorities or developments in spending. A number of other factors need to be taken into account, for example expected **outputs** (what, or how much, the money is expected to buy) and how spending is affected by changing levels of demand.

16. The following paragraphs set out the key features of the Government's plans in each of the main departmental budgets. They highlight the aims and objectives as well as the planned allocation of resources. Summary figures are given in Table 1.6 (page), which shows the cash plans by department, and Table 1.8 (page), which gives the implied trends in real terms. Chart 1.7 (page) illustrates the shares of the main departments in the 1987-88 planning total. Full detail on all departmental plans is given in the individual departmental chapters in Part 3 of this White Paper.

Defence

17. The Government's aims for defence are to ensure the security of the nation and maintain our freedom. Some £18.8 billion has been provided for 1987-88, rising to nearly £19.5 billion in 1989-90.

18. A wide range of measures is in hand to improve efficiency and value for money, particularly through increased competition in equipment procurement. In 1985-86 some 64 per cent of contracts by value were placed by competition or otherwise by reference to market forces, compared to 38 per cent in 1983-84 and 46 per cent in 1984-85.

19. Civilian manpower, taking account of the transfer of personnel to Royal Ordnance plc, has been reduced by about 80,000 since 1979, reflecting improvements in efficiency, a major rationalisation programme and the transfer of tasks to the private sector. Ten years ago there were 79 UK based civilians for every 100 personnel in the regular forces; five years ago there were 69 and the figure now stands at about 52. Further reductions are planned.

20. Although moving from a period of real growth in the defence budget inevitably brings with it some difficult decisions, the UK's defence capabilities will continue to benefit from major re-equipment programmes for all three Services. Major orders since 1979 have included 55 major ships, seven regiments of Challenger tanks and more than 500 aircraft for the Royal Air Force.

Foreign and Commonwealth Office (including the Overseas Development Administration)

21. The main aims of the **overseas aid** programme are to promote sustainable economic and social development and to alleviate poverty in developing countries, particularly

the poorest. Political and commercial considerations are also taken into account in allocating funds.

22. The gross aid programme for 1987-88 is £1308 million, and the revised plans will maintain the overseas aid programme at the same level in real terms as in 1986-87 during the rest of the planning period. About 60 per cent of the programme is spent on bilateral aid - around 70 per cent of which goes to the poorest 50 countries. The main focus is on long term development, but emergency relief is also provided where most needed. The remaining 40 per cent of the aid programme is provided as multilateral aid through channels such as the World Bank Group, the European Community and various United Nations Agencies.

23. The main aims of the **diplomatic wing** of the Foreign and Commonwealth office are to enhance the security and prosperity of the UK and dependent territories, and to promote and protect British interests overseas. £700 million is provided in 1987-88. This includes additional provision to combat the increasing threat to the security of the staff and property overseas of the Diplomatic Service and the British Council, and to offset some of the additional costs of the new visa requirements.

24. The overall demand for the FCO's commercial and consular services abroad has risen steadily in recent years and the trend is expected to continue. For example, the number of British business visitors using the FCO's services abroad rose by 18 per cent between 1980 and 1985, and the number of British nationals travelling abroad has increased by 300 per cent in the last 15 years, with a corresponding increase in public demand for advice and protection.

Agriculture

25. Spending on agriculture is intended to foster an efficient and competitive agricultural industry, taking account of the interests of producers, processors, traders and consumers. Total **domestic** spending is planned to stay broadly constant in cash terms, but since the last White Paper provision has been made for additional spending of some [redacted] to fund flood defence works.

26. The increased spending over the period of the plans is mainly accounted for by expected additional expenditure on market support under the European Community **Common Agricultural Policy** (CAP). The Government will continue to seek changes in the CAP to bring this spending under better control.

Table 1.6 Public spending in cash terms by department[1]

£ billion

	1984-85 outturn	1985-86 outturn	1986-87 estimated outturn	1987-88 plans	1988-89 plans	1989-90 plans
Defence	17.2	18.0	18.6	18.8	19.0	19.5
Foreign & Commonwealth Office[2]	1.8	1.8	2.0	2.1	2.1	2.2
European Community	1.0	0.8	1.1	0.9	0.4	1.1
Ministry of Agriculture, Fisheries and Food[3]	2.0	2.4	1.9	2.3	2.4	2.5
Trade and Industry[4]	2.1	1.8	1.6	1.3	1.1	1.0
Energy	2.6	0.7	0.2	-0.1		-0.2
Employment	3.1	3.4	3.9	4.0	4.2	4.3
Transport	4.6	4.6	4.9	5.1	5.1	5.1
DOE - Housing	3.3	2.8	2.8	3.2	3.0	3.1
DOE - Other enviromental services	4.0	3.9	4.1	3.8	3.9	3.9
Home Office[5]	5.1	5.3	5.9	6.2	6.4	6.6
Education and Science	14.0	14.5	16.0	16.6	17.4	17.8
Arts and Libraries	0.7	0.7	0.8	0.8	0.8	0.9
DHSS - Health and personal social services	15.8	16.6	18.0	19.1	19.9	20.8
DHSS - Social security	38.1	41.5	44.5	46.0	47.5	49.3
Scotland	7.0	7.2	7.8	8.0	8.1	8.2
Wales	2.6	2.8	3.0	3.2	3.3	3.4
Northern Ireland	4.1	4.3	4.7	4.9	5.1	5.2
Chancellor's Departments	1.7	1.8	2.1	2.2	2.3	2.4
Other Departments[6]	1.2	1.3	1.5	1.7	1.8	1.9
Reserve				3.5	5.5	7.5
Privatisation proceeds	-2.1	-2.7	-4.8	-5.0	-5.0	-5.0
Adjustments[7]			[-0.4]			
Planning total[8]	129.8	133.6	[140.4]	148.6	154.2	161.5
General government gross debt interest	16.1	17.7	17.5	18	18	19
Other National Accounts adjustments	4.3	7.2	6.5	7	7	8
General Government expenditure	150.1	158.6	[164.4]	173.7	179.6	187.8

1 Figures rounded to £0.1 billion, except for the forward year figures for general government gross debt interest and other National Accounts adjustments, which are round to the nearest £ billion. (In case of the total general government expenditure, rounding to £0.1 billion does not imply accuracy to this degree.) Includes all spending on departmental policies, whether through central government, local authorities or public corporations. More information is given in Part 2, Table 2.1.

2 including Overseas Development Administration.

3 including Intervention Board for Agriculture Produce and Forestry Commission.

4 including Exports Credit Guarantee Department.

5 including Lord Chancellor's Department.

6 including Property Services Agency and Civil Superannuation.

7 The 1986-87 estimated outturn figure includes external finance of -£400 million for nationalised industries to be privatised that year [and an allowance for shortfall].

8 Total have been rounded independently.

Trade and Industry (including Exports Credits Guarantee Department)

27. Spending is aimed mainly at encouraging and helping trade and industry to increase national production of wealth by competing successfully in the United Kingdom and abroad. Particular emphasis is given to carefully targetted industrial research and development and selective financial assistance intended to improve the technological and commercial competitiveness of UK companies. The estimated costs of interest support for fixed rate export finance have been reduced since the last White Paper.

28. Overall, provision falls over the period of the plans to £950 million in 1989-90. This decline reflects the increased ability of the nationalised industries sponsored by the Department to meet their financing requirements from within their own resources.

Energy

29. The Government wishes to see the best economic use made of the nation's energy resources. This is pursued through the Department's spending on research and development, and schemes to promote energy efficiency.

30. The trend in the Department's total spending is dominated by the finances of the nationalised energy industries. Increased external financing limits for these industries, particularly in 1987-88, take account of reduced market prices for energy following the fall in oil prices, and higher investment in British Coal and the Electricity Supply Industry. The cost of payments for miners' redundancies in 1987-88 and 1988-89 is expected to fall compared with the last White Paper, partly as a result of bringing forward of payments into 1986-87.

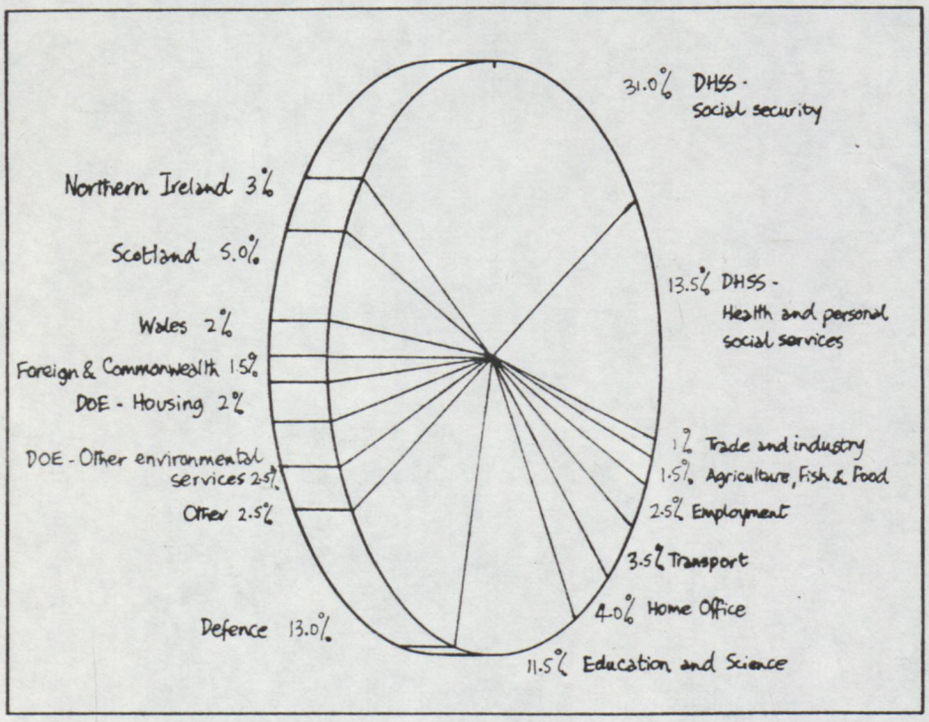
Employment

31. The main aims are to promote enterprise and job creation, to assist unemployed people, to promote training, to help the labour market work more efficiently and to improve health and safety at work and industrial relations.

32. Major new enterprise and employment measures were announced in the 1986 Budget and these are now reflected in departmental plans. Extra spending since then on central government programmes (notably the Technical and Vocational Education Initiative, on an increase in the number of Job Clubs, and higher payments from the Redundancy Fund) has been offset by savings elsewhere in the programme.

33. Promoting enterprise and job creation is a priority area; for instance, numbers helped through the Enterprise Allowance Scheme are planned to rise from around 60,000 in 1985-86 to 100,000 by 1987-88. Increases in efficiency have been achieved in many areas and more are planned. For example, placings per staff unit in jobcentres are forecast to rise from 286 in 1985-86 to 320 in 1989-90. The employment resettlement rate achieved by the employment rehabilitation service has risen from 32 per cent in 1983-84 to 44 per cent in 1986-87, and is forecast to rise further; meanwhile costs per client week will have been reduced from £183 in 1984-85 to £170 in 1986-87 and £166 by 1988-89. The unemployment benefit service's staff: claimant ratio is forecast to improve from 1:122 in 1986-87 to 1:131 in 1989-90.

Chart 1.7 Planning total by department in 1987-88



Transport

34. The Department seeks to increase efficiency and reduce unit costs of transport, for example, by maintaining and improving a national road system; to promote and improve safety; to conserve the environment; and to advance United Kingdom transport interests abroad.

35. The Departments spending is increasingly focussed on the infrastructure, rather than on current subsidies. Compared with this year, provision for capital spending

on national roads will be increased by about 13 per cent by 1989-90. Among other forward targets the department plans to complete motorway and trunk road schemes totalling around 450 miles, to renew 80 miles of motorway each year, and it expects local authorities to complete 105 major local roads schemes in 1987-88. Provision for support to British Rail falls over the period of the plans.

DOE - Housing

36. The main aim of Government policy is to give people a better choice of housing by encouraging the spread of home ownership for those who want it and providing a wider variety of rented housing for those who do not want it or cannot afford it. Well over 1 million public sector dwellings in Great Britain have been sold to their tenants since 1979, mainly through the Government's right to buy legislation.

37. Most expenditure on housing comes from the private sector. Nevertheless gross capital public expenditure is estimated at £3.4 billion in 1986-87, and is planned to rise to £3.7 billion in 1987-88. Nearly £3 billion of this will be spent by local authorities, and the rest by the Housing Corporation and new towns. The increased provision in 1987-88 will allow greater local authority investment mainly on renovation of their own stock, including £75 million of targetted capital allocations to be made through Estate Action (formerly the Urban Housing Renewal Unit). It will also allow £20 million to be spent by the Housing Corporation on pilot housing association schemes primarily financed by the private sector. These schemes, which will provide some £65 million worth of additional investment, will be aimed at helping homeless families and young job movers.

DOE - Other Environmental Services

38. Spending under this programme, which covers a wide range of environmental, economic and recreational services, is diverse in its subject matter and objectives. Most is undertaken by local authorities according to local priorities. More directly the Government also spends through sponsored bodies and its own programmes. It aims to target public money on areas of greatest need, and where it most encourages private sector funding.

39. The Government attaches high priority to tackling inner city problems. For example, the Urban Programme in 1986-87 is expected to create or preserve 23,450 jobs, and derelict land grant should lead to the reclamation of 1,300 hectares of derelict land. Provision for urban spending is being increased by £40 million in 1987/8 to £230 million, and is planned to be maintained at this level in 1988-89 and 1989-90. 4 new urban development corporations (in Greater Manchester, Teeside,

the Black Country and Tyne and Wear), will be set up to build on the success in the London Docklands and Merseyside in regenerating urban areas with particularly concentrated problems of dereliction and unemployment.

40. Resources for wildlife, countryside and heritage programmes are also being increased to meet specific objectives - protection of natural habitats through Wildlife and Countryside Acts, improved access to the countryside and provision of repair grants for historic buildings.

Home Office and Lord Chancellor's Department

41. The main aims of the criminal justice system are to prevent and detect crime, administer the courts effectively, deal adequately and sensibly with the guilty, and give proper effect to the sentences imposed on them.

42. The number of notifiable offences cleared up by the police rose by 22 per cent between 1980 and 1985; total police strength (including civilians) rose by just under 3 per cent between 1980-81 and 1984-85. For 1987-88, there is provision for total police strength to rise to 169,464 compared with an average of 166,752 in 1986-87.

43. The Government's policy is that resources provided for court services should broadly keep pace with changes in the courts' business, with due allowance being made for improvements in efficiency. In 1985, 2.1 million defendants were proceeded against in Magistrates Courts and some 99,000 cases were committed for trial to the Crown Court.

44. The prison population is expected to average 46,700 in 1986-87, and to rise to 50,700 in 1989-90. Manpower costs account for about 60 per cent of prison service expenditure. The Government has published proposals for far reaching reforms of shift and complementing systems, and has put them to the unions and staff associations involved together with an offer on revised pay arrangements. The new working methods proposed should enable prison manpower to be used more efficiently.

Education and Science

45. The Government's main aims for education are to raise standards at all levels of ability and to secure the best possible return from the resources which are invested in the education service. The Government's aim for science is to maintain and enhance the strength and quality of the science base. Total spending of £16.6 billion is now planned in 1987-88, most of it by local authorities.

Table 1.8 Public spending in real terms by department[1]

	1984-85 outturn	1985-86 outturn	1986-87 estimated outturn	1987-88 plans	1988-89 plans	1989-90 plans
					£ billion (base year 1985-86)	
Defence	18.2	18.0	18.1	17.6	17.2	17.1
Foreign & Commonwealth Office	1.9	1.8	1.9	1.9	1.9	1.9
European Community	1.0	0.8	1.1	0.8	0.4	0.9
Ministry of Agriculture, Fisheries and Food	2.1	2.4	1.9	2.1	2.2	2.2
Trade and Industry	2.2	1.8	1.6	1.2	1.0	0.9
Energy	2.7	0.7	0.2	-0.1	–	-0.2
Employment	3.3	3.4	3.8	3.8	3.8	3.8
Transport	4.9	4.6	4.8	4.8	4.6	4.5
DOE - Housing	3.4	2.8	2.7	3.0	2.7	2.7
DOE - Other enviromental services	4.2	3.9	4.0	3.6	3.5	3.5
Home Office	5.4	5.3	5.7	5.8	5.8	5.8
Education and Science	14.8	14.5	15.5	15.6	15.7	15.7
Arts and Libraries	0.7	0.7	0.8	0.8	0.8	0.8
DHSS - Health and personal social security	16.7	16.6	17.5	17.9	18.0	18.3
DHSS - Social security	40.4	41.5	43.2	43.1	43.0	43.4
Scotland	7.5	7.2	7.6	7.5	7.3	7.2
Wales	2.8	2.8	2.9	3.0	3.0	3.0
Northern Ireland	4.3	4.3	4.5	4.6	4.6	4.6
Chancellor's Department	1.8	1.8	2.0	2.1	2.1	2.1
Other Departments	1.2	1.3	1.5	1.6	1.7	1.7
Reserve				3.3	5.0	6.6
Privatisation proceeds	-2.3	-2.7	-4.6	-4.7	-4.5	-4.4
Adjustments			[-0.3]			
Planning total	137.6	133.6	[136.5]	139.3	139.7	142.1
General Governments gross debt interest	17.0	17.7	17.0	17	16	16
Other national accounts adjustments	4.5	7.2	6.5	6	7	7
General Government expenditure	159.1	158.6	[159.9]	162.8	162.7	165.2

1 Cash figures adjusted for general inflation. Footnotes to Table 1.6 also apply except that the detailed figures are given in Part 2.

46. Three quarters of school leavers achieved 5 or more graded GCE or CSE results in 1984-85, an increase of over 50 per cent more than ten years previously. Increased provision for schools capital expenditure, taken together with their increased spending power from receipts, will enable local authorities to maintain progress with removing surplus places while providing new places where necessary. The very substantial increase in teachers' pay provisionally included in these plans would represent a further substantial investment in better schools. The new City Technology Colleges will widen choices in inner cities and provide models for effective teaching. In higher education extra funding has been provided for the universities as part of an agreed programme including selectivity in research funding, rationalisation, better financial management, and improved standards of teaching. The number of students obtaining first degrees is forecast to be around 125,000 in 1990, an increase of some 20 per cent over the preceding decade.

DHSS - Health and Personal Social Services

47. The aim of the National Health Service is to make the best use of resources to help people stay healthy, and to give them effective treatment and care where necessary. In England, spending will increase by almost £1 billion next year, an increase of 2.5 per cent in real terms, continuing the trend in previous years. Total spending will rise from £17.9 billion in 1986-87 to over £20.7 billion by 1989-90.

48. Specific targets for service improvements have been set, for example for hip replacement and cataract operations, coronary artery by-pass operations and bone marrow transplants. Other current problems such as drug misuse and AIDS are being tackled. A full series of performance indicators is being developed to enable managers to make informed judgements about the use of the NHS resources they control.

49. The total plans for hospital spending include £80 million over two years earmarked for two key areas; £50 million for specific measures to tackle waiting lists and waiting times, and £30 million to allow for the continued improvement of services in areas where the population is growing while protecting services in the inner cities.

50. Health authorities will keep the benefit of cash released through their cost improvement programmes. These are expected to yield a further £150 million in 1986-87 on top of the £390 million cumulative savings achieved in the years prior to that.

51. Primary health care, given by family doctors, dentists, pharmacists and opticians, will also expand. The plans allow for forecast demand to be met in full,

meeting the various pressures on these services from demographic and social changes, and from medical advances.

52. The provision for personal social services takes full account of demographic and other pressures. Planned expenditure in 1987-88 also allows for faster progress on the shift to community care.

Social Security

53. The aim of the social security system is, within the Government's wider social and economic policies, primarily to provide for retirement pensioners and to give an efficient and responsive system of financial help to others who need it. Provision has been raised in the light of higher levels of spending identified this year and reflects the latest estimates of benefit expenditure over the next three years. Spending in 1987-88 is now planned to be £46 billion, rising to £49.3 billion in 1989-90.

54. About half (over £23 billion) of the budget will be paid to elderly people. Since the Government came to office the number of people receiving pensions has increased by 12 per cent. Benefits paid to the sick and disabled have increased by [30] per cent in real terms over the same period.

The Reserve

55. The Reserves are intended to provide a margin to meet contingencies including estimating changes.

56. The Reserve for 1987-88 has been set at £3½ billion. The Reserves for 1988-89 and 1989-90 are £5½ billion and £7½ billion respectively. These Reserves are larger, both absolutely and as a percentage of the planning total, than in any White Paper except last year's, where the unusual treatment of local authorities' spending required exceptionally high Reserves (see paragraph 69). Substantial additions to departmental provision have been made in the latest spending review for spending by local authorities and on social security, the two main areas where spending has exceeded plans in 1986-87.

Privatisation

57. The privatisation programme is moving forward strongly. It is increasing efficiency, by competition and other means, and widening share ownership.

58. Privatisation allows more incentives for management and employees, many of whom have become shareholders in their companies. The improved performance of

privatised businesses benefits consumers, employees and the economy as a whole. Following the sale of the British Gas Corporation the proportion of GDP accounted for by state owned businesses has fallen by nearly one third since 1979, from 11% to 7½%. In total the number of individual shareholders in the UK has doubled since 1979.

59. Proceeds from privatisation are, in line with international conventions, netted off the public spending figures. The estimates of receipts in 1987-88 and 1988-89 have been increased by £250 million in each year, compared with the last White Paper, to £5 billion. Receipts in 1989-90 are also expected to be £5 billion.

The planning total and general government expenditure

60. Differences between the planning total and general government expenditure and shown at the bottom of table 1.6 (page). Further details are given in Part 2. The main item is general government gross debt interest payments, which are forecast to be about £18 billion in 1987-88 and 1988-89 and £19 billion in 1989-90.

Main changes in the plans

61. Table 1.9 gives figures for changes in the aggregate planning totals between successive sets of plans. It shows, for each year since 1981-82, how the latest planning totals and outturns compare with the plans when they were first set. Table 1.10 gives equivalent comparisons for general government expenditure as a percentage of GDP.

Table 1.9 Public expenditure[1] plans and outturns

£ billion

	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-9
March 1981 White Paper (Cmnd 8175)[2][3]	104.4	109.9	113.6						
March 1982 White Paper (Cmnd 8494)[3]	105.7	114.7	120.7	127.7			Plans		
Feb 1983 White Paper (Cmnd 8789)	104.6	113.1	119.6	126.5	132.3		outturns and estimated outturns		
Feb 1984 White Paper (Cmnd 9143)	104.7	113.4	120.4	126.5	132.1	136.8			
Jan 1985 White Paper (Cmnd 9428)	104.6	113.5	120.3	128.2	132.1	136.8	141.6		
Jan 1986 White Paper (Cmnd 9702)[3]	103.9	113.4	120.3	129.6	134.2	139.1	143.9	148.7	
This White Paper	104.0	113.5	120.3	129.8	133.6	[140.4]	148.6	154.2	161.5

(1) Public expenditure planning total as defined in this White Paper

(2) Converted into cash as explained on page 103 of Cmnd 8494 Volume 2

(3) Including changes announced in the Budgets Statements preceding the years in question

Table 1.10 General Government expenditure as a percentage of GDP, plans and outturns

per cent

	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89 plans outturn & estimated outturns	1989-90
March 1984 FSBR	45¾	44½	43½	42½			
March 1985 FSBR	45¾	45¾	45	43½	42¼		
January 1986 White Paper	45¾	45¾	44¾	42¾	41¾	41	
This White Paper	45¾	45½	44	43¼	42¾	41¾	41¼

Where it goes

62. Chart 1.11 gives an analysis of total United Kingdom spending by function. The main difference from the departmental analyses, for example in charts 1.4 and 1.5, is that spending in Scotland, Wales and Northern Ireland is included in the same functional groups as spending in England. The chart shows the trends in the proportions of programme spending (that is, excluding the Reserve and privatisation proceeds) going to different types of spending since the Government came to office.

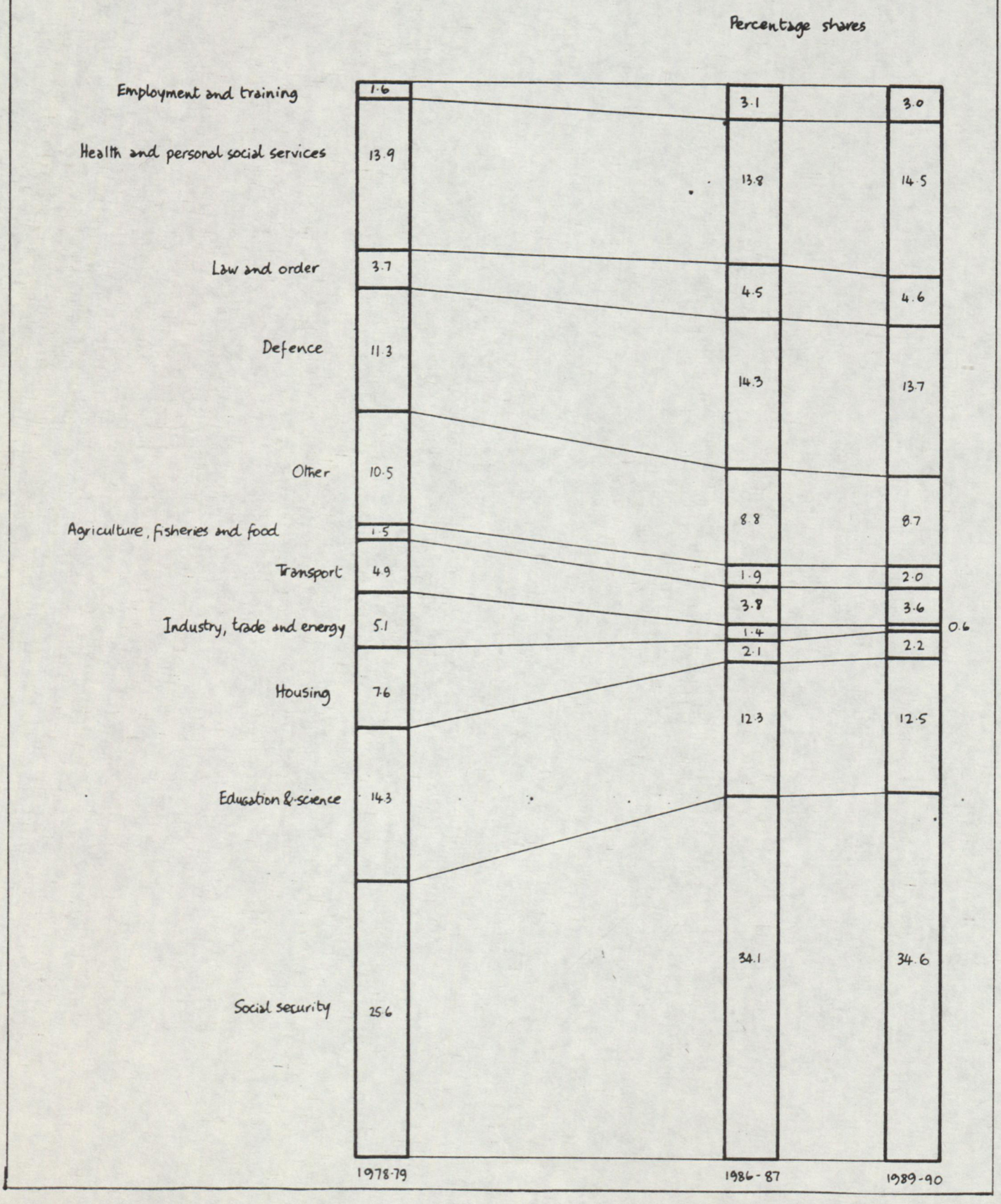
63. The Government has steadily increased the priority given to health and personal social services. Its share of the total increased from [ ] in 1978-79 to[ ] in 1986-87. It is planned to rise further to [ ] per cent by 1989-90. Priority has also been given to spending on law and order - increased from 3½ per cent in 1978--79 to [4½] per cent in 1986-87; this percentage is maintained over the rest of the period of the plans. The percentage share of the total taken by spending on employment and training is planned to double between 1978-79 and 1989-90, from 1 % to 3 %.

64. The fall in the education and science share between 1978-79 and 1986-87 reflects the fall in the size of school rolls, but spending per pupil rose by [ ] per cent in real terms over the same period [redacted]
Some increase in the share is now planned over the next three years. Defence spending was increased from 11 per cent in 1978-79 to nearly 14½ per cent in 1986-87; a slight fall in the percentage is now planned as the benefits from past increases continue to be felt and the programme of efficiency improvements continues to grow.

65. Spending on social security (including pensions) has risen from 26 per cent of the total in 1978-79 to 34 per cent in 1986-87, reflecting increasing numbers of beneficiaries and some real increase in the level of payments. A further increase of [½] per cent is expected by 1989-90.

66. In other areas, the Government has reduced the extent of public sector involvement in providing services. Gross spending on public sector housing, and subsidies to trade, industry and energy, have been reduced substantially as a share of total spending. This is a reflection of Government policies for the private sector to provide a greater share of housing needs, and for support to both private and public sector industry to be reduced as profitability improves.

Chart 1.11 Public Spending by Function



Who spends it - public spending by spending authority

67. Central government is responsible for spending about three quarters of the planning total, with local authorities spending most of the rest. The remainder is the net amount that nationalised industries and other public corporations need to finance their activities. The figures are set out in table 1.12 below.

Table 1.12 Planning total by spending authority[1]

£ billio

	1984-85 outturn	1985-86 outturn	1986-87 estimated outturn	1987-88 plans	1988-89 plans	1989-9 plans
Central government[2]						
Voted in Estimates	66.3	71.3	74.4	76.3	78.7	81.1
other	25.8	27.1	30.4	32.0	32.5	34.6
Total Central Government	92.1	98.5	104.8	108.3	111.2	115.7
Local authorities[2]						
relevant current	26.0	26.9	29.6	31.0	32.2	33.1
other current	4.2	4.5	4.8	4.9	4.9	5.2
capital	4.7	3.9	4.2	4.3	4.0	4.1
Total Local Authorities	34.9	35.2	38.7	40.2	41.1	42.4
Nationalised industries	3.8	1.7	1.0	0.7	0.3	-0.1
Other public corporations	1.1	0.9	0.8	1.0	1.0	1.1
Reserve				3.5	5.5	7.5
Privatisation proceeds	-2.1	-2.7	-4.8	-5.0	-5.0	-5.0
Adjustments[3]			[ ]			
Planning total	129.8	133.6	[140.4]	148.6	154.2	161.5

1 Detailed figures are provided in Part 2, Table 2.6.

2 Central and local government finance for public corporations is included in the nationalised industries and other public corporations lines.

3 The 1986-87 estimated outturn figure includes external finance of -£400 million fo nationalised industries to be privatised that year [and an allowance for shortfall].

Central Government

68. About 70 per cent of central government spending within the planning total is voted by Parliament through the annual Supply Estimates. The rest consists mainly of those social security payments which are paid out of the National Insurance Fund.

69. In total about 40 per cent of central government spending goes on social security. The two other largest components are defence and health.

Local authorities

70. Spending by local authorities accounts for about a quarter of public spending. Education spending is over 40 per cent of the local authority total, with most of the rest spent on law and order, housing and other environmental services, personal social services and transport expenditure. Detailed material on local authority spending and how it is financed is given in part 4 of this White Paper.

-Current spending

71. Local authorities' current spending has continued to exceed the Government's plans, by an estimated £2.7 billion in 1986-87. This has led to calls on the Reserve and added to burdens on rate-payers.

72. No decision was taken last year on provision for 1987-88 and 1988-89 and the figures in Cmnd 9702 were set at the same cash levels as for 1986-87. This was taken into account in setting the level of the Reserves for those two years. Including provision for teachers pay, the plans now allow for annual increases of 4½ per cent, 4 per cent and 2¾ per cent respectively over the estimated outturn for 1986-87.

73. Aggregate Exchequer Grant to local authorities for 1987-88 has been set at £16.4 billion, £1.4 billion more than for 1986-87. A range of measures should constrain spending and protect rate-payers. 20 English local authorities will be subject to rate-capping. In addition, automatic precept control for the 20 authorities set up for fire, police and transport in the metropolitan areas, and for fire and education in the London area, continues. In England and Wales the Government also proposes to abolish grant recycling, the process whereby grant not claimed by high spending authorities is redistributed. This will give authorities greater certainty about their grant entitlements and provide a tougher regime for high spenders. In Scotland, guidelines and grant penalties for exceeding them will continue and the Government will again take action to reduce the rates of any authorities planning excessive and unreasonable expenditure.

74. The Audit Commission has estimated that efficiency gains of approaching £2 billion are possible in local authorities in England and Wales. Value for money studies are also under way in Scotland. The Government continues to look to authorities to improve their efficiency and economy in delivering services and is introducing legislation to expose a wider range of their services to competition to secure better value for money.

- Capital expenditure

75. Local authority gross capital spending in Great Britain in 1986-87 is forecast to be £6.5 billion. After allowing for capital receipts, particularly from sales of council housing, net spending is forecast to be £4.1 billion, £0.5 billion higher than provided for in the last White Paper. These figures remain subject to some uncertainty.

76. Gross provision in 1987-88 has been increased by £0.7 billion to £6.6 billion. Provision of £6.4 billion and £6.5 billion has been made for 1988-89 and 1989-90 respectively. Within this provision the amount which is issued as allocations (permissions to spend) will take account of the expected use by local authorities of the spending power also available to them from other sources, notably capital receipts. The relationship between provision and allocations and the use of receipts are discussed in Part 4 of the White Paper.

Nationalised Industries

77. The planning total includes nationalised industries' external finance - their borrowing and leasing - plus grants from the Government. Detailed information is given in Part 5 of this White Paper.

78. External finance in 1987-88 and 1988-89 is planned to be £680 million and £350 million more, respectively, than provided for in Cmnd 9702. These increases mainly reflect reduced market prices for energy supplies following the fall in oil prices, (this particularly affects British Coal), and higher planned investment.

79. A progressive reduction in the external financing requirements of the nationalised industries from the level in 1987-88 is expected in 1988-89 and 1989-90.

80. The Government will continue to set demanding objectives for industries which improve on achievements to date. The British Steel Corporation's productivity has risen by nearly 80 per cent since 1979. The Post Office's unit costs have fallen by nearly 10 per cent in real terms since 1981-82. British Coal's productivity is now 50 per cent higher than before the miner's strike.

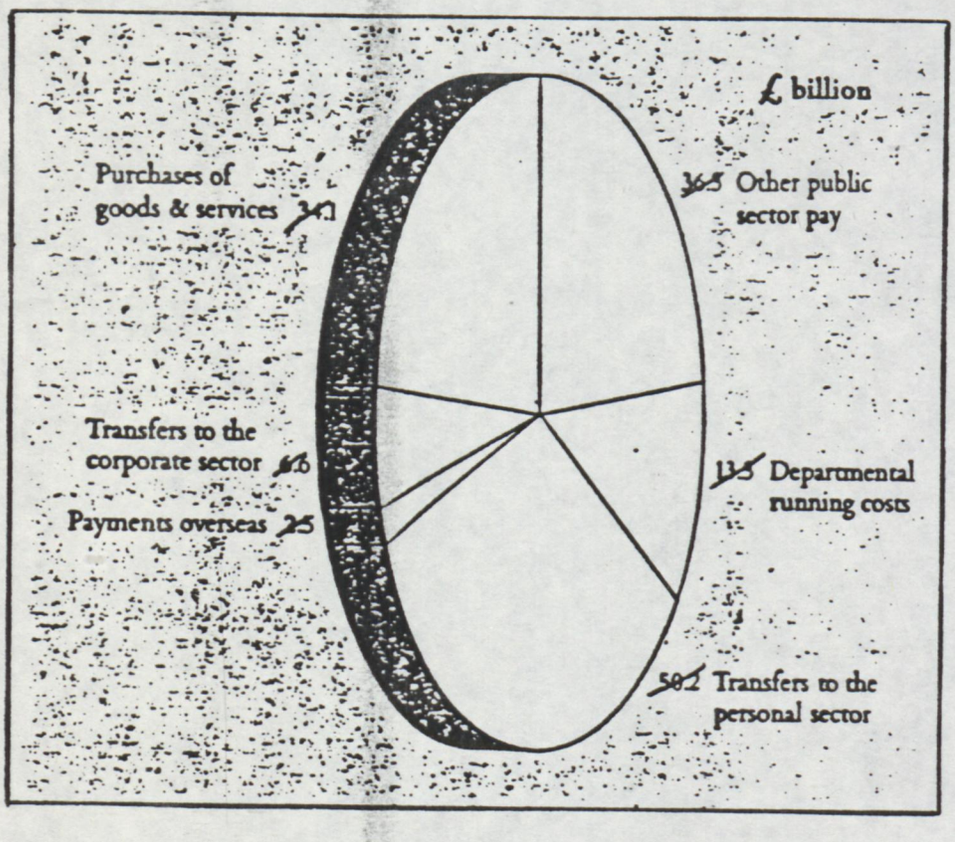
What it is spent on - public spending by economic category

81. Chart 1.13 below shows the main economic categories, and their share of the planning total in 1987-88. Some [ ] billion ([ ] per cent) will take the form

of cash payments to the personal sector - mainly pensions and other social security benefits. Departmental running costs amount to [ ] billion ([ ] per cent). Transfers to the corporate sector include capital grants to private sector companies, nationalised industries and List I and II public corporations, lending to nationalised industries and List I and II public corporations, and subsidies to trading bodies. Other purchases of goods and services from the private sector and other public sector pay both account for around a quarter of the planning total.

82. As last year, no general assumption has been made about the rate at which rates of pay and allowance will increase in 1987-88, though the Government wishes to see the development of greater flexibility eg in the linking of pay to performance and in relating pay in different areas more closely to local labour market conditions. But if pay increases overall are unrealistically high, there will be less money available for other purposes, and services, investment and employment will be the less.

Chart 1.13 Planning total by economic category in 1987-88



83. The mix between these forms of spending varies greatly between different departmental areas. Volume II of this White Paper includes tables showing the broad economic categories of spending by each department.

Capital spending

84. Details of public sector capital spending by department are given in Table 1.14. Around £1 billion has been added to gross capital spending in 1987-88 and around £800 million in 1988-89 in the latest spending review, £0.7 billion and £0.5 billion respectively of which is for local authorities. The largest single increase in gross provision is for housing, which has increased by £450 million in 1987-88 and £350 million in 1988-89.

85. Total general government capital spending is expected to remain broadly stable over the period of the plans, at about £15 billion a year. Total public sector capital spending - including spending by the nationalised industries and capital grants to the private sector - is expected to be at or above £22 billion in each year of the plans.

86. These figures exclude most repair and maintenance spending and do not therefore measure the total flow of work from the public sector to the construction and capital goods industries. The problems of drawing the dividing line between capital and current spending, and details of the coverage of table 1.14 are discussed in Part 2 of this White Paper.

Table 1.14 Public sector capital spending by department

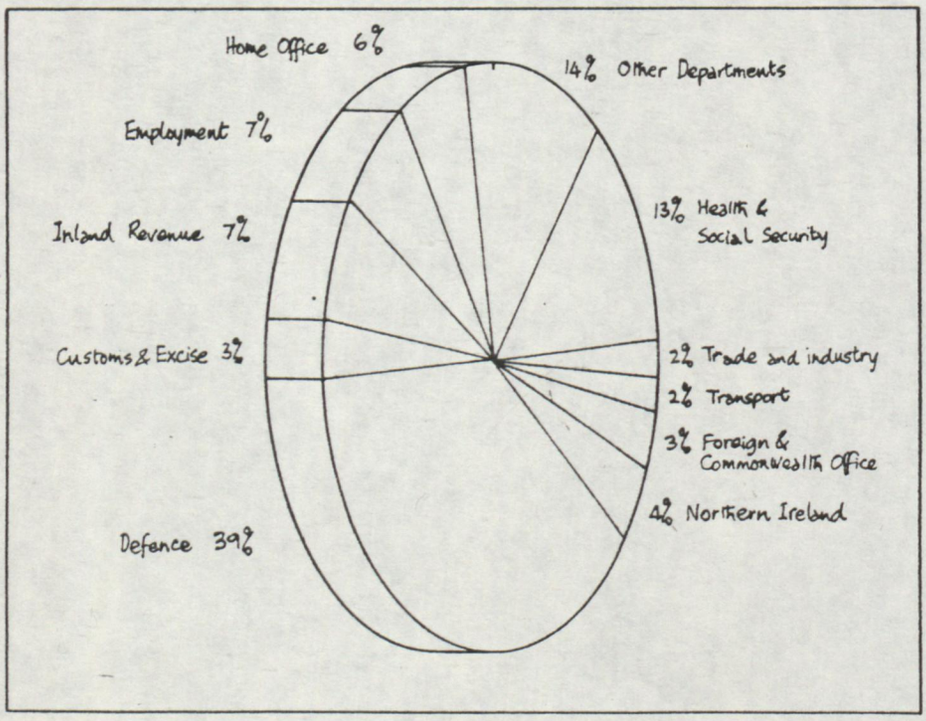
Department	1984-85 outturn	1985-86 outturn	1986-87 estimated outturn	1987-88 plans	1988-89 plans	£ billion 1989-90 plans
Ministry of Defence	5.4	5.7	5.9	5.8	5.7	5.8
Trade and Industry	1.0	0.8	0.8	0.6	0.6	0.6
Energy	1.7	1.9	1.9	1.9	2.0	2.1
Transport	1.9	1.9	1.9	2.1	2.3	2.3
DOE - Housing	3.8	3.2	3.1	3.4	3.1	3.2
DOE - Other Enviromental Services	2.0	2.0	2.2	2.0	2.0	2.1
Home Office	0.4	0.5	0.5	0.6	0.6	0.6
Education and Science	0.7	0.8	0.9	0.7	0.7	0.7
DHSS - Health and personal social services	0.9	1.0	1.1	1.0	1.1	1.1
Scotland	2.0	2.0	2.1	1.9	1.9	1.9
Wales	0.6	0.6	0.7	0.7	0.7	0.7
Northern Ireland	0.6	0.6	0.7	0.7	0.6	0.6
Other	0.6	0.6	0.7	0.7	0.7	0.6
Total Public Sector Capital Spending	21.7	21.6	22.6	22.0	22.0	22.4
of which:						
General government	14.3	14.3	15.0	14.8	14.7	15.0
Public Corporation	4.2	4.6	4.7	4.6	4.8	5.0
Capital grants to the private sector	3.2	2.7	2.9	2.7	2.5	2.5
Real terms (base year 1985-86)	23.0	21.6	21.9	20.7	19.9	19.7

The figures for 1987-88, 1988-89 and 1989-90 make no allowance for allocations to capital spending from the Reserve.

Running Costs and Manpower

Civil Service Running Costs

Chart 1.15 Running costs by department in 1987-88



87. The main element of department's running costs is the pay bill (about two-thirds of the total) but they also cover accommodation, personnel overheads and office services. The use of a running costs control total for all three forward years, which was introduced last year, will help to improve financial management in departments and also reflect the Government's determination to exert a downward pressure on administrative costs.

Civil Service running costs

88. Running costs provision for 1987-88 is some £[13] billion. Chart 1.15 gives a broad departmental breakdown of the main running costs targets in 1987-88. Table 2.13 in Part 2 of this White Paper gives details of the departmental plans for 1987-88 compared with the outturn for 1985-86 and the estimated outturn for 1985-86 and the estimated outturn for 1986-87. This shows that running costs increased by [ ] per cent between 1985-86 and 1986-87 and are expected to increase to by a further 3.7 per cent in 1987-88. Limits on departmental running costs will be set when 1987-88 Supply Estimates are presented to Parliament.

Public sector manpower

89. Chart 1.16 shows public sector manpower by employing authority in April 1986, with a separate breakdown of Civil Service manpower. Of the total of 5,578,000 42 per cent is accounted for by local authorities; 20 per cent by public corporations; 18 per cent by the National Health Service; [11] per cent by the Civil Service; and 6 per cent by the Armed Forces.

Civil Service manpower

90. The Government has not announced manpower targets beyond 1.4.88. The 1.4.88 target of [591,500] represents a fall of [140,800] since April 1979. Departments' manpower plans for the later years show a further fall to 1.4.89 [585,000] with a slight rise to [585,800] by 1.4.90. The Government will review the need for continuing separate manpower targets beyond 1.4.88 in the light of experience of the new running costs control arrangements.

91. Within the plans extra resources have been allocated to DHSS local offices; employment measures; the prevention of drug trafficking; revenue collection and for the Crown Prosecution Service. Table 2.14 in Part 2 of this White Paper gives manpower figures for each department, together with manpower data for other parts of the public sector.

Armed Forces

92. For the armed forces, manpower (including locally engaged personnel) is expected to fall from 332,600 in April 1986 to 329,700 in April 1988. Improved procedures

have been introduced to set the minimum levels of service and manpower needed to support the defence programme.

National Health Service

93. By [March 1986] the number of NHS employees in Great Britain was [983,000], [7] per cent above the 1978-79 level. There are now more front-line staff in the NHS than ever before - 12,000 more doctors and dentists, 20,000 more professional and technical staff and 63,000 more nurses and midwives in the NHS at the end of March 1986 than at the end of 1978.

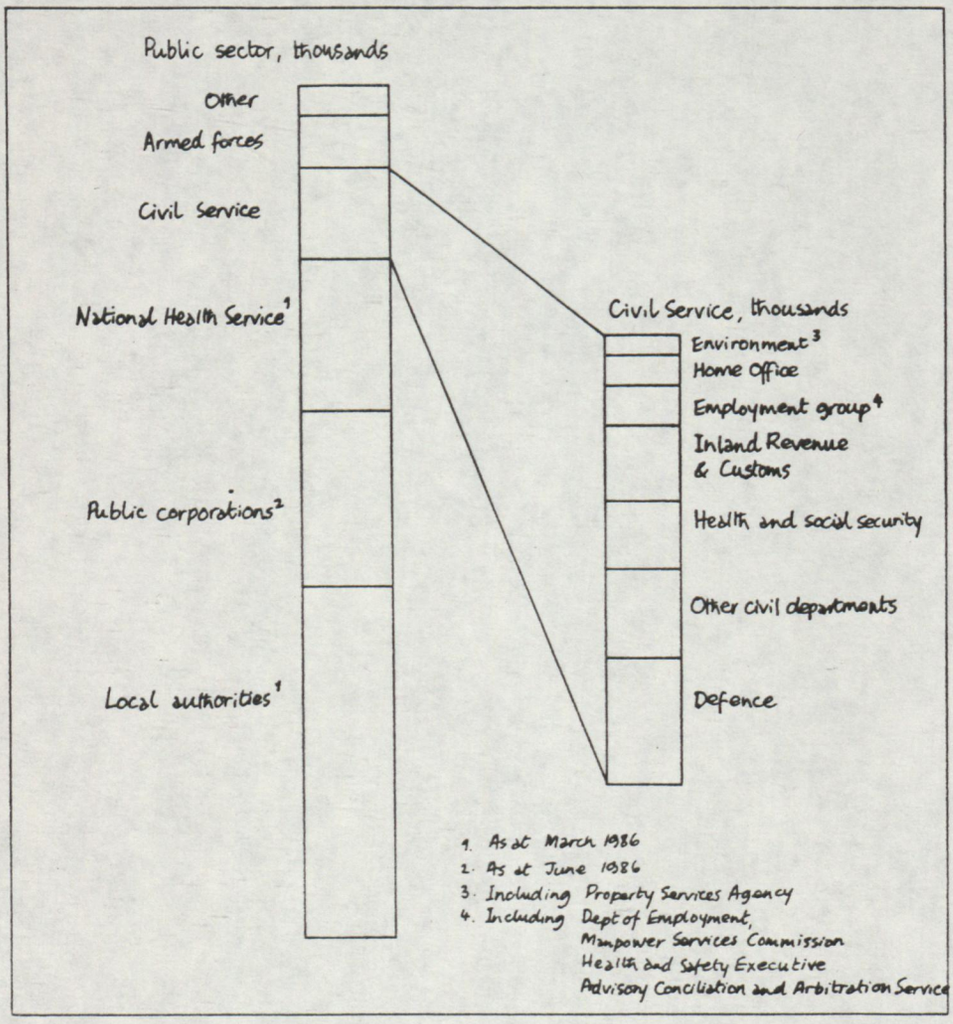
Public Corporations

94. By June 1986, manpower numbers of public corporations had fallen to 1,130,000, a reduction of 44 per cent on the 1978-79 level; this mainly reflects the effects of privatisation (eg British Telecom, National Freight Corporation) and increased productivity.

Local authorities

95. Manpower accounts for about three quarters of local authorities' relevant current expenditure. By March 1986 local authorities manpower at 2,337,000 was marginally above the level in 1978-79 with reductions achieved between 1979 and 1982 offset in recent years as more staff have been allocated to the community programme. Increased resources have been provided for law and order, in line with the Government's priorities in this area while numbers in education have fallen, reflecting reductions in school rolls. Reports by the Audit Commission have demonstrated the importance of better use of manpower in securing value for money improvements.

Chart 1.16 Public Sector Manpower in 1986



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pa Autumn Statement 1986.

Table 1: Changes to Planning Total

		1987-88	1988-89	1989-90
1.	Opening Reserves (after Budget measures)	6.1	7.9	9.6
2.	Total additions to programmes (see C(86)22)	7.5	8.1	10.6
3.	Excess over Reserves	1.4	0.2	1.0
4.	less increase in privatisation proceeds	-0.2	-0.2	-0.2
5.	New Reserves required	3.5	5.5	7.5
6.	Increase in planning total (3-4+5)	4.7	5.5	8.3
7.	Baseline	143.9	148.7	153.2
8.	New planning totals	148.6	154.2	161.5

£5bn

SECRET (until after Autumn Statement)

Table 2: Public Expenditure Trends

		1985-86	1986-87	1987-88	1988-89	1989-90
(i)	Planning total (cash)	133.6	140.4	148.6	154.2	161.5
(ii)	Planning total (real terms 1985-86 prices)	133.6	136.5	139.3	139.6	142.1
	Percentage change	-2.9	2.2	2.0	0.2	1.7
	Average over Survey					1.3

		1978-79	1982-83	1986-87	1987-88	1988-89	1989-90
(iii)	General government expenditure as a proportion of GDP						
	Including privatisation proceeds	43¼	46¾	43¼	42¾	41¾	41¼
	Excluding privatisation proceeds	43¼	47	44½	44	42¾	42¼

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until after Oral Statement
then UNCLASSIFIED

TABLE 3

Prospects: summary

	Outturn 1985	Forecast 1986	Forecast 1987	Average errors from past forecasts*
A. Output and expenditure at constant 1980 prices (percentage change on year earlier):				
Domestic demand	3	3½	3½	1
of which:				
Consumers' expenditure	3½	5	4	1¼
General Government consumption	½	1½	1½	1
Fixed investment	2	2	2½	2¼
Change in stockbuilding (as per cent of level of GDP)	½	0	½	¾
Exports of goods and services	6	1	3	2½
Imports of goods and services	3	5	4½	3
Gross domestic product: total	3½	2½	3	¾
manufacturing	3	0	4	2½
B. Balance of payments:				
Current account (£ billion)	3½	0	-1½	3
C. Inflation:				
Retail prices index (percentage change Q4 on Q4)	5½	3¼	3¼	2¼
	1985-86	**1986-87**	**1987-88**	
Deflator for GDP at market prices (percentage change on year earlier)	6	3	3¼	2
D. Money GDP at market prices (percentage change on year earlier):	9½	5½	7	1¾

Source: Forecasts for 1986 and 1987 and average errors on past forecast published in Autumn Statement Table 1.14.

* Errors relate to average differences (on either side of central figure) between forecast and outturn: relevant to forecast for next calendar or financial year. For method of calculating these errors, see 'Economic Progress Report' June 1981. Margins of error based on forecasts made in ten years 1975-1984. Errors after adjustment for effects of major changes in fiscal policy where excluded from forecasts.

WPU

010

SECRETARY OF STATE FOR SCOTLAND

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

D Norgrove Esq
Private Secretary
10 Downing Street
LONDON SW1

8 December 1986

NBPM

Dear David

I enclose a copy of a statement about public expenditure which my Secretary of State proposes to make in the House tomorrow afternoon. I should be grateful for your clearance.

I am copying this letter and enclosures to Trevor Wooley, Joan MacNaughton, Andrew Lansley, Ivor Llewellyn, Rob Smith, John Turner, Robin Young, Tony Laurance, David Watkins, Chris Cappella, Dr Timonthy Walker, Richard Allan, Alex Allan, Jill Rutter, Murdo Maclean, Colin Williams, Michael Stark, and Steven Wood. + Geoff Dart

Yours
Andy.

ANDY RINNING
Private Secretary

DHF34202

DRAFT ORAL STATEMENT

With permission, Mr Speaker, I wish to make a statement about the allocation of my public expenditure provision in the next three years.

Total expenditure on the programmes within my responsibility will be £7957m in 1987-88, £390m or 5.1% above provision for this year, and some £540m higher than the plans for 1987-88 published in the Public Expenditure White Paper last January. An annotated table giving the allocations for each service is available in the Vote Office and I am arranging for it to be published in the Official Report.

I have given high priority to the Health Service to enable it to meet growing demand for health care over the next three years. Spending on the Health programme will be increased by £130m or 2.5% more than forecast inflation to £2216m in 1987-88. For hospital and community health services next year there will be £1540m, some £87m or 6% more than for this year. I propose to hold a small amount of this extra cash in hand for specific service developments. Allocations to Health Boards will allow a further movement towards parity under the SHARE formula. In addition, Boards will be able to retain resources released within their budgets through efficiency and economy measures.

Capital investment in the Health service will be about £370m over the next three years, and will maintain the programme of major hospital projects, continue the upgrading of the NHS estate, and allow for spending on new technology and computer hardware. Provision for local authority capital spending on social work has also been increased.

To meet fully the needs of Law and Order services my plans provide £625m in 1987-88. This includes sufficient for a modest increase over present police establishment, and for increased costs of the Prison Service, including recruitment of an additional 126 prison officers next year. Capital expenditure within this programme over the three years will be nearly £150m, and will provide for a new prison at Peterhead and new or improved court houses.

There will be an increase in the Education programme in 1987-88 of £214m - 12% - over provision for the current year. This includes the

extra resources we have said we will make available for an acceptable deal on pay and conditions of service for schoolteachers; and the £50m unallocated education margin which I have already announced and £6m for additional non-teaching costs associated with Standard grade and Action Plan. Capital expenditure on local authority education projects is planned to rise by £5m in 1987-88, to cover priority building work and equipment for science and technology subjects. The latter will be of special help in meeting the needs of Standard grade. Centrally funded work on curricular reform in schools and further education is to be maintained; and Scottish PICKUP extended. The importance of higher education has also been fully recognised. An additional £6.1m is being provided for the Central Institutions and the Colleges of Education.

Central Government expenditure on the arts is being increased by £1.1 million or 5.5%. I have authorised a start to the planning of the Second Phase of the new building for the National Library of Scotland at Causewayside; I am providing maintenance for the buildings of the three Scottish national institutions; and I am continuing to back staffing improvements at the Royal Museum of Scotland.

There will be an increase of £25 million or 10.8% in our provision for Industry in 1987-88, compared with the plans published last year. The increase will go almost entirely to direct grants to industry, to meet a continued upsurge in demand which brings valuable jobs and investment to Scotland. This follows a recent increase of £40 million in the amount available this year for such grants, mainly to provide for higher than expected investment during the transitional period for payment of old regional development grant.

For Agriculture, my plans will permit consolidation of our policy of developing cost effective agriculture and fishing industries with particular regard to supporting the rural economy. In response to representations from the agricultural community I have made available an additional sum of £750,000 in each of 1987-88 and 1988-89 for the Advisory services in Scotland.

For Housing in 1987-88 total net provision will be £696m, an increase of £51m over provision for the current year, and £23m higher than the previously planned provision for 1987-88. It remains my intention to

concentrate resources on investment, in particular to meet the needs identified in local authorities' own stock, and to accelerate the payment of private sector improvement grant claims which have already been approved. I have therefore increased net capital provision by 20% - £90m - to £548m for 1987-88 compared with 1986-87. I expect this to take up some 79% of the total housing programme compared to 72% this year. When investment financed by net capital receipts is taken into account the programme will allow for gross capital investment next year of £720m - an increase of £82m over the planned level of £638m in 1986-87. I have made significant extra provision available for the Housing Corporation the Scottish Special Housing Association and the New Towns. I am also pleased to be able to recognise in a tangible way the importance of preserving our heritage by increasing the resources available for historic building grants by 80% next year and by even more thereafter.

The fact that the Government have been able to announce these substantial increases while continuing to reduce public spending as a proportion of national income is a tribute to the success of our control of the economy since we came to office.

£ million

	1986-87		1987-88		1988-89		
	Cmnd 9702-II# Provision	Est Outturn	Cmnd 9702-II# Provision	Revised Provision*	Cmnd 9702-II# Provision	Revised Provision*	1989-90 Provision*
Agriculture	188	189	183	186	190	190	190
Industry	304	344	232	257	240	240	250
Tourism	13	13	13	13	10	10	10
Transport	587	582	595	601	600	620	630
Housing	645	637	673	696	700	700	730
Other Environmental Services	588	616	596	609	600	630	650
Law, order and protective Services	563	566	577	625	580	650	660
Education	1792	1945	1796	1956	1800	2040	2090
Arts and Libraries	75	75	75	82	70	80	90
Health and Social Work	2443	2464	2535	2605	2620	2710	2830
Other Public services	112	112	114	118	120	120	120
LA current expenditure not allocated to services	19	0	19	124	20	130	130
Nationalised Industries External financing	239	239	1	87	-120	-20	-170
	7567	7783	7409	7957	7430	8110	8220

Note Figures for 1988-89 and 1989-90 are rounded to the nearest £10 million
White Paper (Cmnd 9702-II#) figures adjusted for pre-survey changes.
* Figures reflect survey changes. Some figures may be subject to detailed technical amendment
Due to rounding, individual figures may not sum to toals.

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Agriculture

The expenditure plans will permit consolidation of the Government's policy of developing cost effective agriculture and fishing industries with particular regard to supporting the rural economy.

Industry

Overall provision has been increased by £25 million - 10.8 per cent - in 1987-88 compared with last year's White Paper. As explained then provision in 1987-88 will be less than that in 1986-87 because of the ending of payments under the old style regional development grant scheme. The provisional outturn for 1986-87 is £40 million higher than that foreshadowed last year because of the higher than expected take up of old regional development grant. Overall, provision remains broadly constant over the forward years. Within the total an extra £25 million, 26 per cent, has been made available for direct grants to industry in 1987-88.

Transport

Provision next year (excluding grants to transport nationalised industries) will be about £14 million more than was planned for the current year. Progress on the motorway and trunk road programme will continue with priority being given to schemes which will improve accessibility to areas of significant economic activity and remove through traffic from communities. The Government will also continue to honour its commitment to subsidising shipping services and civil aviation facilities in the Highlands and Islands. For the later years the provision has also been increased over the level provided for in the 1986 Public Expenditure White Paper.

Housing

The increased provision for Housing is concentrated on capital investment mainly to meet local authorities identified needs, and to accelerate the payment of private sector improvement grant claims. The additional provision for the Housing Corporation is for their pilot community co-operative project and continuation of their work on area renewal.

That for New Towns housing will allow them to assess the relative priorities between house improvements and new building for rent in their areas following the lifting of the moratorium on general needs house building.

Other Environmental Services

The provision for 1987-88 is about £14 million more than was previously planned. Further growth is planned in future years with provision being set at £630 million for 1988-89 and at £650 million for 1989-90. Much of the increase relates to local authority current expenditure. For the remaining elements within the Secretary of State's direct control increased priority has been given to grants for the maintenance and repair of historic buildings. These increase by over 80 per cent next year and will more than double in later years; reflecting the Government's commitment to the heritage of this country.

Law Order, and Protective Services

Plans for the prison service give full cover for the cost in staff and supplies of an inmate population substantially higher than forecast in the last Survey; provide for an additional 126 prison staff next year to keep Low Moss Prison open into 1988 and to improve standards of nursing care at Glenochil. For the police, provision will meet fully the expected cost of the service with a modest annual increase in manpower and will maintain central support for the Scottish Crime Squad and its Drugs Wing. There will be continuing support for crime prevention measures. The plans also allow for higher levels of demand for legal aid services and for criminal injuries compensation and for increased running costs in the Courts. £150 million of capital spending is planned over the next three years, on new or improved court and prison buildings including the new prison at Peterhead, and on the needs of the police and fire services.

Education

Provision includes the extra resources which will be made available for an acceptable deal on pay and conditions of service for school teachers. As already announced there is also a £50 million unallocated education margin. Increased capital expenditure has also been made available for the Central Institutions, the Colleges of Education and for local authorities for building work (£3 million in 1987-88) and scientific and technical equipment particularly relevant to Standard Grade (£2 million in 1987-88).

Arts and Libraries

Central Government expenditure on the National Institutions in 1987/88 represents an increase of 5.5% over 1986/87. [Planning of the second phase of the new building at Causewayside for the National Library of Scotland has been authorised.] Substantial additional resources will be provided for maintaining the existing buildings of the three Scottish National Institutions; and for staffing and administrative improvements at the Royal Museum of Scotland. Provision for local authority expenditure on arts and libraries has also been increased.

Health

The provision for the Health programme allows for increased spending on hospital and community health services of 6% in 1987-88. In each of the later years, provision increases by 1% more than forecast inflation, to enable Health Boards to continue to develop services in line with national priorities, and to meet pay and price increases. Plans for the Family Practitioner Services allow for expected increase in public demand, and take account of movements in pay and prices. Capital spending on major health service projects will total about £370 million over the next three years. Health Boards will also retain income from sales of surplus land and buildings which can be used to pay for other capital works.

Social Work

Total provision for Social Work is planned to rise by £26 million, just over 7 per cent. These figures reflect particular regard for the needs of the

elderly and the handicapped. Provision for local authority capital expenditure on Social Work Services is planned to rise by £1.5 million in 1987-88 over the current year.

[redacted]

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017/2985

CORR

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

David Norgrove Esq
Private Secretary
10 Downing Street
London
SW1

NBPN.

28 November 1986

Dear David,

CUMULATING COSTS

I would like to draw your attention to the attached PESC paper which has been circulated to Principal Finance Officers of Departments. It arises out of recent experience on presentation of the costs of settling the teachers' pay dispute, and other increases in expenditure agreed upon in the Public Expenditure Survey.

Except for the costs of distinct and finite projects you will see that Treasury Ministers have asked that expenditure levels and changes should in future be quoted per annum in Government statements and publications.

I am copying this to the Private Secretaries to all members of the Cabinet. I would be grateful if they could take note of it when preparing Ministerial speeches or statements.

Yours,

Jill Rutter

JILL RUTTER
Private Secretary

PESC(86)21
18 November 1986

HER MAJESTY'S TREASURY

PUBLIC EXPENDITURE SURVEY COMMITTEE

CUMULATING COSTS

Note by the Secretaries

When the new planning totals were announced, some newspapers described this as "Government spending up £10 billion over the next two years".

2. For a distinct project eg the cost of a hospital, a weapons system or a particular road, the total cost over a number of years is a sensible way to present the figures. But for flow or recurrent expenditure cumulating the costs has no statistical validity and is misleading since the number of years chosen is arbitrary.

3. It may be, however, that the Government itself has contributed to this practice. For example, the Government's original offer to the teachers was presented as £1250 million over four years rather than, say, £200 million in the first year rising to £450 million per year after four years.

4. Except for the cost of distinct and finite projects, Treasury Ministers have asked that expenditure levels and charges should in future be quoted in terms of per annum figures in Government statements and publications. Departments are invited to observe this convention in their own statements and publications.

MRS R M DUNN
MISS M P WALLACE

AJ 1.1

CONFIDENTIAL

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

David Norgrove Esq
10 Downing Street
London SW1

11 November 1986

Dear David,

As foreshadowed in the Chancellor's statement in the House of Commons on 6 November the full printed autumn statement will be published tomorrow, 12 November. I enclose an advance copy of the document which is under embargo until laid before the House at 11am.

I am sending copies also to the private secretaries to the other members of the Cabinet, to the private secretary of the Chief Whip, and to Sir Robert Armstrong.

Yours
Alex

A C S ALLAN
Principal Private Secretary

PH4/61

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

David Norgrove Esq
No.10
Downing Street

7 November 1986

Dear David

AUTUMN STATEMENT: ADDITIONAL BRIEFING

... The Chancellor thought the Prime Minister might like to have copies of the two attached tables, which he and the Chief Secretary have been using in press briefings etc. I understand that copies have already been sent separately to the No.10 Press Office.

Yours
Alex

A C S ALLAN

Prime Minister 2

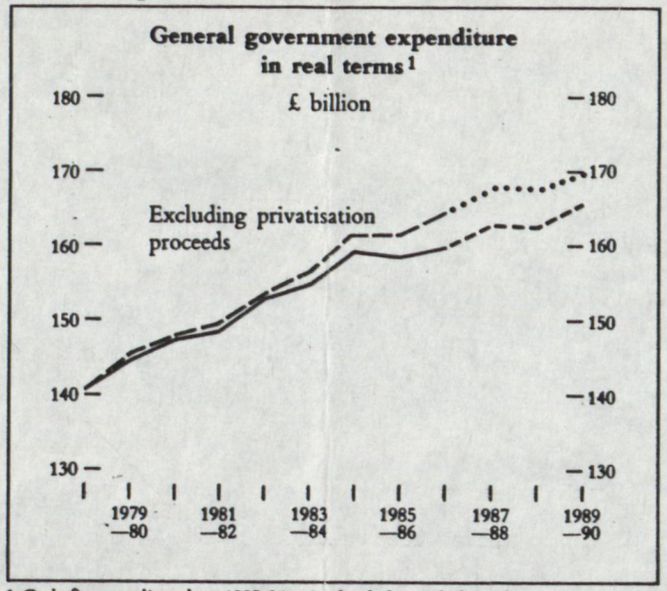
7/11

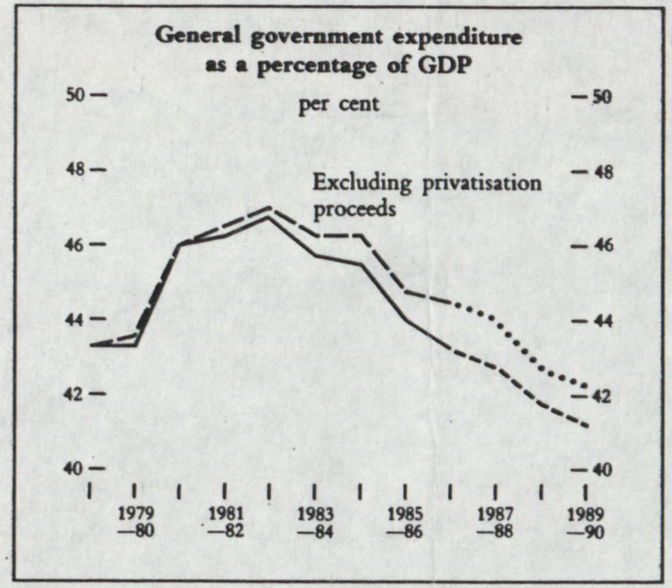
AVERAGE GROWTH IN PLANNED PUBLIC SPENDING IN REAL TERMS COMPARED WITH PAST TRENDS

	1968-69 to 1978-79	1978-79 to 1982-83	1982-83 to 1986-87	1986-87 to 1989-90
GGE* excluding privatisation proceeds	2.9	2.2	1.7	1.0

* GGE (general government expenditure) is the combined expenditure of central and local government including net lending and debt interest.

Public expenditure trends





1 Cash figures adjusted to 1985-86 price levels by excluding the effect of general inflation as measured by the GDP deflator.

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SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

SECRET

Prime Minister 2
Fair point.

David Norgrove Esq
Private Secretary
10 Downing Street
London SW1

DCR
5/11

5 November 1986

Dear David

AUTUMN STATEMENT PUBLICITY

At the conclusion of yesterday's meeting between MISC 130 and my Secretary of State it was agreed that it would be for him to consider how the settlement then reached might be presented (page 3 of MISC 130(86) 25th meeting refers).

Mr Rifkind will be considering the presentational aspects in the course of deciding on allocations within the provision for his programmes with a view to making an announcement about the middle of December. In order to maintain the room for manoeuvre which MISC 130 agreed that he should have, he would be glad if there was no mention of specific aspects of the discussions in MISC 130 such as adjustments to reflect changes in population ratios since 1979 for either the Scotland or Wales programmes in any general briefing which may be released to accompany the Autumn Statement.

I am copying this letter to Alex Allan and Colin Williams.

Yours ever

Robert Gordon

ROBERT GORDON
Private Secretary

DHV30911.B

cc MFA
BI
SM/AS

SECRET

Prime Minister
The latest version

DRAFT 5/11/86.
7 PM.

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

Cabinet today agreed the Government's public expenditure plans for the next three years.

In the normal course of events that would be followed by the publication of the printed Autumn Statement, accompanied by an Oral Statement to the House, next Tuesday.

For obvious reasons that is not possible this year.

So while the Autumn Statement will be printed in the normal way and presented to Parliament as soon as the House reassembles next Wednesday, I thought it would be for the convenience of the House if I made my Oral Statement today.

This will cover all three of the key elements in the printed Statement: the Government's outline public expenditure plans for each of the next three years and the expected outturn for this year; proposals for next year's national insurance contributions; and the forecast of the economic prospects for 1987 required by the 1975 Industry Act.

The full text of the economic forecast, together with the public expenditure figures and the rest of the information customarily published with this Statement will be available from the Vote Office as soon as I have sat down.

They will also appear in the printed Autumn Statement to be published next week.

I turn first to the outturn for the current financial year, 1986-87.

The public expenditure planning total now looks likely to amount to almost £140½ billion - £1¼ billion, or a little less than 1 per cent, above what was allowed for in this year's Public Expenditure White Paper.

The main reason for this excess is a 9 per cent rise in the current spending of local authorities - far more than was provided for.

However, other items on the expenditure side, the largest of which is debt interest, are likely to fall short of what was forecast at the time of the Budget, thus reducing the total overrun on the expenditure side to about £½ billion.

On the receipts side, the North Sea tax take is likely to be even lower, by about £1 billion, than I envisaged at

the time of the Budget, largely because for a long period the oil price has been below the $15 a barrel level on which the Budget arithmetic was explicitly based.

This shortfall, however, is more than offset by the continuing buoyancy of non-oil tax revenues, in particular VAT and Corporation Tax.

Non-oil revenues now look likely to exceed the Budget forecast by £2 billion.

This would imply a net overrun on the receipts side of about £1 billion, rather more than that on the expenditure side.

But this will be reduced by a change I propose to make to the North Sea fiscal regime.

The collapse of the oil price has led to a sharp cutback in investment activity in the North Sea, with inevitable consequences for the UK offshore supplies industry both in Scotland and the North East of England.

Against this background the Government is conducting a review of the North Sea fiscal regime, and I shall be announcing my conclusions in the Budget in the light of that review.

But given the current difficulties of the offshore supplies industry, there is one change I believe it right to make without further delay.

I propose, on a carefully targeted basis, to accelerate the arrangements for the repayment to the oil companies of Advance Petroleum Revenue Tax due to them.

The details of this change, which will require legislation early in the new Session of Parliament, are set out in a Press Notice which the Inland Revenue will be issuing as soon as I have sat down.

The new arrangements will have a revenue cost this financial year of some £300m, which will be fully recouped over the next three years.

Taking this into account, the Public Sector Borrowing Requirement for the current year is still forecast to be about £7 billion, the figure I set in the Budget.

I turn now to the public expenditure plans for the next three years.

This year, for the fourth successive year, public spending, both before and after deducting the proceeds of privatisation, is set to decline as a proportion of national output.

The Government is determined to ensure that this trend continues: to see to it that total public spending, even without taking account of privatisation proceeds, continues to decline as a percentage of GDP.

The plans I am about to announce for the next three years secure that objective.

Indeed, they show that by the end of the period the ratio of public spending to national output will be back to the level of the early seventies.

But within this overall constraint, and in the context of its policy priorities, the Government has felt it right to allow an increase in the previously announced planning totals for 1987-88 and 1988-89.

Compared with the prospective outturn for the current year, we are now planning for an average growth in the public expenditure planning total of about 1¼ per cent a year in real terms, well within the prospective growth of the economy as a whole.

The new planning totals have thus been set at £148½ billion for 1987-88 and £154½ billion in 1988-89, an increase of £4¾ billion and £5½ billion respectively.

For 1989-90 the planning total has been set at £161½ billion.

As usual, these totals incorporate estimates for the proceeds of privatisation.

Last year I increased the estimate of these proceeds very substantially to £4¾ billion in each of the three Survey years, a figure which I expect to be duly achieved this year.

Although the privatisation programme is now moving ahead more strongly than ever before, I have decided to make only a modest further addition to this estimate, bringing it to £5 billion in each of the next three years.

The new planning totals also contain substantial reserves, rising from £3½billion in 1987-88 to £7½ billion in 1989-90.

The public expenditure increases I have announced allow us to make realistic provision both for local authority current expenditure, over which the Government has no direct control, and for demand-led programmes such as social security, while still leaving scope for increased spending on services to which the Government attaches particular priority.

But before referring to some of the more important changes, let me make one thing absolutely clear.

There can be no question of allowing the projected increases in public expenditure over the next two years to undermine the prudence of the Government's overall fiscal stance.

The Government's fiscal stance has been clearly set out in the medium-term financial strategy published at the time of this year's Budget.

There will be no relaxation of that stance.

Within the totality of public expenditure, the largest increase is for the local authorities, whose current spending next year is now put at £4 billion above the previous provision.

This in part reflects the fact that the previous plans simply carried forward the same level of cash spending as in 1986-87.

At the same time, we are increasing next year's Aggregate Exchequer Grant - the contribution that taxpayers make to local government spending - by almost 10 per cent over this year's Settlement; a rise of almost £1½ billion.

These substantial sums demonstrate in particular the priority the Government is giving to education, which, including the new proposals on pay and conditions of service for teachers announced last week, accounts for about half the increase in provision.

A further major portion of the increase is for the police.

On top of the increased provision for the cost of education in schools, which is contained within local authority current spending, there will be additional provision for the universities of £60 million in 1987-88 and £70 million in 1988-89.

Spending on the health and personal social services will be increased by more than £600 million.

For the National Health Service alone, the increase in England amounts to over £300 million a year.

Combined with the additional resources being generated by greater efficiency, this will not only enable the Health Service to cope with the growing number of elderly patients but will also allow it to improve services.

Gross provision for housing investment is being increased by £450 million.

This will sustain the rising trend of spending on local authority renovation and improvements and provide additional resources for the housing associations.

In the light of this year's experience, £1¾ billion has been added to next year's provision for social security,

most of which represents a greater expected expenditure on existing means-tested benefits.

Provision for investment in roads is being increased by £65 million next year and £75 million the year after, mostly for local authority roads.

For defence, the provision remains as planned in the last White Paper after allowing for minor changes, including a reduction in the estimated cost of the Falklands deployment.

The defence programme will continue to benefit from the substantial real growth in previous years and the wide-ranging action to improve efficiency and value for money.

Taking all programmes together, the additions to planned capital expenditure amount to getting on for £1 billion in 1987-88, of which about two-thirds is local authority spending.

Further details of these and other changes will be contained in the printed Autumn Statement which will be published as soon as the House returns next week.

In addition, full details, together with information on running costs and manpower, will be given in the public expenditure White Paper early in the New Year.

I now turn to National Insurance contributions.

The Government have conducted the usual Autumn review of contributions in the light of advice from the Government Actuary on the prospective income and expenditure of the national insurance fund, and taking account of the benefit uprating which my Rt Hon Friend the Secretary of State for Social Services announced on 22 October.

The lower earnings limit will be increased next April to £39 a week, in line with the single person's pension, and the upper earnings limit will be similarly raised to £295 a week.

The limits for the reduced rate bands which I announced in last year's Budget will also be increased again in April, but by proportionately larger amounts.

The upper limit for the 5 per cent and 7 per cent bands will be raised to £65 a week and £100 a week respectively, and the upper limit for the 9 per cent rate for employers will be raised to £150 a week.

The taxpayer's contribution to the National Insurance Fund - the so-called Treasury Supplement - will be reduced by 2 per cent to 7 per cent, but this will not require any change in contribution rates.

Thus the main Class I contribution rates will once again remain unchanged at 9 per cent for employees and 10.45 per cent for employers.

Finally, I turn to the Industry Act Forecast.

Both growth and inflation have turned out to be slightly lower this year than I envisaged at the time of the Budget.

Growth now looks like turning out at 2½ per cent, against a Budget forecast of 3 per cent, and inflation in the fourth quarter of this year is likely to be 3¼ per cent, against the Budget forecast of 3½ per cent.

The principal reason for this slower growth has been the disappointing performance of exports, which were hard hit by the cutback in spending by OPEC and other primary producers affected by the sharp fall in commodity prices in general and the oil price in particular.

Combined with a halving in the value of our own oil exports, this has meant a significant deterioration in the current account of the balance of payments, from a surplus of some £3½ billion in 1985 - and a cumulative surplus of £21 billion over the six years from 1980 to 1985 inclusive -to a forecast of broad balance for 1986.

Looking ahead to 1987 the prospects are generally encouraging.

While the necessary adjustment of the exchange rate to the oil price collapse has now taken place, it will inevitably take time before the full benefits come through in higher non-oil exports and reduced import penetration at home.

This means we can expect the current account of the balance of payments to go into deficit next year, for the first time since 1979, to the tune of some £1½ billion.

Even so, non-oil exports are forecast to rise next year by 5½ per cent, compared with an increase of only 1 per cent this year, with manufacturing output, in consequence, up by 4 per cent.

And with domestic demand continuing to expand at the same rate as this year, the economy overall is likely to grow by a further 3 per cent next year - the sixth successive year of steady growth at an average annual rate of almost 3 per cent.

Recorded inflation is likely to edge up a little, to 3¾ per cent in the Fourth Quarter of 1987.

This is almost entirely due to the effect on the RPI of the timing of mortgage rate changes.

The Government's commitment to a monetary policy that will squeeze out inflation remains unabated.

Meanwhile the likelihood of faster growth next year, coming at a time when unemployment already appears to have stopped rising, suggests that the prospects for some fall in unemployment are now more promising.

But this promise could still be frustrated by excessive pay settlements.

Mr Speaker, the strategy we have followed since 1979 has brought inflation down to the lowest level for two decades, combined with sustained growth and steadily rising living standards.

This is a combination that has eluded successive Governments for a generation.

We have brought it about by the determined pursuit of free markets and sound money.

And that is what we will stick to.

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PRIME MINISTER

PUBLIC EXPENDITURE SURVEY

You will first ask the Lord President to introduce his paper. I suggest you then thank him most warmly, noting that he has carried the very heavy burden of the Star Chamber at the same time as the very difficult legislative pressures in the Lords, which most members of Cabinet do not see. You could ask Robert Armstrong to record the Cabinet's gratitude formally in the minutes.

You will then ask the Chief Secretary to speak, followed by the Chancellor.

At the end of the discussion you could ask the Chancellor or Chief Secretary, as appropriate, to respond to points made by Cabinet colleagues.

In your summing up, you could:

(i) Thank the Lord President again, and colleagues, for their cooperation in the work of the Star Chamber.

(ii) Record that Cabinet has endorsed the proposals set out in the Lord President's paper.

(iii) Record that Cabinet has endorsed the planning totals proposed by the Chancellor.

DN

5 November, 1986.

JD3ARQ

CCB/UP
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Ref. A086/3178

PRIME MINISTER

Public Expenditure Survey 1986
C(86) 22

CONCLUSIONS

You will wish the Cabinet to record conclusions on:

i. Whether the settlements on individual programmes agreed bilaterally between the Chief Secretary, Treasury and spending Ministers, or recommended by the Ministerial Group on Public Expenditure (MISC 130), are acceptable. Particular issues arise on the electricity (England and Wales), defence, Scotland and Wales programmes on which it may be appropriate for the Cabinet to give guidance.

ii. Given that the additions to programmes arising from the 1986 Survey more than exhaust the available Reserves in each of the Survey years, what additions should be made to the public expenditure planning totals (ie how and to what extent should the Reserves be reconstituted)?

iii. The announcement and presentation of the Government's decisions.

BACKGROUND

2. At their meeting on 17 July the Cabinet agreed that the Chief Secretary, Treasury and spending Ministers, in carrying forward discussions of the 1986 Survey, should work within the publishing planning totals of £144 billion for 1987-88 and £149 billion for 1988-89, and within a newly set planning total of

BRIAAB

£153 billion for 1989-90 (CC(86) 28th Conclusions, Minute 7). Since then there have been extensive bilateral discussions between the Chief Secretary, Treasury and spending Ministers and, more recently, in MISC 130 under the chairmanship of the Lord President of the Council.

3. As the Lord President's paper summarising the work of MISC 130 makes clear, settlements have been reached on all programmes. The main elements in the 1986 Survey are summarised in the following table.

Additions to Programmes

	£ billion		
	1987-88	1988-89	1989-90
Local authority current expenditure	3.4	4.3	5.1
Social Security (demand-led and administration)	1.6	1.7	2.6
Agreements reached bilaterally	1.1	0.7	1.1
Teachers' Pay	0.6	0.9	1.0
Other additions recommended by MISC 130	0.8	0.5	0.9
Total additions to programmes	7.5	8.1	10.6
(compared with starting Reserves of	6.0	7.9	9.6)

BRIAAB

4. As will be apparent, MISC 130 have had very little room for manoeuvre. The Rate Support Grant settlement agreed in the summer absorbed more than half the available Reserves in each of the three Survey years. Demand-led expenditure on social security (ie allowing for changes in economic assumptions, the latest estimates of take-up, and administration costs) meant irresistible increases of £1.6 billion, £1.7 billion and £2.6 billion for the three Survey years respectively, which absorbed much of the remaining balance of the Reserves. Settlements reached bilaterally by the Chief Secretary, Treasury took the process a stage further. The additional bids on the eight programmes considered by MISC 130 (net of demand-led additions to social security) amounted to £1.5 billion, £1.0 billion and £2.1 billion respectively for the three years; the settlements agreed by the Group reduced these amounts by nearly 50 per cent for 1987-88, 70 per cent for 1988-89, and 60 per cent for 1989-90. Nevertheless, despite the Group's efforts, the total additions to programmes exceed the available Reserves in each of the three years by £1.5 billion, £0.2 billion and £1.0 billion respectively.

Programme Agreed Bilaterally

5. Annex B to C(86) 22 summarises the settlements reached bilaterally between the Chief Secretary, Treasury and the responsible spending Ministers. A number of these reflect economic circumstances over which the Government have little or no control; examples are EC contributions, IBAP, ECGD interest support, civil superannuation and the costs of mortgage interest relief for those whose incomes fall below the income tax threshold. There are substantial increases for the work of the courts, legal aid, the Crown Prosecution Service and various elements of Home Office expenditure. Apart from the large increases agreed last week by the Cabinet for teachers' pay, there are significant increases for universities and science - both of them programmes subject to a sharp spending squeeze in

recent years. Substantial increases have been agreed for local authority capital programmes (housing, schools and other) primarily in 1987-88, in order to meet the Government's previous commitment that allocations to local authorities in that year would be no less than 80 per cent of the 1985-86 level. Additional receipts from asset sales will help to support new local authority capital investment, particularly in the later Survey years. Local authority capital expenditure is likely to be an area of continuing friction, while science and universities are unlikely to be entirely satisfied by the increases agreed; with these exceptions, the settlements agreed bilaterally seem unlikely to give rise to significant controversy.

Programmes Considered by MISC 130

6. Paragraphs 8-16 of C(86) 22 set out the main elements of the settlements agreed in MISC 130. A detailed commentary is attached at Annex A. You may like to note particularly what is said about defence, electricity and Scotland and Wales, on which some discussion may arise.

Implications for Public Expenditure Planning Totals

7. Some increases in the planning totals are inevitable. It will be for the Chancellor of the Exchequer to suggest how large these increases should be. Some part of them might be offset by further increases in forecast privatisation receipts, but this is unlikely to be of much help in presenting the new position to the financial markets. Since the programmes now include 'realistic' figures for local authority current expenditure (in marked contrast to last year's White Paper), and in addition full provision has been made for teachers' pay, it is arguable that somewhat smaller Reserves than shown last year would be

reasonable. But when all things are considered, increases in the planning totals of the order of £5 billion in each year seem inevitable. An inkling of this was, of course, given in today's front page article in the Daily Telegraph.

8. All of this will need to be covered in the Chancellor of the Exchequer's Autumn Statement, in which he will make clear that the current year's planning total will be overspent by £1.3 billion. The implication of these figures is that there will be a real increase in public expenditure this year of about 1.5 per cent, followed by a further increase of nearly 2 per cent in 1987-88; thereafter increases of 0.5 per cent and 1.5 per cent are in prospect. These figures need to be set against real growth in the economy, now put at 2.5 per cent for 1986 (a little lower than expected at the time of the Budget) and 3 per cent in 1987; although it has not proved possible to hold expenditure broadly flat in real terms as indicated in the 1986 Financial Statement and Budget Report, it remains clear that public expenditure will still be growing more slowly than Gross Domestic Product (GDP), and thus represent a declining proportion of GDP.

9. So far as the markets are concerned, the key to their response is likely to lie in what the Chancellor of the Exchequer says about his fiscal stance. The pattern of growth in the United Kingdom economy this year and next will be dominated by fast growth in consumers' expenditure fuelled by pay increases which have been, and are expected to continue to be, well above the rate of inflation. The implication of this is that income tax and value added tax revenue will also be moving ahead rapidly, more than counter-balancing the revenue lost through the reduction in oil prices. These additional revenues will be of substantial help in absorbing the higher level of expenditure, without resulting in public sector borrowing higher than shown in the Government's Medium Term Financial Strategy. A clear statement that the Government will

not allow the higher expenditure levels to result in higher borrowing should be of substantial reassurance to the market; the fact that revenues will be increasing relatively rapidly reduces the risk that there might need to be awkward adjustments in tax. However, the Chancellor of the Exchequer will not wish to get drawn into any discussion at this stage of the size of the fiscal adjustment, if any, available at the time of the 1987 Budget.

Announcement and Presentation

10. The timing of the opening of the new Parliamentary Session in relation to the privatisation of British Gas means that the Autumn Statement needs to be made without delay. The need to minimise speculation and reassure markets similarly argues for a Statement as soon as possible after the Cabinet have to the substantial increases in the public expenditure planning totals resulting from the 1986 Survey. Accordingly arrangements have been made for the Autumn Statement to be made on the afternoon of the Cabinet's discussion. This procedure has been considerably helped by the fact that all programmes have been settled, so that there are no substantial loose ends to be tied up by the Cabinet. The spending Departments have all been instructed to prepare appropriate press notices setting out the main elements of their programmes over the three years of the Survey period, and these will have been cleared as appropriate with the Treasury and other interested Departments. There remains the problem that different messages have to be conveyed to different audiences: on the one hand, it is essential that the financial markets retain confidence in the Government's determination to stick to their announced fiscal stance and to maintain firm control over the public expenditure programmes, but at the same time spending Ministers will wish to take credit for increases in their programmes as responding to demands by the population at large for the maintenance of proper standards

of public services. The Chancellor of the Exchequer will no doubt be seeking to steer a careful course addressing both audiences in his Autumn Statement.

HANDLING

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

a. the results of the 1986 Survey, and any points on individual programmes;

b. the setting of new public expenditure planning targets, in the context of the discussion of the economic outlook;

c. announcements and presentation.

No. You decided the Chancellor should follow the Chief Secretary.

12. You may wish to invite the Lord President of the Council to report on the work of his Group and on the results of the Survey. Thereafter the Chief Secretary, Treasury might be invited to give his reactions to the results of all the discussions of the individual programmes. Other Ministers may wish to raise specific points on individual programmes; since it would be extremely awkward to reopen any of the settlements, you will not wish to encourage any extended discussion, although you may perhaps wish the Cabinet to record a specific conclusion on advancing the minehunter programme. Once the Cabinet have agreed on the programmes, you will wish to invite the Chancellor of the Exchequer to set out the economic prospects as he will be presenting them in his Autumn Statement, and to suggest how and to what extent the Reserves should be reconstituted in setting new public expenditure planning totals. Other Ministers may wish to register particular points on this part of the discussion. You will wish to ensure that the Cabinet are firmly behind the approach the Chancellor of the Exchequer would be

putting forward. On announcements and presentation, the fact that the Autumn Statement will be made the same day should considerably simplify the task of dealing with press inquiries following the Cabinet discussion; all that needs to be said is that the 1986 Survey has been completed; that agreement has been reached on all programmes; and that the Chancellor of the Exchequer will be announcing the results in a Parliamentary Statement in the afternoon.

RCA

ROBERT ARMSTRONG

5 November 1986

ANNEX A

1. Defence

Some relatively small net changes were agreed bilaterally, covering the latest estimates of actual Falklands costs, some additional funds for the Agencies, and other Departments' contributions towards the cost of bringing forward the order for AOR 02. These changes apart, provision was added for actual Falklands costs in the third year (the baseline had been constructed by deducting the Falklands costs from the Falklands-inclusive figure agreed last year for 1988-89), and £33 million was transferred from year 2 to year 3, on the understanding that this would not be taken into account in next year's Survey in setting the 1990-91 baseline. The implication of the settlement is that real expenditure on defence is scheduled to decline by about 2 per cent in each of the first two Survey years, and about 1/2 per cent in the third year. Some of this decline, of course, reflects the falling costs of the Falklands operations.

The one outstanding issue is the possible advancement of the minehunter programme, so as to provide continuity of work at Vosper Thornycroft, which E(A) were inclined to support and asked MISC 130 to consider. In the event the Chief Secretary and the Defence Secretary, neither of whom has any interest in bringing forward the minehunters, have agreed outside MISC 130 that nothing should be done; in view of the Defence Secretary's earlier offer to bear 25 per cent of accelerating the orders, and of MISC 130's decision not to pursue the Chief Secretary's demand for £300 million reductions in the defence budget in each Survey year, the Cabinet might feel it would be reasonable to insist that the defence budget should absorb the whole costs of bringing the programme forward (which amount to only £29 million over the three Survey years). The arguments would be that this was necessary to defend the reputation of the Government's privatisation of the warship-yards, and that the

Ministry of Defence, while remaining a keen and competitive purchaser, should not abuse its monopsony power.

2. Electricity (England and Wales)

This was a very difficult programme. The industry makes net cash payments to the Exchequer, and the Department of Energy thus has no direct financial leverage. Nor has the Energy Secretary any specific power to control prices or fix financial targets; financial targets have to be agreed between the Government and the industry, and the initiative on pricing rests with the industry. For the 3-year period 1985-86 to 1987-88, the agreed target rate of return on current cost net assets is 2.75 per cent, which will be hansomely exceeded during the current year; the industry have accordingly insisted that they need only earn a little over 2.50 per cent next year, and that they should fix prices accordingly. For 1988-89, the external financing requirement figure agreed last year implied a return of 3.50 per cent; the industry have accepted this year that they will have to deliver the 'savings' agreed last year, although they have not committed themselves to a higher financial target, and clearly intend to resist doing so until after the next Election.

For 1989-90 the industry's figures were constructed on the basis of a reversion to a return to 2.75 per cent; the Energy Secretary has agreed that the additional bid resulting from this should be eliminated from the figures, but there is no commitment on the part of the industry to comply with this. The only figure which will actually have to be published at this stage is the external financing requirement for 1987-88, where MISC 130 have been obliged to accept an additional bid of £380 million; for the later years only total figures for all nationalised industries' external financing requirements are shown (although in the White Paper there is a table showing the Department of Energy's nationalised industries all taken together). Thus it will not be possible to deduce from the published figures

exactly what has been assumed for electricity in years 2 and 3.

The Group seek Cabinet endorsement that the Energy Secretary, in negotiating the financial target for 1988-89 and 1989-90, should aim at a rate of return of 3.75 per cent. On the basis of this year's experience, the industry will be reluctant, and the Energy Secretary may object that he cannot deliver. However, a target ought in principle to be agreed before next year's Survey, since the result of the Survey will effectively determine the external financing limit for 1988-89. It would certainly be useful to put the Cabinet's authority behind the requirement of a higher financial target.

3. Overseas Development Administration

The Foreign Secretary asked for increases sufficient to keep aid expenditure at a constant proportion of a rising gross domestic product (GDP). The Group rejected this, and were not prepared to do more than concede the small increases required to maintain constant expenditure in real terms. As the interest subsidy element in the Aid and Trade Provision (ATP) programme expands in the third year, it will have the effect of squeezing the bilateral aid element in the overall total.

4. Health and Personal Social Services

The settlement here gives the Social Services Secretary two-thirds of his additional bid for 1987-88 and three- quarters or more for the two subsequent years. Substantial increases were agreed by the Chief Secretary, Treasury in advance of the Group's discussions on account of demographic growth and higher expenditure on the demand-led Family Practitioner Services. The case for the remaining additional bids was made in terms of specific requirements for identified purposes; since in practice the Health Authorities have to meet demands of all kinds as best they can out of a central allocation, the Group preferred to concentrate on the overall real change in current expenditure on

Hospitals and Community Health Services (HCHS), which are the main focus of public interest. The settlement would enable the Social Services Secretary to point to a real increase of 2.2 per cent next year in HCHS current expenditure, with 1 per cent increases in the two subsequent years. Much of these increases, of course, reflects real increases in the pay of the medical profession in line with pay elsewhere in the economy; this is likely to be a continuing problem.

5. Social Security

The additions agreed by the Group essentially reflect demand-led changes resulting from revised estimates of take-up and revised economic assumptions, and would in any event have been irresistible. The 'policy' increase of £35 million in 1987-88 reflects the difficulty of delivering savings in this area; legal and procedural problems have made it impossible to introduce the capital cut-off for housing benefit as from April 1987, in accordance with the agreement reached by last year's Star Chamber. It has also been necessary to make some concession on the restriction of Supplementary Benefit payments for mortgage interest which was agreed as part of last year's settlement; this concession has been offset by not uprating the limits for board and lodging payments next April. For the second and third Survey years the Social Services Secretary has agreed to make reductions of £100 million and £250 million respectively. Some part of these savings may come from further measures to combat fraud (which should not really count as 'policy' savings) but the main substance will require new primary legislation (e.g. to impose tighter contribution conditions for unemployment benefit) to be enacted as soon as possible after the Election. No decisions have been reached about how the larger savings for the third year should be secured; one possibility would be not to uprate child benefit in April 1989 - but the figures already assumed no uprating in April 1988 when the Family Credit Scheme will be available for the first time to give assistance to the families most in need.

6. Arts and Libraries

The prospective overspend on the British Library is being separately investigated, and has been set on one side for the purposes of this year's Survey. The increases agreed by the Group amount to about half the remaining bid for 1987-88, and about a third for each of the two subsequent years. Despite Mr Luce's strenuous efforts, district councils are continuing to fall well short of assuming the burden formerly carried by the Metropolitan Authorities as patrons of the arts. The settlement should be just enough to avoid politically embarrassing closures (e.g. Sadlers Wells Theatre or the Royal Liverpool Philharmonic Orchestra), but continuing criticism is likely from the arts lobby. National museums and galleries will continue to have difficulty with inadequate maintenance and shortages of funds for new purchases. Ministers can, however, respond that the budget tax concessions should make it possible for arts organisations to secure substantially more income from the private sector, and that museums and galleries are free to do whatever they like with income from entrance fees.

7. Scotland and Wales

The arguments here focussed on the extent to which the territories should receive the benefit consequent upon the 'legitimisation of overspending' by English local authorities implicit in the Rate Support Grant (RSG) settlement for 1987-88. The territorial argument is that application of the formula keeps movements in the aggregate of central Government and local authority expenditure in Scotland and Wales in line with comparable movements in England, and that they should therefore receive the full consequential adjustments on local authority current expenditure just as they do on central Government and on local authority capital programmes. The counter arguments are that Scottish and Welsh local authority expenditure has already been settled, so that giving Scotland and Wales the additional territorial consequentials in effect gives them more money for

other programmes on which they will get the regular consequentials in any event; and that some recognition ought to be given to relative changes in population in setting the territorial baselines. In the event the Group allowed the Welsh Secretary more than two-thirds of his additional local authority consequentials, noting that some part of the reductions accepted by the Welsh Secretary would be attributed to the small change in the relative Welsh population since 1979.

In the case of Scotland, however, where the relative change in population is much more significant, and where expenditure per head on public services is 28 per cent higher than in England, the Group pressed very hard for a change in the base which would have meant a significant net reduction in the central Government and local authority capital consequentials as well as nothing in respect of the additional consequentials on local authority current. The Scottish Secretary fiercely resisted this demand for further reductions, which in his view could only be justified if clear evidence were available from a full needs assessment. He did accept, however, that there should be reductions to the extent that these could be absorbed without requiring him to make overt reductions in public service provision which were not paralleled in England and Wales. In the event the Scottish Secretary surrendered the bulk of the additional local authority current consequentials, accepting that this would in due course need to be explained in part by reference to the relative population change, as in the case of Wales.

Mr Rifkind is likely in due course to face substantial criticism in Scotland, given that he has accepted a settlement significantly less generous than that achieved by Wales. Meanwhile the Group for their part remain unpersuaded that public expenditure per head in Scotland 28 per cent higher than in England can be justified. One possible avenue would be to commission the needs study resisted last year by Mr Younger, which Mr Rifkind now says he would accept. But this would bury the issue in the

long grass for 2-3 years, during which time it would be hard to make any adjustments. This may be something which should be considered again after the next Election. Meanwhile there may be a case for reconsidering the operation of the formula so far as it affects local authority current expenditure; on the face of things it is odd that the territories should get more money for their central government programmes as a result of over-spending by English local authorities.

Luce agreed for Press Office to take.
pa DRW
5/11

The Star Chamber has completed its talks and we would expect that its recommendations will be considered by Cabinet tomorrow. Until Cabinet has approved the recommendations, nothing is decided. ~~If agreement is reached it would be possible for~~ we hope to be able Mr Lawson to make a statement tomorrow. ~~But we can't be certain.~~ But We can't discuss the content of any statement in advance, ~~including the projected levels of spending. We have said repeatedly that it has been a difficult PES round. Talk of tax cuts having to be sacrificed is entirely~~ premature and the possibility of an early election is not merely pure speculation but has repeatedly been scotched by the Prime Minister.

CONFIDENTIAL

FROM: B FOX

DATE: 5 November 1986

ALL UNDER SECRETARIES AND ABOVE
PS/CHANCELLOR
APS/CHANCELLOR
PS/CHIEF SECRETARY
PS/FINANCIAL SECRETARY
PS/ECONOMIC SECRETARY
PS/MINISTER OF STATE
MR P GRAY
MR R PRATT
MRS R BUTLER
MISS SINCLAIR
MISS O'MARA
MR C MOWL
MR SEDGWICK
MR R CULPIN
MRS R DUNN
MR M STOCK
MISS C EVANS
MR C PICKERING
MR A RICHIE
MS M WALLACE
MISS L ADAMSON
MR D WALTERS
MR J DARLINGTON
MR M REES
MR N WICKS)
MR D NORGROVE) No 10
MR B GRIFFITHS)

F

Note.

Told Fox no one had spoken to A. Sod anyone at Telegraph tho' DN had spoken to J B-G. about the PM's Guildhall Speech N-L-U 5.11

DAILY TELEGRAPH

Today's Telegraph carries a lead story speculating on the contents of tomorrows Autumn Statement.

2. I should be gald to know, by 3.30 today, if you have spoken to Anne Segall, or anyone else at the Telegraph, in the past two weeks and, if so, the nature of the conversation. I should be grateful for nil returns, by 'phone if convenient.

B FOX

19

The Lord President is to be thanked most earnestly for his unfailing, matchless sense of duty. MT.

Prime Minister!
Content with the proposed paper?
Yes MT DRN 4/11

PRIME MINISTER

STAR CHAMBER: REPORT TO THE CABINET

I thought that you would like to see the attached copy of the Star Chamber's report which I should like to circulate tomorrow to Cabinet for consideration on Thursday.

2. After a further very difficult meeting this morning, I have now settled with Malcolm Rifkind on the basis of an addition of £10 million to baseline in 1987-88, with an equivalent arrangement in the two later years. This is not as low as either I or the rest of the Star Chamber would have wished, but I fear it was the best that was possible in the circumstances, given the desirability of not leaving this programme unresolved for Cabinet.

3. The key facts of the overall exercise are summarised in paragraphs 4 to 6 and in paragraph 17. In brief, despite reductions secured by the Group of £0.7 billion, £0.7 billion and £1.3 billion in the three Survey Years, the overall outcome (including the amount agreed last week for teachers' pay) exceeds the present published programmes, including the Reserves, by some £1.5 billion, £0.2 billion and £1.1 billion in the three years. As stated in paragraph 17 of the report, the Chancellor of the Exchequer will be recommending to the Cabinet to what extent the Reserves now need to be reconstituted.

4. What the bare figures above do not convey is the extreme difficulty of the task that faced the Star Chamber. We started from a position where the combination of the July local authority settlement, the irresistible demand led additions to the social security programme, and the range of bilateral agreements already reached by the Chief Secretary had more than exhausted the whole of the Reserve in the first year and about 90 per

cent of it in each of the two following years. Moreover, we were left with the most difficult, and certainly most politically sensitive, programmes to deal with.

5. As a result, I have to say that the negotiations were the toughest I have experienced, and in many respects the most unpleasant. In some cases, in addition to separate bilateral talks that I myself held, the Group had to hold three protracted negotiating sessions with the Minister concerned, and 25 full meetings in all. I should, of course, have liked to be able to bring the outcome nearer to the agreed planning totals. But I strongly believe that I have carried our position to the limits of political acceptability - and indeed in some cases beyond the limits of what the Minister concerned considered defensible.

6. I think that, after the dust has settled on this exercise, we shall need to consider very seriously how to tackle this exercise in the future. I am sure that the Chief Secretary will have views on this too. I should not like to see the Star Chamber again being required to operate from such a difficult and constrained negotiating position as on this occasion.

Privy Council Office
4 November 1986

SECRET - CMO until 31 December 1986

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C(86)

COPY NO

November 1986

CABINET

PUBLIC EXPENDITURE SURVEY 1986

Memorandum by the Lord President of the Council

At their meeting on 17 July the Cabinet decided that the Survey should be conducted within the published public expenditure planning totals of £144 billion for 1987-88 and £149 billion for 1988-89, and within a total of £153 billion for 1989-90, and invited the Chief Secretary, Treasury to pursue bilateral discussion of expenditure programmes with the Ministers responsible on that basis. At their meeting on 2 October (CC(86)32nd Conclusions, Item 2) the need to reach agreement with the Chief Secretary, Treasury was reinforced, and the Cabinet noted that a Ministerial Group on Public Expenditure (MISC 130) was being set up to discuss matters which could not be agreed between Departments and the Chief Secretary, Treasury and to make recommendations to the Cabinet.

2. This memorandum reports on the work of the Group and sets out the recommendations of MISC 130. 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.

3. A large number of programmes were agreed in bilateral discussions between the Chief Secretary, Treasury 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 130 were, however, left with eight programmes to consider, inevitably the most difficult.

4. Cabinet agreed on 17 July that discussions should be carried forward within the existing published planning totals referred to above. These contained uncommitted Reserves of £6 billion, £7.9 billion and £9.6 billion respectively. However, the July E(LA) decision on local authority current provision in 1987-88, together with the implications for the territories, added some £3.4 billion to the previous total, using up more than half the available 1987-88 Reserve. The subsequent agreement with the Ministers concerned to base provision for the two later years on 1/2 per cent real reductions in LA current spending also required additions to provision of £4.3 billion and £5.1 billion in 1988-89 and 1989-90 respectively. In addition to these amounts it was necessary to allow for increases of £1.1 billion, £0.8 billion and £1.1 billion respectively over the 3 years to take account of the agreements reached bilaterally by the Chief Secretary, Treasury.

5. As a consequence of these changes, the Group were faced with the position summarised in the following table at the beginning of their work:

	£ billion		
	1987-88	1988-89	1989-90
LA current additions:	3.4	4.3	5.1
Additions from bilateral settlement:	1.1	0.8	1.1
Giving total agreed increases on programme of:	4.5	5.1	6.2
Compared with starting Reserve of:	6.0	7.9	9.6

3.1. 2.9 4.8
0.7 0.7 1.3
2.4 2.2 3.5

AGREED PROGRAMMES

6. I am glad to report that the Group have reached agreement on all programmes and made significant progress towards removing the outstanding excesses. Of total outstanding bids of £3.1 billion, £2.9 billion and £4.8 billion in the 3 years on the programmes described below, the Group have agreed reductions of £0.7 billion, £0.7 billion and £1.3 billion, leaving additions of £2.5 billion, £2.2 billion and £3.5 billion, of which already agreed demand led changes and changes in administration costs on the social security programme account for some £1.6 billion, £1.8 billion and £2.6 billion. On the basis of the evidence presented to them the Group did not consider it practicable, in many cases from a political point of view, to seek reductions in programmes beyond this.

7. The proposals on the agreed programmes are summarised in parragraphs 8 to 16 below. All figures are in £ million unless otherwise stated.

Defence

8. The Survey baseline is as follows:-

18,817	18,990	19,268

Changes agreed outside the Group's discussions, including contributions to the cost of advancing AOR 02, are:

- 23	+ 26	+ 40.

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

+ 131	+ 136	+ 432

The Chief Secretary Treasury sought reductions below baseline of £300 million in each year.

The Group agreed to recommend the following further changes to baseline, taking account of the latest estimate of Falklands costs, which it is agreed will in future be subsumed within the baseline.

0	- 33	+ 157.

The Group have not been able to reach agreement on the cost of advancing the minehunter programme.

Electricity

9. The Survey baseline is as follows:-

-1,685	-1,281	-1,313

The Secretary of State for Energy had proposed the following additions to baseline:

+ 450	+ 171	+ 427.

The Chief Secretary, Treasury was prepared to accept additions of 100 and 50 in the first two years, but sought a reduction of -150 below baseline in the last year. After discussion with the Group and with the Chief Secretary, the Secretary of State for Energy has agreed to reduce his bid above baseline by £70 million, £80 million and £397 million respectively, leaving additions to beaseline of

+ 380	+ 91	+ 30

The Secretary of State for Energy has made it clear that the large reduction in the final year must in his view be regarded as without commitment and subject to revision in the light of negotiations with the industry in due course. The Group are prepared to accept the EFLs now proposed, but they believe that further planning should be on the basis that the financial target for the period after 1987-88 is assumed to be an average rate of

return on current net assets of 3.75 per cent in the years 1988-89 and 1989-90. (For the three years up to 1987-88 a target of 2.75 per cent has already been set). The Group believe that 3.75 per cent is a reasonable target to aim at, and that it would be right for the Government to press strongly for it to be agreed in time for it to be taken into account in the 1987 Survey. They therefore recommend the above figures on that basis.

Overseas Development Administration

10. MISC 130 and the Foreign and Commonwealth Secretary have agreed to recommend the following increase in the baseline provision for the overall programme:

+ 5	+ 8	+ 15

This will maintain the net aid programme constant in real terms during the Survey Period.

Health & Personal Social Services

11. The Survey baseline (excluding local authority current expenditure) is as follows:

15,937	16,617	17,032

The Secretary of State for Social Services sought additions of:

+ 461	+ 408	+ 772

Following discussions with the Group, and taking account of bids of £191 million, £205 million and £561 million for demographic growth and demand-determined service (eg Family Practitioner Services) already agreed by the Chief Secretary, Treasury, the Secretary of State for Social Services has agreed to accept the following additions to the baseline:-

+ 309	+ 219	+ 683

This will allow an increase of 2.2 per cent in real terms on hospital and community health services current spending in 1987-88, and 1 per cent in each of the two following years. The Group recommend these figures.

Social Security

12. The Survey baseline is as follows:

44,197	45,617	46,758

There are very large additions as a result of the effect of higher estimates of take-up of benefits and revised economic assumptions. In addition the Chief Secretary, Treasury has accepted further revisions for increased administration costs and other policy changes. The combined effect of these was to add the following net amounts to the above baseline

+1,597	+1,755	+2,618.

In addition to this the Secretary of State for Social Services proposed further additions of 45, 35 and 11, whereas the Chief Secretary, Treasury sought reductions of:

- 150	- 300	- 550.

13. After a very careful and detailed examination of the options for further savings, the Group, with the agreement of the Secretary of State for Social Services, recommend the following changes:

+ 35	- 100	- 250

The savings in the later years will be achieved by a variety of policy changes which the Secretary of State for Social Services will be considering further with the Chief Secretary, Treasury. Some of them will require primary legislation, which will need to be introduced in November or December 1987, or very early in 1988. The Group accept that the Secretary of State for Social Services should retain some flexibility over the precise measures, and commend the above reductions on this basis.

Arts and Libraries

14. The Minister of State, Privy Council Office (Minister for the Arts) sought substantial additions to his programme (£20 million, £29 million and £35 million in the 3 years respectively) in part to provide for overruns and other expenditure on the British Library St Pancras project, and in part for the Arts Council and for national museums and galleries. MISC 130 are concerned at the escalation of the British Library costs and agreed with the Chief Secretary, Treasury that further study is required before decisions can be taken. These bids have therefore been withdrawn and the position will be reviewed in the light of the above Study. MISC 130 have agreed the following additions to the baseline provision, with the Minister of State, Privy Council Office:

+ 7	+ 7	+8

Wales

15. In addition to formula consequentials on central government and local authority capital programmes agreed in England, the Secretary of State for Wales sought the full formula consequentials for the increase in local authority current expenditure in England resulting from the RSG settlement. This exceeded the amounts agreed for local authority current provision in Wales by:

+ 95	+ 97	+ 98

MISC 130 took the view that it would not be right to provide these full consequentials which would be devoted to the Secretary of State's other programmes. After discussion with the Group the Secretary of State for Wales agreed to surrender resources of £25 million, £27 million and £28 million in the three years respectively. £8 million of this in each year reflects an adjustment to the baseline to reflect the change in population ratios since 1979.

Scotland

16. In addition to formula consequentials on central government and local authority capital programmes agreed in England, the Secretary of State for Scotland sought the full formula consequentials for the increase in local authority current expenditure in England from the RSG settlement, together with additional provision for regional and industrial expenditure. These sums totalled

+ 107	+ 76	+ 91

As in the case of Wales, MISC 130 took the view that it would not be right to provide either these full consequentials or the extra provision for regional and industrial assistance. After discussion with the Group the Secretary of State for Scotland agreed to reduce the additional sums he sought to:

+ 10	+ 9	+ 9

Part of the sums foregone reflects the need to take some account of the change in population ratios since 1979, as in the case of Wales.

OVERALL POSITION

17. Parallel with the Group's discussions, the Cabinet agreed on 30 October to substantial additions for teachers' pay. Thus the position at the conclusion of the Group's work is as follows:

LA current	3.4	4.3	5.1
Teachers' Pay	0.6	0.9	1.0
Agreement reached bilaterally	1.1	0.8	1.1
Additions recommended by MISC 130	2.5	2.2	3.5
Total additions to Programmes	7.5	8.1	10.7
(compared with starting Reserves of)	6.0	7.9	9.6

(Note: Figures may not sum due to rounding).

The Group understand that the Chancellor of the Exchequer intends to consider and recommend to the Cabinet to what extent the Reserves need to be reconstituted in the light of the above outcome.

RECOMMENDATIONS

18. I invite the Cabinet to endorse the agreements reached, as summarised in paragraphs 6 to 16 above.

David

This is revised draft.

(1) now says "one change in NS fiscal regime" not "one tax change". (p 3)

(2) p 6 now says "there will be no relaxation" in fiscal stance

(3) p 12 now omits "than at any time this decade" in ht of unemployment

AC.

SM/AS

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

Cabinet today agreed the Government's public expenditure plans for the next three years.

In the normal course of events that would be followed by the publication of the printed Autumn Statement, accompanied by an Oral Statement to the House, next Tuesday.

For obvious reasons that is not possible this year.

So while the Autumn Statement will be printed in the normal way and presented to Parliament as soon as the House reassembles next Wednesday, I thought it would be for the convenience of the House if I made my Oral Statement today.

This will cover all three of the key elements in the printed Statement: the Government's outline public expenditure plans for each of the next three years and the expected outturn for this year; proposals for next year's national insurance contributions; and the forecast of the economic prospects for 1987 required by the 1975 Industry Act.

The full text of the economic forecast, together with the public expenditure figures and the rest of the information customarily published with this Statement

will be available from the Vote Office as soon as I have sat down.

They will also appear on the printed Autumn Statement to be published next week.

I turn first to the outturn for the current financial year, 1986-87.

The public expenditure planning total now looks likely to amount to almost £140½bn - £1¼bn, or a little less than 1 per cent, above what was allowed for in this year's Public Expenditure White Paper.

The main reason for this excess is an 8 per cent rise in the current spending of local authorities - far more than was provided for.

However, other items on the expenditure side which lie outside the planning total, the largest of which is debt interest, are likely to fall short of what was forecast at the time of the Budget, thus reducing the total overrun on the expenditure side to about £½bn.

On the receipts side, the North Sea tax take is likely to be even lower, by about £1bn, than I envisaged at the time of the Budget, largely because for a long period the oil price has been below the $15 a barrel level on which the Budget arithmetic was explicitly based.

This shortfall, however, is more than offset by the continuing buoyancy of non-oil tax revenues, in particular VAT and Corporation Tax.

Non-oil revenues now look likely to exceed the Budget forecast by £2bn.

This would imply a net overrun on the receipts side of about £1bn, rather more than that on the expenditure side.

At the same time I have one change on the North Sea fiscal regime to announce.

The collapse of the oil price has led to a sharp cutback in investment activity in the North Sea, with inevitable consequences for the UK offshore supplies industry both in Scotland and the North East of England.

Against this background the Government is conducting a review of the North Sea fiscal regime, and I shall be announcing my conclusions in the light of that review in the Budget.

But given the current difficulties of the offshore supplies industry, there is one change I believe it right to make without further delay.

I propose, on a carefully targeted basis, to accelerate the arrangements for the repayment to the oil companies

of Advance Petroleum Revenue Tax due to them.

The details of this change, which will require legislation early in the new Session of Parliament, are set out in a Press Notice the Inland Revenue will be issuing as soon as I have sat down.

The new arrangements will have a revenue cost this financial year of some £300m, which will be fully recouped over the next three years.

Taking this into account, the Public Sector Borrowing Requirement for the current year is still forecast to be about £7bn, the figure I set in the Budget.

I turn now to the public expenditure plans for the next three years.

This year, for the fourth successive year, public spending, both before and after deducting the proceeds of privatisation, is set to decline as a proportion of national output.

The Government is determined to ensure that this trend continues: to see to it that total public spending, even without taking account of privatisation proceeds, continues to decline as a percentage of GDP.

The plans I am about to announce for the next three years secure that objective.

Indeed, by the end of the period the ratio is planned to be back to the level of the early seventies.

But within this overall constraint, and in the context of its policy priorities, the Government has felt it right to allow an increase in the previously announced planning totals for 1987-88 and 1988-89.

Compared with the prospective outturn for the current year, we are now planning for an average growth of public spending of about 1¼ per cent a year in real terms, well within the prospective growth of the economy as a whole.

The new planning totals have thus been set at £148½bn for 1987-88 and £154½bn in 1988-89, an increase of £4¾bn and £5½bn respectively.

For 1989-90 the planning total has been set at £161½bn.

As usual, these totals incorporate estimates for the proceeds of privatisation.

Last year I increased the estimate of these proceeds very substantially to £4¾bn in each of the three Survey years, a figure which I expect to be duly achieved this year.

Although the privatisation programme is now moving ahead more strongly than ever before, I have decided to make only a modest further addition to this estimate, bringing

it to £5bn in each of the next three years.

The new planning totals also contain substantial reserves, rising from £3½bn in 1987-88 to £7½bn in 1989-90.

The public expenditure increases I have announced allow us to make realistic provision both for local authority current expenditure, over which the Government has no direct control, and for demand-led programmes such as social security, while still leaving scope for increased spending on services to which the Government attaches particular priority.

But before referring to some of the more important changes, let me make one thing absolutely clear.

There can be no question of allowing the projected increases in public expenditure over the next two years to undermine the prudence of the Government's overall fiscal stance.

X The Government's fiscal stance has been set out in the medium-term financial strategy published at the time of this year's Budget.

There will be no relaxation of that stance.

Within the totality of public expenditure, the largest increase is for the local authorities, whose current

spending next year is now put at £4bn above the previous provision.

This in part reflects the fact that the previous plans simply carried forward the same level of cash spending as in 1986-87.

At the same time, we are increasing next year's Aggregate Exchequer Grant - the contribution that taxpayers make to local government spending - by 9 per cent over this year's settlement; a rise of almost £1½bn.

These substantial sums demonstrate the priority the Government is giving to education, which, including the new proposals on pay and conditions of service for teachers announced last week, accounts for about half the increase in provision.

A further major portion of the increase is for the police.

On top of the increased provision for the cost of education in schools, which is contained within local authority current spending, there will be additional provision for the universities of £60m in 1987-88 and £70m in 1988-89.

Spending on the health and personal social services will be substantially increased.

For the National Health Service alone, the increases in

England amount to some £300m a year.

Combined with the additional resources increasingly being generated by greater efficiency, this will not only enable the Health Service to cope with a growing number of patients but will allow it to improve services.

Housing investment will be increased by £225m in 1987-88 over the expected outturn for 1986-87.

This will sustain the rising trend of spending on local authority renovation and improvements and provide additional resources for the housing associations.

In the light of this year's experience, £1¾bn has been added to next year's provision for social security, most of which represents a greater expected take-up of existing means-tested benefits.

Provision for roads is being increased by £65m next year and £75m the year after, mostly for local authority roads.

For defence, the provision remains as planned in the last White Paper after allowing for minor changes, including a reduction in the estimated cost of the Falklands deployment.

The defence programme will continue to benefit from the substantial real growth in previous years and the wide-

ranging action to improve efficiency and value for money.

Taking all programmes together, capital expenditure has been increased by almost £1bn in 1987-88, of which about two-thirds is local authority spending.

Further details of these and other changes will be contained in the printed Autumn Statement which will be published as soon as the House returns next week.

In addition, full details, together with information on running costs and manpower, will be given in the public expenditure White Paper early in the New Year.

I now turn to National Insurance contributions.

The Government have conducted the usual Autumn review of contributions in the light of advice from the Government Actuary on the prospective income and expenditure of the national insurance fund, and taking account of the benefit uprating which my Rt Hon Friend the Secretary of State for Social Services announced on 22 October.

The lower earnings limit will be increased next April to £39 a week, in line with the single person's pension, and the upper earnings limit will be similarly raised to £295 a week.

The limits for the reduced rate bands which I announced in last year's Budget will also be increased again in

April, but by proportionately larger amounts.

The upper limit for the 5 per cent and 7 per cent bands will be raised to £65 a week and £100 a week respectively, and the upper limit for the 9 per cent rate for employers will be raised to £150 a week.

The taxpayer's contribution to the National Insurance Fund - the so-called Treasury Supplement - will be reduced by 2 per cent to 7 per cent, but this will not require any change in contribution rates.

Thus the main Class I contribution rates will once again remain unchanged at 9 per cent for employees and 10.45 per cent for employers.

Finally, I turn to the Industry Act Forecast.

Both growth and inflation have turned out to be slightly lower this year than I envisaged at the time of the Budget.

Growth now looks like turning out at 2½ per cent, against a Budget forecast of 3 per cent, and inflation in the fourth quarter of this year is likely to be 3¼ per cent, against the Budget forecast of 3½ per cent.

The principal reason for this slower growth has been the disappointing performance of exports, which were hard hit by the cutback in spending by OPEC and other primary

producers affected by the sharp fall in commodity prices in general and the oil price in particular.

Combined with a halving in the value of our own oil exports, this has meant a significant deterioration in the current account of the balance of payments, from a surplus of some £3½bn in 1985 - and a cumulative surplus of £21bn over the six years from 1980 to 1985 inclusive - to a forecast of broad balance for 1986.

Looking ahead to 1987 the prospects are generally encouraging.

While the necessary adjustment of the exchange rate to the oil price collapse has now taken place, it will inevitably take time before the full benefits come through in higher non-oil exports and reduced import penetration at home.

This means we can expect the current account of the balance of payments to go into deficit next year, for the first time since 1979, to the tune of some £1½bn.

Even so, non-oil exports are forecast to rise next year by 5½ per cent, compared with an increase of only 1 per cent this year, with manufacturing output, in consequence, up by 4 per cent.

And with domestic demand continuing to expand at the same rate as this year, the economy overall is likely to grow

by a further 3 per cent next year - the sixth successive year of growth at 3 per cent or thereabouts.

Recorded inflation is likely to edge up a little, to 3¾ per cent in the Fourth Quarter of 1987.

This is almost entirely due to the effect on the RPI of the timing of mortgage rate changes.

The Government's commitment to a monetary policy that will squeeze out inflation remains unabated.

Meanwhile the likelihood of faster growth next year, coming at a time when unemployment already appears to have stopped rising, suggests that the prospects for some fall in unemployment are now more promising.

But this promise could still be frustrated by excessive pay settlements.

Mr Speaker, the strategy we have followed since 1979 has brought inflation down to the lowest level for two decades, combined with sustained growth and steadily rising living standards.

This is a combination that has eluded successive Governments for a generation.

We have brought it about by the determined pursuit of free markets and sound money.

And that is what we will stick to.

SM2/77

SECRET

18

FROM: A P HUDSON
DATE: 3 NOVEMBER 1986

PS/CHIEF SECRETARY

cc Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Scholar
Mr Turnbull
Mr Sedgwick
Miss O'Mara
Mr Culpin
Mr Gray
Miss Noble
Mr Pickering
Mr Cropper
Mr Tyrie
Mr Ross Goobey

AUTUMN STATEMENT

I attach the Chancellor's own draft of the Oral Statement.

2. The sections on detailed public expenditure measures are pending the Chief Secretary's views.

3. Please could I have comments and additional contributions by close tonight?

David
This is <u>very</u> draft
– likely to be substantially
amended @ meeting tomorrow.

A P HUDSON

for the current financial year, 1986-87.

The public expenditure planning total now looks likely to amount to some £140½bn ~~-~~ £1½bn, or a little over 1 per cent, more than was allowed for in this year's Public Expenditure White Paper. The main reasons for this excess is an 8 per cent rise in the current spending of local authorities - far more than was provided for. However, two major items of public expenditure which lie outside the planning total, debt interest and the overseas borrowings of the nationalised industries, are likely to fall £1bn short of what was forecast at the time of the Budget, which reduces the overall expenditure overrun to about £½bn.

On the revenue side, the North Sea tax take is likely to be even lower, by about £1bn, than I envisaged at the time of the Budget, largely because for a long period the oil price has been below the $15 a barrel level on which the Budget arithmetic was explicitly based.

This shortfall, however, is more than offset by the continuing buoyancy of non-oil revenues, in particular VAT and Corporation Tax, which now look likely to exceed the Budget forecast by £1½bn. This would imply an overall revenue overrun of about £½bn, the same as the projected expenditure overrun.

At the same time I have one tax change to announce.

The collapse of the oil price has led to a sharp cutback

fourth successive year, public spending is set to decline as a proportion of national output.

And this remains true even before deducting the proceeds of privatisation.

The Government is determined to ensure that this trend continues: to see to it that total public spending, even without taking account of privatisation proceeds, continues to decline as a percentage of GDP. The plans I am about to announce secure that objective. But within this overall constraint the Government has felt it right, in the context of its policy priorities, to allow an increase in the previously announced planning totals for 1987-88 and 1988-89.

The new totals have been set at £148½bn for 1987-88 and £154½bn in 1988-89, an increase of £4½bn and £5½bn respectively.

For 1989-90 the planning total has been set at £XYZbn. IP Compared with the forecast outturn for 1986-87, these totals suggest an average growth of public spending of a shade over 1 per cent a year in real terms, well within the prospective growth of the economy as a whole.

As usual, these totals incorporate estimates for the proceeds of privatisation. Last year I increased the estimate of these proceeds very substantially to £4¼bn in each of the three Survey years, a figure which I expect

to undermine the prudence of the Government's overall fiscal stance, either next year or subsequently.

The Government's fiscal stance will remain as set out in the medium-term financial strategy published at the time of this year's Budget, that is, the PSBR for 87-88 will be around below 1¾% of G.D.P.

Pending CST's views

[The largest increase comes on local authority current spending, where provision for 1987-88 and 1988-89 had previously been set at the same cash level as in 1986-87, pending further decisions. Full account has now been taken of likely future levels of spending, and this has meant an increase of £4bn in provision for 1987-88. Over half of this increase is for education, including the new proposals on pay and conditions of service for teachers announced last week. A further major portion of the increase is for the police. In subsequent years provision has been set so as to grow [broadly in line with] inflation.

In addition to the increased provision for the cost of education in schools contained within local authority current spending, there will be additional provision for universities of £60m in 1987-88 and £70m in 1988-89.

Spending on the health service will be increased by £310m in 1987-88 with further increases in subsequent years. Combined with the resources increasingly being generated

week. In addition, full details, together with information on running costs and manpower, will be given in the public expenditure White Paper early in the New Year.

I now turn to National Insurance contributions. The Government have conducted the usual Autumn review of contributions in the light of advice from the Government Actuary on the prospective income and expenditure of the national insurance fund, and taking account of the benefit uprating which my Rt Hon Friend the Secretary of State for Social Services announced on 22 October.

The lower earnings limit will be increased next April to £39 a week, in line with the single person's pension, and the upper earnings limit will be similarly raised to £295 a week. The limits for the reduced rate bands which I announced in last year's Budget will also be increased again in April, but by proportionately larger amounts. Thus the upper limit for the 5 per cent and 7 per cent bands will be raised to £65 a week and £100 a week respectively, and the upper limit for the 9 per cent rate for employers will be raised to £150 a week. The taxpayer's contribution to the National Insurance Fund - the so-called Treasury Supplement - will be reduced by 2 per cent to 7 per cent, but this will not require any change in contribution rates. Thus the main Class I contribution rates will once again remain unchanged at 9 per cent for employees and 10.45 per cent for employers.

reduced import penetration at home.

This means we can expect the current account of the balance of payments to go into deficit next year, for the first time since 1979, to the tune of some £1½bn.

Even so, exports are forecast to rise next year by 3 per cent, compared with an increase of only 1 per cent this year, with manufacturing output, in consequence, up by 4 per cent. And with domestic demand continuing to expand at the same rate as this year, the economy overall is likely to grow by a further 3 per cent next year - the sixth successive year of growth at 3 per cent or thereabouts, and into the seventh.

Record*ed* inflation is likely to edge up a little, to 3¾ per cent in the Fourth Quarter of 1987.

This is [entirely/almost entirely] due to the effect on the RPI of the timing of mortgage rate changes, and the Government's commitment to a monetary policy that will squeeze out inflation remains unabated.

Meanwhile the likelihood of faster growth next year, coming at a time when unemployment already appears to have stopped rising, suggests that the prospects for some fall in unemployment are now more promising than at any previous time this decade.

But this promise could still be frustrated by

R. Nagpur.

17

SECRET

P 02327

From: J B UNWIN
31 October 1986

LORD PRESIDENT

STAR CHAMBER: DRAFT REPORT TO CABINET

I attach a draft report which, subject to a detailed check of the figures and to the points below, I have discussed and agreed with Treasury officials.

2. The Treasury are submitting it to the Chief Secretary tonight; subject to his and to your comments, I should like to circulate it as soon as possible on Monday morning for discussion and clearance by the Star Chamber at the meeting we have arranged for 4 o'clock on Monday afternoon. Thereafter I assume that you will want to show it to the Prime Minister before circulation to Cabinet on Wednesday.

3. Mutatis mutandis, the paper follows the same shape as last year's. The context is, however, very different. On this account, I have tried to spell out in reasonable terms in the introductory paragraphs the virtually impossible position from which the Star Chamber were asked to start their work. You will want to consider yourself whether you think the balance here is fair from your point of view; the Chief Secretary will no doubt be looking at it closely also. As for the outcome and how to explain it, I have by agreement with the Treasury simply concluded on the basis that the Chancellor of the Exchequer will be making separate recommendations.

4. I would invite your attention to the following particular points:-

SECRET

(i) Scotland: we are still, I fear, not out of the wood, and I am minuting to you on this separately;

(ii) Defence: I think the Star Chamber should pause on this in their discussion on Monday. As you may recall, E(A) on 14 October saw a "good case for advancing the minehunter programme in order to provide continuity of work for Vosper Thornycroft". The decision was, however, remitted for further consideration in the Star Chamber in the context of the defence programme. Since then both the Chief Secretary and the Defence Secretary have confirmed in writing that they are not willing to finance the programme. You will, therefore, need to consider at this late stage whether some accommodation could be reached; or simply note that no agreement has proved possible. As things stand, neither the Chief Secretary nor the Defence Secretary are willing to fork out from the Reserve or the defence programme respectively;

(iii) Electricity: you will see that I have attributed to the Group a strong recommendation on the seriousness of the 3.75 per cent financial target. The purpose of this is to be able to secure endorsement of this proposition in the Cabinet Minutes for use next year. But you will need to consider whether this would be too provocative;

(iv) Social Security: as agreed with the Prime Minister and in the Star Chamber, I have omitted any specification of the possible savings in the packages for the later years. This is precisely the reverse of last year's policy when we took great trouble to itemise all the individual items so that no one could subsequently complain that they had not formally been warned. You may wish to reflect on this with your colleagues before giving final endorsement to this approach.

J B UNWIN

Cabinet Office

DRAFT

SECRET - CMO until 31 December 1986

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C (86) COPY NO

November 1986

CABINET

PUBLIC EXPENDITURE SURVEY 1986

Memorandum by the Lord President of the Council

At their meeting on 17 July the Cabinet decided that the Survey should be conducted within the published public expenditure planning totals of £144 billion for 1987-88 and £149 billion for 1988-89, and within a total of £153 billion for 1989-90, and invited the Chief Secretary, Treasury to pursue bilateral discussion of expenditure programmes with the Ministers responsible on that basis. At their meeting on 2 October (CC(86)32nd Conclusions, Item 2) the need to reach agreement with the Chief Secretary, Treasury was reinforced, and the Cabinet noted that a Ministerial Group on Public Expenditure (MISC 130)was being set up to discuss matters which could not be agreed between Departments and the Chief Secretary, Treasury and to make recommendations to the Cabinet.

2. This memorandum reports on the work of the Group and sets out the recommendations of MISC 130. 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.

3. A large number of programmes were agreed in bilateral discussions between the Chief Secretary, Treasury 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 130 were, however, left with eight programmes to consider.

4. Cabinet agreed on 17 July that discussions should be carried forward within the existing published planning totals referred to above. These contained uncommitted Reserves of £6 billion, £7.9 billion and £9.6 billion respectively. However, the July E(LA) decision on local authority current provision in 1987-88, together with the implications for the territories, added some £3.4 billion to the previous total, using up more than half the available 1987-88 Reserve. The subsequent agreement with the Ministers concerned to base provision for the two later years on 1/2 per cent real reductions in LA current spending also required additions to provision of £4.4 billion and £5.2 billion in 1988-89 and 1989-90 respectively. In addition to these amounts it was necessary to allow for increases of £1.0, £0.6 and £1.0 billion respectively over the 3 years to take account of the agreements reached bilaterally by the Chief Secretary, Treasury.

5. As a consequence of these changes, the Group were faced with the position summarised in the following table at the beginning of their work:

	£ billion		
	1987-88	1988-89	1989-90
LA current additions:	3.4	4.4	5.2
Additions from bilateral settlement:	1.0	0.6	1.0
Giving total agreed increases on programmes of:	4.4	5.0	5.1
Compared with starting Reserves of:	6.0	7.9	9.6

AGREED PROGRAMMES

6. I am glad to report that the Group have [reached agreement on all programmes] and made significant progress towards removing the outstanding excesses. Of total outstanding bids of £3.1 billion, £2.9 billion and £4.8 billion in the 3 years on the programmes described

below, the Group have agreed reductions of £0.7 billion, £0.7 billion and £1.3 billion, leaving additions of £2.5 billion, £2.2 billion and £3.5 billion. But the Group did not consider it practicable in the circumstances to seek reductions in programmes beyond this.

7. The proposals on the agreed programmes are summarised in paragraphs to below. All figures are in £ million unless otherwise stated.

Defence

8. The Survey baseline is as follows:-

18,818	18,990	19,268

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

+ 131	+ 148	+ 456

The Chief Secretary Treasury sought reductions below baseline of

- 300	- 288	- 276.

After taking account of small additions agreed by the Chief Secretary in the two later years as a contribution to the cost of advancing the order for AOR 02, the Group agreed to recommend the following provision in relation to baseline, which takes account of the latest estimate of Falklands costs.

0	[- 21]	[+ 181].

[The Group have not been able to reach agreement on the cost of advancing the minehunter programme]

Electricity

9. The Survey baseline is as follows:

-1,685	-1,281	-1,313

The Secretary of State for Energy had proposed the following additions to baseline:

+ 450	+ 171	+ 427.

The Chief Secretary, Treasury was prepared to accept additions of 100 and 50 in the first two years, but sought a reduction of -150 below baseline in the last year. After discussion with the Group and with the Chief Secretary, the Secretary of State for Energy has agreed to reduce his bids above baseline by £70, £80 and £397 million respectively, leaving additions to baseline of
:

+ 380	+ 91	+ 30

The Secretary of State for Energy has made it clear that the large reduction in the final year must in his view be regarded as without commitment and subject to revision in the light of negotiations with the industry in due course. The Group are prepared to accept the EFLs now proposed, but they believe that further planning should be on the basis that the financial target for the period after 1987-88 is assumed to be an average rate of return on current net assets of 3.75 per cent in the years 1988-89 and 1989-90. The Group believe that this is a reasonable target to aim at, and that it would be right for the Government to press strongly for it to be agreed [in time for it to be taken into account in the 1978 IRF.] They therefore recommend the above figures on that basis.

Overseas Development Administration

10. MISC 130 and the Foreign and Commonwealth Secretry have agreed t recommend the following increase in the baseline provision for the overall programme:

[2] [8] [13]

This will maintain the net aid programme constant in real terms during the Survey Period.

Health & Personal Social Services

11. The Survey baseline (excluding local authority current expenditure) is as follows:

15,937 16,617 17,032

The Secretary of State for Social Services sought additions of:

+ 461 + 408 + 772

Following discussions with the Group, and taking account of bids of £191, £205 and £561 million for demographic growth a demand-determined service (eg Family Practitioner Services) already agreed by the Chief Secretary, Treasury, the Secretary of State for Social Services has agreed to accept the following additions to the baseline:-

+ 309 + 291 + 683

This will allow an increase of 2.2 per cent in real terms on hospital and community health services current spending in 1987-88, and 1 per cent in each of the two following years. The Group recommend these figures.

Social Security

12. The Survey baseline is as follows

44,197 45,617 46,758

There are very large additions as a result of the effect of revised economic assumptions and higher estimates of take-up of benefits which are inevitable without changes including the April 1987 uprating. In addition the Chief Secretary, Treasury has accepted further revisions for increased administration costs and other policy changes. The combined effect of these was to add the following net amounts to the above baseline

+1,597	+1,755	+2,618.

In addition to this the Secretary of State for Social Services proposed further additions of £45, 35 and 11 million, whereas the Chief Secretary, Treasury sought reductions of:

- 150	- 300	- 550.

13. After a very careful and detailed examination of the options for further savings, the Group, with the agreement of the Secretary of State for Social Services, recommend the following changes:

+ 35	- 100	- 250

The savings in the later years will be achieved by a variety of policy changes which the Secretary of State for Social Services will be considering further with the Chief Secretary, Treasury. Some of them will require primary legislation, which will need to be introduced in November or December 1987, or very early in 1988. The Group accept that the Secretary of State for Social Services should retain some flexibility over the precise measures, and commend the above reductions on this basis.

Arts and Libraries

14. The Minister of State, Privy Council Office (Minister for the Arts) sought substantial additions to his programme (£20, £29 and £35 million in the 3 years respectively) in part to provide for overruns and other expenditure on the British Library St Pancras project, and in part for the Arts Council and for national museums and galleries. MISC 130 are concerned at the escalation of the British Library costs and agreed with the Chief Secretary, Treasury that further study is required before decisions can be taken. These bids have therefore been withdrawn and the position will be reviewed in the light of the above Study. MISC 130 have agreed the following additions to the baseline provision, with the Minister of State, Privy Council Office:

7	7	8

Wales

15 In addition to formula consequentials on central government and local authority capital programmes agreed in England, the Secretary of State for Wales sought in addition the full formula consequentials for the increase in local authority current expenditure in England resulting from the RSG settlement. This exceeded the amounts agreed for local authority current provision in Wales by:

95	97	98

MISC 130 took the view that, it would not be right to provide these full consequentials which would be devoted to the Secretary of State's other programmes. After discussion with the Group the Secretary of State for Wales agreed to surrender resources of £25, £27 and £28 million in the three years respectively. £8 million of this in each year reflects an adjustment to the baseline to reflect the change in population ratios since 1979.

Scotland

[16. To be completed later].

OVERALL POSITION

17. Parallel with the Group's discussions, the Cabinet agreed on 30 October to substantial additions for teachers' pay. Thus the position at the conclusion of the Group's work is as follows:

LA current	3.4	4.4	5.2
Teachers' Pay	0.6	0.9	1.0
Agreements reached bilaterally	1.0	0.6	1.0
Additions recommended by MISC 130	2.5	2.2	3.5
Total additions to Programmes	7.5	8.1	10.6

(**Note**: Figures may not sum due to rounding).

The Group understand that the Chancellor of the Exchequer intends to consider and recommend to the Cabinet to what extent and how the Reserves need to be reconstituted in the light of the above outcome.

RECOMMENDATIONS

18. I invite the Cabinet to endorse the agreements reached, as summarised in paragraphs to above.

PERSONAL Mr Nagrove.

16

SECRET & PERSONAL

P 02328

Prime Minister

From: J B UNWIN
31 October 1986

We may need an urgent meeting on Monday to discuss further tactics eg whether this should go next to E(S) or to Cabinet. DRN 31/10.

LORD PRESIDENT

STAR CHAMBER: SCOTLAND

I much regret that, despite protracted further discussions with the Scottish, I have still been unable to bridge the gap.

2. Scottish Office officials themselves are being constructive and helpful and doing what they can to persuade the Secretary of State that he can defend further reductions that would bring him to baseline. But (according to them) his position is now harder than it was yesterday and he has so far refused to accept anything that would take him below £25.5 million above baseline. My last assessment from the Scottish Office this afternoon was that they thought they might get him to £20 million above baseline - but they could at present find no means of going further.

3. To summarise the arithmetic briefly, you will recall that Mr Rifkind's last formal offer was £50 million above baseline. The Group stuck on £50 million below baseline; you floated the possibility of a settlement at baseline.

4. The only further reductions Mr Rifkind now seems willing to offer are:

(i) deduction from base of provision for rate revaluation rebates	14.5
(ii) reduction from applying population change to formula (from 11.76% to 11.51%)	10
Total further reductions	24.5
Amount still outstanding above baseline	25.5

5. It is simply not credible that Mr Rifkind could not defend removing this remaining 25.5. In my view the simplest way of so doing would be to attribute a larger reduction to the effect of relative population changes on the base (he has already accepted the principle by being willing to attribute 19.5 to this). His position seems to be, however, that this would take him too far down the slippery slope.

6. I am sorry not to have been more successful. I have made one or two further suggestions that the Scottish Office are considering, but there has been no joy so far. You may like to have a word on Monday morning on how to take matters further. I think it will be necessary for you to have another word with Mr Rifkind (necessarily on the telephone) before the Star Chamber on Monday afternoon.

7. I should add that the Chief Secretary continues to take a very hard line. He told me last night that his position remained that Mr Rifkind must be brought well below baseline.

J B UNWIN

Cabinet Office

David

This is what I propose to send. OK?

Alex

Suggested shortening first two paras & referring simply to contingency plans.

DGS.

SM/169

CONFIDENTIAL

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

30 October 1986

Tony Galsworthy Esq
PS/Secretary of State for Foreign & Commonwealth Affairs

AUTUMN STATEMENT

At this morning's meeting of Cabinet, the Prime Minister said she intended that Cabinet should discuss the outcome of the Public Expenditure Survey at its next meeting on 6 November.

In previous years, the Autumn Statement has been made on the Monday or Tuesday following the Cabinet meeting. This year, Parliament will not be sitting then. Rather than hold over the announcement until Thursday, 13 November after Parliament has resumed, the Chancellor plans, assuming all the necessary decisions have been taken, to make an Oral Statement on the afternoon of 6 November. The printed document would be presented to Parliament the following week.

The Chancellor proposes to accompany his Oral Statement with Press Notices containing the Industry Act forecast and a summary table of the expenditure plans; these would be made available in the Vote Office. He hopes that Departments will be ready as usual to issue Press Notices on the same day giving the main features of their programmes, and wherever possible backing that up with appropriate material on output, rather than emphasizing the money spent. The Prime Minister has stressed the importance she attaches to a positive and forward-looking presentation of the main features of the Autumn Statement.

A Statement on 6 November would not leave the usual interval between the Cabinet discussion and the Autumn Statement, and it is therefore particularly important that the texts of Press Notices should be agreed with the Treasury in advance to ensure both that the figuring is consistent and that the presentation is in line with the way the Autumn Statement as a whole is put over.

To ensure that the release of departmental Press Notices is properly co-ordinated with the announcements from the Treasury, I would be grateful if each Department could:

(i) notify the relevant Treasury Division by Monday morning whether it intends to issue a Press Notice on the day of the Autumn Statement;

(ii) show the Treasury Division concerned a draft by close on Monday;

(iii) provide Doug Walters here (233-8652) with the name and telephone number of someone in each Department who can be contacted about the arrangements for sending copies to the Treasury;

(iv) provide this office with 100 copies of the Press Notice by 4.00 pm on Wednesday so that we can circulate them if the Oral Statement is made the following day.

(v) arrange for the contact to inform Doug Walters by 2.00 pm at the latest on Thursday, 6 November if there is to be any modification of the Press Notice following the Cabinet discussion.

Although these plans are being made to allow for the Oral Statement to be made on 6 November, this cannot of course be taken for granted. It will depend on the settlement of any programmes still outstanding and the Cabinet discussion itself. For the time being, therefore, no public statement of the likely date of the Statement should be made. I should be grateful if you could ensure that knowledge of the arrangements is confined to those who need to know. If Departments are asked about the date of the Statement, they should say that the public expenditure round has not yet been concluded and that the Autumn Statement will be made as soon as practicable after final agreement has been reached.

I am copying this letter to the Private Secretaries to all Cabinet Ministers and to David Norgrove (No 10).

A C S ALLAN
Principal Private Secretary

SECRET

Ref. A086/3078

Prime Minister
to note the possible
course at X.
N.L.W.
29.10.

MR WICKS

Public Expenditure

If it proves impossible to settle the figures for Scotland without some formal discussion, and it is desired not to convene a full Cabinet, one possible course would be to call a meeting of E(A) on Tuesday 4 or Wednesday 5 November (a meeting of E(A) has already been arranged for 4 November at 11.00 am, which could be used for the purpose). A majority of the Cabinet attend meetings of E(A).

X 2. Another possible course would be to call a meeting of E(S). That is smaller, but grander (its members are the Prime Minister, the Lord President, the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Secretary of State for Energy, the Chancellor of the Duchy of Lancaster, the Secretary of State for Employment and the Secretary of State for Trade and Industry). It would be necessary to invite the Secretaries of State for Scotland and for Wales and the Chief Secretary, Treasury, to attend. A meeting of this Committee would be less likely to attract public attention (because it is smaller) than one of E(A); but, if it could reach an agreed (or nearly agreed) conclusion, it would no doubt carry the Cabinet.

RA

ROBERT ARMSTRONG

29 October 1986

SECRET

PAYABD

RA7.16

CCBE
B/up

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

29 October 1986

David Norgrove Esq
10 Downing Street
LONDON
SW1

Dear David

CABINET 30 OCTOBER: PUBLIC EXPENDITURE

As you know, at the Prime Minister's meeting this afternoon, the Chancellor suggested that the Prime Minister should tell Cabinet tomorrow that the intention was to discuss public expenditure at Cabinet next week; and that the Chancellor would make his Oral Statement that afternoon, providing everything was agreed.

... I attach a speaking note which the Prime Minister may like to use.

Yours,
Alex

A C S ALLAN
Principal Private Secretary

CONFIDENTIAL

DRAFT SPEAKING NOTE FOR THE PRIME MINISTER AT CABINET ON 30 OCTOBER

The Ministerial Group under the Lord President has reached agreement on a number of programmes referred to it, and the Chief Secretary has now resolved outstanding issues on a number of others. My intention is that Cabinet next week should discuss the outcome of the public expenditure Survey with a view to endorsing the settlements already reached and resolving any programmes that, despite all efforts, may be still outstanding. In the past we have found it possible to do so after one full discussion, and I very much hope that it will be possible to do again this year.

2. Assuming we are able to reach agreement at next week's Cabinet, it would be for the Chancellor to announce the outcome in his Autumn Statement. The timetable we have followed in previous years has been for the Chancellor to make the Statement in the House on the Monday or Tuesday following the Cabinet meeting. That timetable is not possible this year as the House will not then be sitting. Rather than hold up the announcement until a week later, the Chancellor would make an Oral Statement in the afternoon immediately after the Cabinet meeting. The printed document would be presented to the House when it resumes business the following week.

3. Although I am sure we should set up our planning on the basis of completion and announcement next Thursday, we cannot, of course, take that for granted. If, therefore, we are asked about the likelihood of a Statement next week, we should make clear that the survey is not yet completed and the date of the Autumn Statement depends on the progress we make.

[Chancellor then to amplify.]

CC(86)UP

14

SECRET

P 02324

From: J B UNWIN
29 October 1986

MR NORGROVE - No 10

DW 29/10.

STAR CHAMBER: LATEST POSITION

The following aide memoire may be helpful for the Prime Minister's discussion with the Lord President this afternoon.

Overall Position

2. Following developments this morning, and subject to the comments below, it now looks as if we are at or very near settlement on all programmes except Scotland.

Individual Programmes

3. The position on the main programmes may be summarised as follows:-

(i) Health: we have virtually agreed a settlement with Mr Fowler which will increase the HCHS programme by some 2.2 per cent in real terms in the first year, and by 1 per cent in each of the two following years;

(ii) Social Security: subject to clearance by the Chief Secretary, we are nearing a settlement which would produce savings of £100 and £250 million in the second and third years. Some of the savings will be unspecified, and primary legislation in late 1987 or early 1988 would be needed;

(iii) Defence: this has been settled on broadly baseline in each of the 3 years (with a small switch between the two later years). It does not, however, make provision for advancing the minehunters;

SECRET

(iv) Electricity: in response to the Lord President's letter of yesterday Mr Walker appears to be willing to accept a settlement at or near baseline in the two later years, based on an assumed average rate of return of 3.75 per cent over the survey period as a whole. If confirmed, this would eliminate his outstanding bid of around £330 million in the last year. But the details of the settlement now need to be examined quickly and confirmed by the Treasury;

(v) Overseas Aid: Sir Geoffrey Howe accepted this morning a settlement based on maintaining the programme in real terms. This gives him small additions, but removes the bulk of his bids;

(vi) Arts and Libraries: Mr Luce accepted this morning a compromise offer of £7, £7 and £8 million on his programme;

(vii) Scotland: this remains unresolved. Cutting through the complex range of subsidiary arguments, the gap in essence is as follows. The Star Chamber are seeking from Mr Rifkind a net cut of £50 million in his starting Survey baseline (excluding local authority current). Mr Rifkind's final offer would entail an addition of £40 to £50 million above this baseline. He argues strongly that anything below this would involve actual cuts in present Scottish services which are not being imposed anywhere else in the UK. The Lord President discussed the issues at length with him this morning and will want to report his views to the Prime Minister himself.

J B UNWIN

Cabinet Office

SECRET AND PERSONAL

CC 87 UP
13

Ref. A086/3065

MR WICKS

Public Expenditure

I understand that the Chancellor of the Exchequer may propose to the Prime Minister that he should raise the issue of public expenditure at Cabinet on 30 October, under the Home Affairs item. He is wondering whether colleagues ought to be given a little more warning in advance, both of the probable date of the Autumn Statement and of the nature of the very severe problems which the Government faces on public expenditure. The suggestion might be that the Prime Minister should say at Cabinet on 30 October that the recommendations of MISC 130 (the Star Chamber) will come to the Cabinet on 6 November, followed by the Autumn Statement the same day. In doing this she could give some inkling of where matters stand and emphasise the need for agreement and a united front.

2. This is a high risk strategy, I think, given the risk of leaks between 30 October and 6 November, particularly if one or two issues remain unresolved by 30 October. I am particularly concerned about the Secretary of State for Energy on electricity prices. It begins to look as if he may be determined to bring this matter to the Cabinet to resolve. If that is right, it would be very risky to leave it until the morning of 6 November, with the Statement that afternoon: it might be necessary to have a special meeting of the Cabinet on Tuesday 4 November or Wednesday 5 November, to give time for any necessary behind-the-scenes resolution before the meeting of Cabinet on 6 November.

RA

27 October 1986

ROBERT ARMSTRONG

SECRET AND PERSONAL

PAYABB

010 RC2.48

CC/BG

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

27 October 1986

Mark Addison Esq
10 Downing Street
LONDON
SW1

Dear Mark,

INFRASTRUCTURE SPENDING

... Further to the discussion at Cabinet last Thursday, I attach a note on infrastructure spending.

I am copying this letter and attachments to the Private Secretaries of all Cabinet Ministers.

Yours,

Cathy.

CATHY RYDING
Assistant Private Secretary

I have taken a copy
PAG 28/10

1. Mr Wicks
2. Mr Norgrove
to see

1a. Mr Bearpark

Can we get some of A and perhaps B into the M25 speech.

N.C.W

28.10.

ANNEX

CAPITAL SPENDING AND INFRASTRUCTURE: SPECIFIC SECTOR BULL POINTS

A

Roads: Since 1979, capital spending on motorway and trunk roads increased by 30 per cent in real terms. During 1985-86 70 miles of motorway and 145 miles of trunk road renewed. Backlog of motorway and trunk road repairs should be eliminated during next 5 years. Planned expenditure in 1986-87 on motorway and trunk roads in England increased to £900 million - increase of 10 per cent over 1985-86. Between 1979 and end July 1986 over 600 miles of new motorway and trunk roads were completed. Most of M25 London Orbital now opened at cost of over £1 billion. 20 bypasses now being built and 150 bypass schemes in preparation. In 1986-87 work planned to start on more than 40 new schemes worth £430 million, including 150 miles of new road. Since 1979, road prices have on average fallen relative to prices in economy as whole by about 11 per cent.

Water and Sewerage (England and Wales): Between 1978-79 and 1986-87 estimated to be public investment of £6.7 billion. Estimated to be £940 million invested in 1986-87. Plans in Cmnd 9702 show further increase in investment to £1,024 million by 1988-89.

B

Rail: Since 1979 investment of £2½ billion in railways and further £2 billion is planned over 5 years from 1986-87. Will include £300 million expenditure on East Coast main line electrification - greatest single railway investment in last 25 years. BR has investment plan for Channel tunnel involving expenditure of about £380 million.

Gas: Estimated that between 1978-79 and 1985-86 £5 billion spent on new capital expenditure on fixed assets. By end 1985-86 total of more than £2 billion invested in Rough field gas store and Morecambe Bay gas field. (BGC expected to be privatised in second half of November 1986.)

Electricity: Capital expenditure on fixed assets (including Scottish electricity) rises from £810 million in 1978-79 to estimated £1,671 million in 1985-86 - broadly in line with inflation. Torness AGR power station planned to be completed in 1986-87 at estimated cost of £1.2 billion. 2 gigawatt Cross Channel Link with France expected to be completed in 1986-87 at estimated cost of £390 million.

NHS: Between 1978-79 and 1985-86 capital spending on NHS increased by 28 per cent in real terms. Over £1 billion yearly now being spent on NHS capital repair and maintenance. More than 100 new hospital schemes planned to be completed over next 3 years. In England, more than 380 large hospital schemes underway in £3 billion hospital building programme.

Educational Buildings: In 1986-87 12 universities have major building projects in progress, or starting soon - at total estimated cost to public funds of £61 million (1986-87 prices). Maintenance expenditure on educational buildings risen substantially in real terms over recent years.

Housing (England): Capital spending on housing renovation increased from £481 million in 1978-79 to estimated £1,450 million in 1986-87 - 54 per cent in real terms. New private sector house building starts up 8½ per cent in 1986Q1 on year earlier - second highest level for 12 years and higher than at any time under last Labour Government.

Prisons (England & Wales): Programme of 14 new prisons, plus two at feasibility study stage, costing £387 million, with extra funds made available during Survey period. Between 1978-79 and 1985-86 capital spending on new buildings increased by 105 per cent in real terms.

Contact Point: N Barker
GEP2
233 4809

27 October 1986

fa. Send to me on a personal basis. DRN 29/10.

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SECRET

DRAFT ORAL AUTUMN STATEMENT (consistent with Plan B)

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

2. As the House will not be sitting next week, it is not possible this year to follow in every detail the usual timetable for publication of the Autumn Statement. But I thought it would be for the convenience of the House if I were to make a full oral statement today about the Government's public expenditure decisions, its proposals for next year's national insurance contributions, and the forecast of economic prospects for 1987 required by the Industry Act 1985. The printed Autumn Statement, in its usual form, will be laid before the House when we come back next week.

The outturn for 1986-87

3. I deal first, as usual, with the current year, 1986-87. In the public expenditure White Paper published last January, the planning total for this year was put at £139 billion. My best estimate of the prospective outturn is an excess of just over 1 per cent, at £140.5 billion. The main factors behind this have been the current spending of local authorities, whose budgets indicated an increase in spending of [8 per cent] over last year, an excess of £3 billion over the provision in the White Paper; local authorities' capital spending, which is now estimated to be running at £½ billion over plans; and an extra £1 billion on social security.

4. Revenue has also been running somewhat ahead of the forecast I made in the budget. In March it was already clear that buoyant demand in the non-North Sea economy, and an increasingly profitable corporate sector, were generating additional tax revenues which would more than offset the loss of revenue from the North Sea. That buoyancy is set to continue, both this financial year and next. Taking account of further increases in government receipts this year, which will in large measure offset the increased expenditure, I now estimate the outturn for the PSBR in the current financial year at [£7½] billion compared with the estimate of £7 billion made at the time of the Budget. Public sector borrowing is, then, running broadly on the track I set for it at budget time.

Public expenditure plans 1987-88 to 1989-90

5. I turn now to our public expenditure plans for the next three years, 1987-88 to 1989-90.

6. During the 1960s and 1970s, public expenditure grew by around 3½ per cent a year, faster than the economy as a whole. As a result, public spending came to represent a greater and greater proportion of GDP. With that, as the House and the country know to their cost, the burden of taxation and public borrowing inexorably increased.

7. Our objective has been to reverse these trends. The borrowing requirement is back at the level last seen in the early 1970s. In each of the last five budgets taxes have been reduced. From its peak of 46½ per cent in 1982-83, Government expenditure has fallen as a proportion of GDP to an estimated 43½ per cent in 1986-87.

8. Our approach to expenditure planning has been to relate spending to what the nation can afford to finance, whether by taxation or borrowing. To achieve our objective of bringing taxes down and keeping borrowing low in accordance with our medium-term financial strategy, it is essential that public spending continues to fall as a proportion of GDP. The plans I am about to announce will take the ratio down from [43½] per cent this year to [41½] per cent in 1989-90, back to the level of the early 1970s.

9. Within this constraint we have sought to achieve three things:

- to establish priorities, allowing us to increase spending on certain vital services such as education, health and the renovation of public sector housing;
- to make realistic provision for those areas such as local authority current expenditure which are not directly under government control, and the so-called demand-led programmes such as social security;
- over the whole range of spending to secure greater value for money so that better services are delivered from whatever resources are made available.

10. Within the constraints of this approach, and with the prospect of steady and continuing growth of national output over the next three years, we have felt able to make some increase in the previously announced planning totals of £144 billion in 1987-88 and £149 billion in 1988-89. The revised planning totals for the next three years will be £x billion, £y billion and £z billion. Compared with the forecast outturn for 1986-87, these totals represent an average growth of [just over 1 per cent] per year in real terms, well within the prospective growth of the economy.

11. These totals incorporate estimates for the proceeds of privatisation. Last year I raised the estimate of these proceeds to £4¾ billion in each year, a figure which I expect to be achieved this year. Although this programme is now moving ahead strongly, I have not thought it right to make any further substantial adjustment to this estimate, which has been rounded to £5 billion in each year.

12. For defence, our plans remain unchanged though in 1989-90 the cost of the Falklands Garison, now down to £130 million a year, will be met from within the Defence budget. The benefit of the heavy re-equipment programme of recent years and the increasing savings from greater efficiency will ensure that our improved defence capability is sustained.

13. In addition to enjoying the benefits of substantially higher receipts from council house sales, housing investment will be increased by £240 million in 1987-88. This will sustain the rising trend of spending on renovation and improvements.

14. Spending on the health service will be increased by £x million a year. Combined with the resources increasingly being generated by greater efficiency, this will not only meet the growing demands on the health service but will allow it to improve services.

15. The largest single increase is for local authorities whose current spending, including the provision for teachers' pay, is now put next year at £4 billion above previous provision. In subsequent years this spending is projected to grow more or less in line with inflation.

16. In addition to the very substantially increased expenditure on schools contained within local authority current spending, there will be additional provision for universities of £60 million in 1987-88 and £70 million in 1988-89. This fulfils the undertaking by the former Secretary of State for Education and Science to increase support for universities as part of a major programme to improve efficiency and raise standards. Grants to the Research Councils will be increased by £20 million a year.

17. £1¾ billion has been added to next year's provision for social services. Less than a third of this increase is attributable to changed economic assumptions about prices and unemployment. Most of the rest represents greater take-up of existing benefits.

18. Finally the plans will contain substantial and rising reserves of £a, b and c million. As I have made clear, additions have been made, from 1987-88 onwards, to local authority current and capital expenditure and to social security spending - the 3 programmes which, in the current year have put most pressure on the Reserve. This has been necessary to ensure realistic provision in each of the next 3 years. Although, in the current year, net increases in other programmes has been modest, I have nevertheless judged it prudent to include substantial Reserves for the next 3 years.

19. A summary table setting out the figures for each programme will be available in the Vote Office when I sit down and further details of these and other changes will be contained in the printed version of the Autumn Statement which will be published as soon as the House returns. In addition, full details together with

information on running costs and manpower, will be given in the public expenditure White Paper early in the New Year.

20. I now turn to National Insurance contributions. The Government have conducted the usual autumn review of contributions in the light of advice from the Government Actuary on the prospective income and expenditure of the national insurance fund, and taking account of the benefit uprating which my Rt Hon Friend the Secretary of State for Social Services announced on 22 October.

21. The lower earnings limit will be increased next April to £39 a week. The upper earnings limit will be similarly raised, to £295 a week, an increase of just 3½ per cent on the present limit of £285 a week. [That is the maximum permissible increase within the existing legislation.]

22. The limits for the reduced rates of contribution which I announced in the 1985 Budget, as a measure to boost lower paid employment, will also be increased in April. The limit for the 5 per cent and 7 per cent rates will be raised to £65 and £105 respectively. The contribution rate for employers will be raised from £140 a week to £150. In each case, the increase is rather more than the projected increase in earnings.

23. The Treasury supplement will be reduced from 11 per cent of contribution to 9 per cent. However, for the fourth year running, there will be no change in Class I contribution rates. Despite the growing number of pensioners and the substantial increase in social security spending which I have already announced, the main rates

will remain at 9 per cent for employees and 10.45 per cent for employers.

24. My Rt Hon Friend the Secretary of State for Social Services will announce details of these proposals [this afternoon] and will [shortly] lay before Parliament the necessary order and the accompanying report by the Government Actuary.

25. Finally I turn to the Industry Act Forecast.

26. Developments in the economy this year have in many ways been similar to those in the other large industrial economies. The world economy has been through a difficult phase of adjustment to a number of major shifts in relative prices - including the dollar, commodity prices in general and the oil price in particular. Exports by the major economies to OPEC and other developing countries have been weak, and this has led to some stagnation in industrial output, of which the United Kingdom has experienced its share. But total output growth in the major industrial countries in 1986 has generally been running somewhat ahead of growth in industrial output; here at home output as a whole has been about 2-2½ per cent above last year's level, compared with the Budget forecast of 3 per cent. 1986 has been the fifth successive year of growth, and has seen the start of the sixth, with growth averaging about [3 per cent] a year.

27. Domestic demand has risen rapidly this year, as expected at the time of the Budget. Inflation has fallen even more sharply than forecast, to levels not seen in the this country for almost

20 years. I now expect it to rise slightly above the current level, to 3¼ per cent in the fourth quarter of this year and to 3¾ per cent in the fourth quarter of 1987. Excluding the effects of mortgage rates it is now a little above 3 per cent and on this basis I expect it to be 3¼ per cent in the fourth quarter of this year; and 3¼ per cent in the fourth quarter of next year.

28. Employment has continued to rise; since the 1983 general election a million new jobs have been created, and total employment has risen for thirteen successive quarters. Unemployment may at last have begun to fall - although it must be some time before we will know if the very welcome falls in the last two months are the beginning of a new and sustained trend.

29. Looking ahead to 1987 the prospects are generally encouraging. There are now signs of buoyant domestic demand in most of the major industrial countries, and, with the fall in demand from OPEC and other developing country markets coming to an end we may expect a more vigorous and assured growth in world output and trade. Over recent years, in sharp contrast to the previous pattern, we have maintained our volume share of world trade in manufactures, and it is now clear that our exports have resumed the vigorous growth they were showing before the pause in activity began.

30. British industry is now in an exceptionally favourable position to take advantage of the strengthening of the world economy. The adjustment of the sterling exchange rate to a lower level of oil prices has now taken place, and our exports are now more competitive than they have been for many years. Full

adjustment of our trade to all these shifts in relative prices will, of course, take time, and, taking account of the much slower than forecast growth in our export markets, I now expect the current account of the balance of payments to be in approximate balance this year, with a deficit of some £1½ billion in 1987.

31. Although output in the North Sea is likely to fall next year the growth of non-oil exports is, as I have indicated, expected to run more strongly in 1987. Domestic demand is likely to grow at about the same rate in 1987 as this year. The favourable prospects for industry should mean a good investment performance. All in all I expect 1987 to be a year of balanced growth at a sustainable pace, with output as a whole rising by almost 3 per cent.

32. The full text of the Autumn forecast is to be published today by the Treasury and will be included as usual in the printed Autumn Statement next week. The forecast is now available in the Vote Office.

PERORATION

33. Mr Speaker, the strategy we have followed since 1979 has brought inflation down to the lowest level for two decades, combined with sustained growth and rising living standards. That combination has eluded governments of both parties for many years. We have brought it about by sticking to policies of free markets and sound money. We shall continue to stick to those policies.

11

Prime Minister

DRV

24/10.

PRIME MINISTER

PUBLIC EXPENDITURE: STAR CHAMBER

I thought I should let you have for the weekend a brief report on where matters stand following our discussion on Tuesday.

2. Since we met, I have had further discussions in the Star Chamber with Norman Fowler, Nicholas Edwards, Malcolm Rifkind, Peter Walker, Geoffrey Howe and Richard Luce. The outcome is broadly as follows:

i. Social Security and Health: I have asked Norman Fowler to make further large reductions in the Social Security programme in the two later years (£100 and £250 million respectively) and to consider the implications of keeping within a profile of real increases of 2 per cent, 1 per cent and 1 per cent on the hospital and community health services current programme. He is due to report back to me by tonight and I very much hope that we shall be able to reach a settlement. There are indications that this may be possible;

ii. Scotland and Wales: I have reached a conditional agreement with Nicholas Edwards on Wales, in which he is prepared to accept the adjustment for relative population change since 1979 (£8 million) provided Malcolm Rifkind does also. We are still, however, far from agreement on Scotland. I am pressing hard for acceptance of at least a substantial part of the population change effect there (the full amount would be £133 million in 1987-88) and I plan to see Malcolm Rifkind again in the Star Chamber next Tuesday;

iii. Electricity: This is so far the most difficult, and most important, outstanding issue. Peter Walker has offered further modest savings, which would reduce his bid for an extra £1,048 million over the three years by some £250 million. He is adamant that he cannot do more. The Star Chamber have, however, made it clear to him that this is not an acceptable offer, and I have asked him to consider the possibilities further and let me have his reaction before the weekend. Subject to that, I plan to invite him to come to the Star Chamber again next Tuesday. As you know, the crucial issues are price increases and the target rate of return for the industry. To increase the present assumed rate of return of 2.75 per cent in the last year to 3.75 per cent would yield around another £350 million, which would make a crucial difference;

iv. Overseas Aid: I saw Geoffrey Howe yesterday and made it clear that we saw no case at all for going beyond maintenance of the programme in real terms, which would mean rejecting his bids except for the addition of £6 million in the last year. He will reflect on this, and I think there is just a possibility that he may accept it;

v. Arts and Libraries: Although the amounts are small, there remains a significant gap between the Group and Richard Luce, with whom, however, negotiations are still continuing.

3. As indicated above, I hope to see Norman Fowler, Malcolm Rifkind and Peter Walker - and if necessary Geoffrey Howe - again in the Star Chamber next Monday and Tuesday. I suggest, therefore, that it might be more sensible if I were to postpone

a meeting has been arranged.

seeing you for a further round up discussion until Wednesday, when I believe you may have time in your diary in the afternoon. I shall then be in a better position to advise you on the overall position and in particular to discuss with you which of our colleagues it might then be advisable for you to consider seeing yourself. I shall, of course, continue to do what I can to achieve the toughest possible settlements within the Star Chamber, but the overall position is still very difficult indeed and there are some hard nuts to crack.

4. I am sending a copy of this minute to the Chief Secretary.

J M Macmillan

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

Privy Council Office
24 October 1986

PERSONAL Mr Nagrove

10

pa

SECRET & PERSONAL

P 02306

From: J B UNWIN
23 October 1986

LORD PRESIDENT

STAR CHAMBER, TAKING STOCK

The purpose of this minute is to suggest how you might tackle the meeting at 5.30 pm today to discuss the work of the Group.

Overall Position

2. I do not have the exact numbers but on a rough assessment if we settled on the proposals made this week to the Group we should exceed the target by some £0.8 billion in 1987-88, and by larger amounts than earlier assessed in the later years (particularly in the last year because of electricity). The general strategy must, therefore, remain to continue the pressure where ever you judge it feasible.

Main Issues

3. You will have to review Overseas Aid after today's meeting. Otherwise, the key outstanding issues now boil down to:-

(i) Social Security: year 1 is virtually settled. You have asked for savings of £100 and £250 million in years 2 and 3. The crucial issue is the new benefit rates in April 1988;

(ii) Health: the target to aim at seems to me to be real increases of 2 per cent, 1 per cent and 1 per cent on HCHS (though it might be necessary to go to 2.2 per cent in the first year to match the previous year). This would give increases over baseline of £285, 264 and 659 million (£305 million for 2.2 per cent in year 1). The key question is

SECRET & PERSONAL

whether the Group are prepared to hold out for this;

(iii) Wales and Scotland: you have told Mr Rifkind that his offer of reducing his bids to £50 million in year 1 is not good enough. The key issue is whether the Group are prepared to insist on the relative population change, which could not be concealed when the figures are public;

(iv) Electricity: Mr Walker's offers bring the increase over baseline to £380, 91 and 327 million (reducing his total bid of £1048 to £798 million). You have told him that, although we are nearly at agreement on year 2, the Group must seek much larger reductions on years 1 and 3. The key issues are:

- Year 1: whether the Group are prepared to face the April 1987 price increase issue head on (each 1 per cent increase gives £80 to 90 million);

- Year 3: whether to insist on a higher rate of return (an increase from 2.75 per cent to 3.75 per cent would yield around £350 million).

Next Steps

4. My assessment is that on social security and health you are still in negotiation, and there is still a prospect of agreeing a settlement. I suggest, therefore, that you should plan on an early meeting with Mr Fowler next week.

5. On Scotland and electricity, however, although you may want to make one last effort when you see their responses, I suspect that both of these will need to go to the Prime Minister. This may also be the case with Overseas Aid, if you make no progress this afternoon; as also on Arts and Libraries depending on developments.

Handling

6. Subject to the Chief Secretary's views, I suggest you steer the Group through the discussion on the above basis.

J B UNWIN

Cabinet Office

PERSONAL Mr Nagrove

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pa

SECRET

P 02303

From: J B UNWIN
22 October 1986

LORD PRESIDENT

STAR CHAMBER: OVERSEAS AID
(MEETING WITH SIR GEOFFREY HOWE AT 4 PM ON THURSDAY, 23 OCTOBER)

The position on the aid programme may be summarised as follows:

	£ million		
	1987-88	1988-89	1989-90
Survey baseline	1,350	1,391	1,426
Department's desired outcome	+ 36.4	+ 72.5	+116.7
Treasury's desired outcome	+ 0.4	+ 1.5	+ 0.7
Gap	36.0	71.0	116.0

2. The Foreign Secretary's bid comprises two items:-

(i) Net Aid Programme + 30 + 65 +110

As you know, this simply represents the amount necessary to maintain the aid programme as a proportion of GNP (0.31 per cent) after 1986;

(ii) War service Credit + 6 + 6 + 6

This represents the amount necessary to give former members of the Overseas Civil Service pension credit for war service (which apparently they alone of other public service pensioners do not at present receive).

SECRET

3. When you saw Sir Geoffrey Howe privately on 8 October he refused to make any concessions. He will no doubt deploy again the usual range of arguments - the "Geldof" factor, general political pressures, the desirability of a further move towards the UN target of 0.7 per cent of GNP, the need to alleviate the squeeze on bilateral aid programmes etc.

4. There are counters to all these arguments. For example, there is (so far!) no evidence of widespread political pressure this year for further increases; and last year's increases put the Government in the wholly defensible position of maintaining the aid programme in real terms until 1988-89 (and an extra £6 million would maintain it to 1989-90 also). The Government's aid record is in any case not bad - sixth largest among Western donors and third largest in the EC. Beyond these is the simple fact that, with all the other (more politically sensitive) competing pressures, we simply cannot afford the increases demanded.

Tactics

5. You will want to encourage the Chief Secretary and the other members of the Group to put the counter arguments as strongly as possible to the Foreign Secretary. If he shows any signs of being willing to offer a reasonable compromise, you will want to explore it. Bearing in mind Mr Luce, however, I would interpret "reasonable" as being no more than, say, £10, £15 and £20 million in the three years. If, however, he remains unyielding, you will want to make it clear that you will have to refer the issue forthwith to the Prime Minister. I have asked Mr Norgrove to see if he can contingently earmark a slot for an early follow up meeting.

J B UNWIN

Cabinet Office

SECRET AND PERSONAL

SUBJECT cc MASTER

8 ECL

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

21 October 1986

PUBLIC EXPENDITURE

The Prime Minister this afternoon discussed with the Lord President, the Chancellor of the Exchequer and the Chief Secretary the position reached so far in the Star Chamber. Sir Robert Armstrong and Mr. Unwin were also present. The meeting discussed in turn each of the major programmes which have not so far been settled.

Please handle this letter with particular care.

Scotland

The Lord President and the Chief Secretary explained that Mr. Rifkind and Mr. Edwards were adamant in refusing as a matter of principle to accept any overt reduction in the full consequentials of the local authority settlement in England. Mr. Edwards was prepared to accept a reduction of £8 million on the grounds of relative population changes. The counterpart reduction in Scotland would be over £130 million in the first year and Mr. Rifkind was not willing to accept that. There was also a Northern Ireland dimension. Mr. King had accepted less than the full consequentials from the English local authority settlement. If Wales and Scotland were to receive the full amount he might seek to reopen the settlement in Northern Ireland, and he could also ask for more money on the grounds of population changes.

It was agreed that the Star Chamber should seek to win the largest concessions possible from Mr. Edwards, including the reduction on account of population changes. They should do the best deal they could. This would establish the principle of the population adjustment which could then be used against Scotland. The Star Chamber should open by seeking the full population adjustment in Scotland, though it might be necessary to accept some reduction in this. Mr. Rifkind should be left the freedom to decide how to justify the reduction in public. Any request from Mr. King to reopen the settlement in Northern Ireland should be firmly refused. The Lord President would be willing to see him if necessary.

SECRET AND PERSONAL

Social Security

It was agreed:

(i) the decision that people on supplementary benefit should meet their mortgage interest payments in their first six months on benefit should stand;

(ii) it would certainly be worth considering whether 16 to 18 year olds could be denied the right to supplementary benefit; this would also probably save on payments of housing benefit because the people concerned would then not set up independent homes; no guarantee of a YTS place should be given;

(iii) extension of the period for which the voluntary unemployed could be denied social security was certainly worth considering; withdrawal of the 25p payment for over 80s was not;

(iv) the least difficult way of finding the required savings in 1988/89 and the bulk of the savings in 1989/90 would be to begin the new social security system with lower rates of payment in April 1988;

(v) it would be important to agree figures for reductions with Mr. Fowler which he was prepared to accept without too much reluctance; this would reduce the risk that he would seek to open up a discussion in Cabinet.

It was recognised that to agree global reductions with Mr. Fowler, rather than specific measures would reduce the risk of damaging leaks though it would in turn increase the risk that when specific proposals were put forward later they would be rejected and the savings lost.

Health

It was agreed that the Star Chamber should work very hard to achieve a settlement which involved no more than a two per cent increase in health spending in real terms in 1987/88 and one per cent in each of the two following years.

Overseas aid

It was recognised that Sir Geoffrey Howe was unlikely to reach agreement with the Star Chamber. The Prime Minister would see him, with the Lord President, the Chancellor and the Chief Secretary, after the Star Chamber had met him.

Electricity

It was noted that the effect of achieving the Treasury's objective of a three per cent nominal increase in electricity prices in the first year would put a shade under 0.1 per cent on the RPI for a reduction of £$^1/_4$ billion in public expenditure. It should be perfectly possible to ensure that

the increase was put into effect. Indeed three per cent amounted to a reduction in real terms and was less tough than the agreement which had been reached for electricity in Scotland in the first year.

It was agreed that Mr. Walker should be presented with the choice of finding savings of this order in the first year in his own way or by an increase in electricity prices. If this failed to achieve a settlement the matter would have to be brought to the Prime Minister.

It was agreed that a further meeting with the Lord President, the Chancellor and the Chief Secretary would be held early next week to take stock of the position then reached by the Star Chamber.

I am copying this letter to Alex Allan (H.M. Treasury), Jill Rutter (Chief Secretary's Office), Trevor Woolley (Cabinet Office) and Brian Unwin (Cabinet Office).

Yours,

David.

DAVID NORGROVE

Miss Joan MacNaughton,
Lord President's Office.

CABINET OFFICE

With the compliments of

J. B. UNWIN

70 Whitehall, London SW1A 2AS
Telephone 01 233

PERSONAL : PC Norgrove

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SECRET & PERSONAL

P 02297

From: J B UNWIN
21 October 1986

LORD PRESIDENT

STAR CHAMBER: MEETING WITH THE PRIME MINISTER

You may find the following notes helpful for your meeting with the Prime Minister this afternoon.

General Situation

2. The Prime Minister is familiar with the general position, both from my minute of last Friday and from the Chief Secretary's report at Chequers. You will, however, want to give her your general assessment of the exceptionally difficult position the Group are in, and leave her under no illusions about the stiff opposition you are facing and very small room for manoeuvre you have been left with. You might, if necessary, wish to consider hinting that the 70:30 settlement in favour of the Chief Secretary that you have been asked to achieve in the first year seems a good deal tougher than many of the settlements that the Treasury have already made bilaterally.

Individual Programmes

3. You will want to report to the Prime Minister the outcome of the discussions with Mr Fowler today on social security and health. On the former, it may be necessary to disabuse the Prime Minister of any lingering notion that very much more can be done, particularly next year, although Mr Fowler has agreed to consider further the possibility of reductions of £100 and £250 million in the two later years. On health, you will want to consider in the light of this afternoon's discussion, whether to seek her support for pressing Mr Fowler to go further than the modest savings of £95.5, 71 and 47 million he has offered. Would she consider a

real growth profile of 2%, 1% and 1% defensible?

4. For the rest, I suggest you raise with her only the following programmes:-

(i) Electricity (England and Wales): the key issue is how far the Prime Minister is prepared to lend her support in pressing Mr Walker to moderate his bids of some £1050 million over the three years. Apart from an offer of £40 million in the first year, Mr Walker's position is that he cannot agree to any further savings, and even if he did, he could not deliver them. But the remainder of your discussions show how crucial electricity is. Despite the problems, it would be much preferable to make savings here than on, say, some of the extremely difficult and contentious social security proposals. I attach for convenience a copy of the Chief Secretary's suggested savings. These are predicated on a real tariff path of -1/2 per cent in the first 2 years, and 0 per cent in the last year. I think this is perhaps a little ambitious, and, as you have already acknowledged, the scope in the first year is more limited. But it really ought to be possible for Mr Walker to bring the numbers down substantially by making tougher assumptions about financial targetting in the last two years. This need not at this stage imply precise judgements on the tariff path; and the RPI effects in any case are not all that large - 0.03 per cent on the RPI for each 1 per cent increase in tariffs;

(ii) Scotland and Wales: the fundamental obstacle, which all the Group acknowledge, is the application of the formula consequentials to the local authority current settlement. In Wales, on top of the 1 per cent increase in real terms in 1987-88 already agreed, this would provide additions of 95, 97, and 98 in the three years (which the Welsh Secretary would use for other purposes). In Scotland, the amounts are smaller (67, 66 and 58) but the bids for non block purposes are larger (40, 10 and 33).

The Scottish and Welsh Secretaries have made it very clear that as a matter of principle they cannot agree to suspension of the formula arrangements. They argue that in a bad year, when things go wrong, they have to find extra money from within their block; so it is reasonable for them to take the "benefit" when things go the other way. There are now two main options. The first is to suspend the block arrangements this year for LA current, perhaps followed by a new enquiry into the relationship of LA spending to the block. The second, which you now favour, is to adjust the base-line once off to reflect the change in population ratios since 1979. This would save:-

	£ million		
	1987-88	1988-89	1989-90
Scotland	133	163	190
Wales	8	8	8

Would the Prime Minister support this? In either case you would presumably reject the other non block bids.

(iii) Overseas Aid: the Prime Minister is aware of the Foreign Secretary's bid for £36, 73 and 117 million, which is related to maintaining the same GNP proportion. You will want to discover how far the Prime Minister would be prepared to support the Group in resisting this bid, though perhaps at the cost of some further small additions.

Tactics for Cabinet

5. In the light of discussion of the above you will also want to take the Prime Minister's view on how many, if any, issues she would be prepared to see come to Cabinet. It may also be necessary for her to be willing before then to engage in some "trilaterals" on some of the issues referred to above. You will no doubt in any case want to report to her again on progress at the end of this week.

J B UNWIN

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MISC 130 : electricity

		1987-88	1988-89	1989-90	total
Comparisons with baseline (£m)					
A	Outcome for all nationalised industries assuming latest offer for ESI	+680*	+350	+260	+1290
Electricity					
B	Bid net of agreed savings	+450	+171	+427	+1048
C	Treasury position	+100	+50	-150	0
	Savings available by real tariff path of	-½%	-½%	0%	
D		-240	-220	-420	-875
E	Unspecified savings previously mentioned by Mr Walker	~~-60~~ 4	-	-	-60
F	Outcome with these savings = B-D-E (rounded)	+150	-50	0	+100

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*subject to agreement for coal in 1987-88 and to a decision on the BAA entry for 1987-88.

Tougher deal w. McKinnon.

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(6)

P 02296

From: J B UNWIN
20 October 1986

LORD PRESIDENT

STAR CHAMBER: SOCIAL SECURITY
MEETING WITH MR FOWLER AT 9.30 AM ON TUESDAY, 21 OCTOBER

The outcome of your first meeting with Mr Fowler last week was as follows:

(i) 1987-88: virtual agreement, subject to settling the uprating and consultation with the Chief Whip on the proposal to restrict supplementary benefit (SB) for mortgage interest to 50 per cent in the first 6 months of a claim. Mr Fowler wanted to modify it to 3 months at a cost of £10 million a year;

(ii) 1988-89 and 1989-90: Mr Fowler was asked to produce a further paper setting out a menu of possible savings.

2. I fear that we still do not have Mr Fowler's paper. As usual, DHSS are leaving it until the very last minute. The following briefing is, therefore, based on such advance intelligence as I have been able to get, and will need to be checked against the actual paper when we receive it.

MAIN ISSUES

3. I think you should pause briefly on 1987-88, and then proceed to the later years, on the basis below.

1987-88

4 The slightly higher uprating (2.1 per cent) has added some £25 million to the base. This increases the need to press Mr Fowler on the mortgage interest point. Subject to this, however, I think you can close the book on this year. I understand the possibility

of not uprating Additional Requirements in 1987 is now academic; DHSS now find that the uprating factor is too small to justify uprating most of these amounts anyway.

1988-89 and 1989-90

5. I understand that DHSS will circulate a note by officials (agreed with the Treasury) which lists the main savings possibilities, together with a brief statement of the pros and cons. Mr Fowler will probably add a short covering note declaring most if not all of them to be politically unacceptable.

6. The "menu" will select from the three illustrative packages in the Chief Secretary's original paper (MISC 130(86)7). The main measures likely to be included are:-

- changes to the earnings rule for widows and retirement pensions;

- changes in the rules for offsetting occupational pensions against benefits;

- tightening the National Insurance (NI) contribution conditions for unemployment benefit (UB) and supplementary benefit (SB);

- increasing the qualifying period for invalidity benefit from 26 to 52 weeks (a big saver - 20 in 1988-89 and 130 in 1989-90);

- abolishing the 25p age addition for the over 80s (saves 23 in 1989-90);

- extending the disqualification/deduction from UB and SB for voluntary unemployment from 13 to 26 or 52 weeks;

- paying attendance allowance for children at half adult rates (saves around 40 a year);

- forego the April 1989 child benefit uprating (saves 120).

7. You will want to go through these in order on the basis of the paper at the meeting, starting with the view of Mr Fowler and the Chief Secretary. Since Mr Fowler is likely to dismiss most if not all of them, the onus must be on the Chief Secretary to declare his own preference.

Need for Legislation

8. A crucial consideration will be whether the Group are prepared to recommend changes that need primary legislation. If not, the options will be even further constrained. If so, and subject to Mr Fowler's comments, I think that it should be possible to postpone announcement of legislation until the November 1987 Queen's Speech. The Treasury also believe that the details of those savings could be "lost" in the meantime - in other words, the gaff need not be blown in next Spring's Public Expenditure White Paper. If this is correct, it could have a significant bearing on the possibilities in relation to the prospective date of the next election.

Child Benefit

9. The largest single savings option is to forego the April 1989 child benefit uprating. This would save an estimated £120 million in the last year. This would not need legislation. The present position is that, as agreed at last year's Star Chamber, there is no provision in the figures for an April 1988 child benefit uprating; but Mr Fowler has put in a bid for one in April 1989. It would be possible to remove this from the figures on the basis (if questioned) that the Government will review the position nearer the time in the light inter alia of the introduction in April 1988 of the new social security arrangements, including the

generous Family Credit Scheme.

Conclusions

10. I think that you ought to aim to reach at least a provisional conclusion tomorrow morning on what savings might be possible. You might then wish, before finally making up your mind, to try this out on the Prime Minister when you see her tomorrow afternoon.

J B UNWIN

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P 02291

From: J B UNWIN
17 October 1986

MR NORGROVE - NO 10

cc PS/Lord President

STAR CHAMBER: CURRENT POSITION

The Lord President has asked me to let you have for the Prime Minister a short report on the work of the Star Chamber, which he will wish to discuss when he sees her next Tuesday.

General Position

2. Apart from Overseas Aid (due to Sir Geoffrey Howe's absence) the Group have held initial discussions covering 7 of the 8 disputed programmes. Although this is fewer than last year, the Lord President has asked me to say that in his opinion the resistance, apart from the Defence Secretary, has been the stiffest he has ever known.

3. Although the Star Chamber have made some exploratory proposals without commitment, they have not reached any firm conclusions. They are meeting to discuss tactics on Monday and will start negotiations in earnest during the coming week. The Lord President will particularly wish to discuss with the Prime Minister which issues it would be right to continue to contest very strongly, and on which it would be sensible for the Star Chamber to strike the best deal they can.

4. In view of the provisional nature of the discussions it is far too soon to reach any precise overall judgement. But it is clear that to reach or even come near the targets set for the Group will entail very much greater cooperation from the Ministers concerned than has been forthcoming so far. As the Prime Minister will know, the aim set by Treasury Ministers was to settle within the Reserve in 1987-88, and to leave £3/4 billion and £1 billion of

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the Reserve unallocated in the two later years. This implied settlement of the outstanding "gap" some 70:30 in the Chief Secretary's favour in the first year, and 50:50 and 60:40 in the two later years. The implied outcome of the discussions so far on the first year (on which the Group have concentrated) falls well short of this; on a very rough calculation, it would produce a total some £1/2 billion over the planning total, including the Reserve (and excluding anything extra for teachers' pay). But there is a long way to go, and it would be wrong to reach conclusions yet.

Individual Programmes

5. Since the Group started its work the Chief Secretary has reached bilateral agreement on agriculture and Scottish electricity. He also hopes to reach agreement on coal and on the Chancellor's own Departments, which have submitted large additional bids. These agreements will add some £370, £530 and £330 million respectively in the three PES years. For the rest, I summarise below the position on the main outstanding programmes before the Star Chamber.

Defence

6. Although Mr Younger had made bids substantially above baseline, he seems ready to accept baseline in the first two years and baseline plus an agreed amount for the Falklands (some £127 million) in the last year. There is still an issue over how the baseline in the last year is constituted, whether by a 21/2 per cent or 3 per cent uplift. I think Mr Younger may well agree to accept the former, or some acceptable variant, in which case the Group would be inclined to settle with him.

Scotland and Wales

7. The Group have found the problems here exceptionally difficult. Although there are particular differences between the

two sets of bids, the crux of the problem is the unyielding insistence of both Secretaries of State on receiving the full territorial block and formula consequentials of the local authority settlement in England. This would give them both substantial uncovenanted sums which they would propose to use for other (ie non local authority) spending purposes. The preliminary view of the Group is that, although they would like to do so, such a radical step as dismantling the block arrangements entirely is not feasible now. They are, however, exploring the possibility of taking local authority current expenditure out of the Scottish and Welsh blocks and so denying the relevant "consequentials". Another possibility is to make the relative population change adjustment recommended in my report earlier this year. But Mr Rifkind will not accept this; it would reduce his block by £133 million in 1987-88, but by only some £10 million in Wales. The Group are in any case inclined to turn down the other bids outside the block (eg for the Scottish and Welsh Development Agencies) that the two Secretaries of State have submitted. The Group are due to see both Mr Rifkind and Mr Edwards again next Wednesday, and the Lord President would particularly wish to confer with the Prime Minister on this before they do so. If it proved possible to make any of the major changes described above, very careful thought would need to be given to the presentation.

Health

8. Mr Fowler has submitted very large bids (some £460, £410 and £770 million in the three years). The Group have asked him without commitment to show what further savings could be made, and their implications, in order to halve the gap between him and the Chief Secretary. If this were achieved, it would still leave a real growth rate of well over 2 per cent in the health programme in the first year, and roughly 1/2 per cent and 1 1/2 per cent in the later years. The Group will be pursuing this and other possibilities further with Mr Fowler on Tuesday.

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Social Security

9. With the decision on the uprating, the first year is virtually settled. The Group have asked Mr Fowler to produce for further discussion a list, in ranking order, of possible savings for the later years, but their preliminary judgement is that the scope for making any substantial inroads into the very large (and mostly demand-determined) excesses is likely to be very limited.

Electricity (England and Wales)

10. This ranks so far with Scotland and Wales as the most difficult issue facing the Group. Mr Walker has submitted additional bids on behalf of the Electricity Supply Industry (ESI) totalling nearly £1 billion over the three years. Among other things these predicate real reductions in tariffs over that period of -3.5% -0.5% and -2% respectively. The Chief Secretary is seeking the elimination of most of these bids by assuming that prices would simply keep pace with inflation (ie no real increases). This would in turn imply negotiating tougher financial targets with the ESI, whose projected rate of return is low. Apart from the possibility of a small reduction (£40 million) in the first year, Mr Walker has argued strongly that no further savings are possible, or could be delivered even if he agreed to them. The Lord President has, however, asked him to consider the possibilities further, and he would like to discuss the handling of this matter with the Prime Minister.

Overseas Aid

11. As noted above, the Group have not yet been able to discuss this. They will see Sir Geoffrey Howe next Thursday. The bid is a substantial one (£36, £73 and £117 million) and is related to maintaining the programme at the same proportion (0.31%) of GNP as in 1986. This seems to be an opportunistic switch from the successful bid last year to maintain the programme level in real terms. The Lord President is particularly concerned about the possibility of a strong aid programme lobby (as last year) being mounted.

J B UNWIN

Cabinet Office

Personal

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With the compliments of

Jonathan

We spoke. Let us have another word tomorrow morning (I am seeing the Lord President for a private round up at 10-30 am.

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16/x

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P 02289

From: J B UNWIN
16 October 1986

LORD PRESIDENT

STAR CHAMBER: TAKING STOCK

The Group are due to have a "take stock" meeting at 6 pm this evening. I thought you might find the following notes helpful.

Present state of play

2. Given the various uncertainties, I do not think it very useful just yet to try to draw up a revised score card of where we stand. But taking 1987-88 only at this stage, I think the following summarises the key points so far to have emerged:-

Defence: Mr Younger has offered baseline;

Health: Mr Fowler is to produce a paper showing how the gap could be halved. This would reduce the excess over baseline from 460 to 265;

Social Security: We have the uprating out of the way, but the other savings Mr Fowler agreed would only reduce the excess by about £20 million (including the mortgage interest restriction) [the position for the later years must await consideration of Mr Fowler's ranking of the possible savings];

Scotland: Mr Rifkind was asked to show how a saving of 80 below baseline could be achieved;

Wales: Mr Edwards offered 20, bringing down the excess over baseline to 75;

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[Electricity (England and Wales): to be discussed earlier this afternoon].

3. The above position and prospect leave the Group far short, of course, of the target the Treasury set. But I do not think the task is absolutely hopeless. I am quite sure that the Treasury will still have something up their sleeve, although it is not as voluminous as last year. And there is still scope for inroads into some of the big programmes, difficult though it will be.

4. My own view, after discussion with John Wiggins and Paul Gray, is that they Group's priorities should now be as follows:-

Defence: You must secure the 2.5 per cent uplift plus a realistic Falklands figure for the last year. The question then will be whether you could possibly push Mr Younger a bit further;

Scotland and Wales: I suggested this morning that you might try to impose on Scotland the relative population adjustment that Mr Edwards is prepared to accept for Wales. An alternative approach, however, would be to take local authority current expenditure now out of the Scottish and Welsh blocks altogether. I think this merits very serious consideration. Although it comes late in the day, it would be defensible if the territorial Secretaries were willing to go along with it. It would, of course, just about halve the size of the two blocks. But it would stop the absurd situation in which they are at present able to use local authority money they do not need for other purposes. If this could be achieved, the Chief Secretary's savings could be largely secured; and I think you could keep Northern Ireland out of it as being sui generis (their local authority arrangements are different anyway);

Health: A possible alternative to the formula explored with Mr Fowler (halving the gap) would be to agree to a 2 per cent growth for the whole programme. This would probably give something like 220 above the baseline in 1987-88 and could be publicly defensible (thought I do not underestimate all the problems);

Social Security: The Group will have to have another go at this, but I really doubt whether you will be able to make any further significant inroads. It will not be worth spending a great deal of effort on this if you share this broad judgement when you see Mr Fowler's further paper on the savings options;

Electricity (England and Wales): Again, I do not underestimate the special difficulties, but it will be critical to get these bids down. Mr Walker is bidding for nearly £1 billion over the 3 years - the largest single bid after DHSS. However, you will need to appraise this after this afternoon's meeting.

5. The above does not, of course, take account of teachers' pay, which should be decided next week, and is bound to add several hundred £ million to the figures. But that has to be treated as a new factor, outside the Group's current terms of reference, and Treasury Ministers will have to consider in the first instance how they wish to advise treating it. The above analysis also excludes overseas aid; I suspect that the Group will do very well on this if they can halve the Foreign Secretary's bid.

Next week's timetable

6. In the light of the above I have asked Dr Walker provisionally to arrange the following time table for next week (scrapping the Monday morning meeting!):-

Monday 20 October, 4.15 pm:	Work of the Group;
Tuesday 21 October, 9.30 am:	Social Security;
Tuesday 21 October, 3.15 pm:	Health;
Wednesday 22 October, 9.00 am:	Scotland;
Wednesday 22 October, 4.00 pm:	Wales;
Wednesday 22 October, 5.15 pm:	Defence;
Thursday 23 October, 9.00 am:	Electricity (England and Wales);
Thursday 23 October, 4.00 pm:	Overseas Aid;
Thursday 23 October, 5.30 pm:	Round up session.

On the assumption that one or two other things can be dealt with in the margins (eg Arts and Libraries) the above programme should enable you to cover the full ground and have a good idea of prospects by the end of the week. This would then enable you to report to the Prime Minister and give plenty of time for further meetings in the following week (it might, of course, be necessary to engage the Prime Minister in some "trilaterals").

Interim Report to the Prime Minister

7. You are due to see her at 5 pm next Tuesday. You will want to consider in the light of this afternoon's discussion whether to minute to her on how things are going. If you do, I imagine that you will not want to clear a text in terms with the Group, but you could outline your intentions to them at the meeting next Monday afternoon. If you decide not to report to her in writing, my present view is that there would still be great advantage in sounding her out on Tuesday on how far she would be ready to support pressure by the Group on some of the difficult issues discussed above.

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From the Private Secretary

16 October 1986

ECONOMIC ASSUMPTIONS

Thank you for your letter of 10 October setting out the proposed economic assumptions for use in the current round of public expenditure decisions and in some cases for publication. The Prime Minister read this without comment.

(David Norgrove)

Alex Allan, Esq.,
H.M. Treasury.

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bc Mr Wiggins
Dr Walker

P 02287

From: J B UNWIN
15 October 1986

LORD PRESIDENT

STAR CHAMBER: ELECTRICITY (ENGLAND AND WALES) (ESI)

HANDLING

Since (at the time of drafting this brief) we have still not got an agreed position paper, I think you may need to spend some time establishing the position reached and the figures on which debate takes place. This ought to be Mr Walker's revised bid of 20 August of:

	+647	+305	+591

less agreed savings principally on Sizewell and other power stations of:

	-197	-134	-164
net bids	+450	+171	+427

2. I suggest you then concentrate on revenue and aim to settle further savings on investment, working capital, costs as a balancing item. Mr Walker has previously mentioned possible unspecified savings of £40 million a year.

MAIN ISSUES

3. The ESI has proposed tariff increases of:

			%
	0	+0.75	+3
or in real terms	-3.5	-0.5	-2.0

The Chief Secretary argues that this aim is unreasonable at a time when the industry is:

(a) making a very large additional bid on public expenditure of over £1 billion over the three years;

(b) has a low profitability. ESI strategy is to expand turnover and compete with gas for market share rather than to increase profitability.

(c) a path of 0/0/0 for real prices is sound economically and acceptable politically.

Part of the additional bid represents necessary capital expenditure on extra construction costs and repairs for AGRs. But these ought to affect what can be afforded elsewhere.

4. Mr Walker will argue:

(a) he has no powers to force the ESI to adopt a different price path;

(b) the industry has massive negative EFLs already. Why should it put up prices more than it wants in order to send money to the Treasury? But the Treasury's proposal is not primarily to increase negative EFLs but to eliminate the additional bid;

(c) the ESI must hold down prices next year to compete with gas where a price cut is expected. But gas already earning a better return on capital (4 per cent real last year against 21/2 per cent for electricity).

(d) that higher prices in 1987-88 will cause the target rate of return (the average of three years ending in 1987-88) to be exceeded. The industry envisaged only slow progress towards improved profitability - say a further 2 per cent over the next 10 years.

5. Mr Walker is probably right in arguing that he cannot (legally) compel the ESI to adopt a different price path. But it is not plausible that Ministers could not influence them. They have done in the past. As the Chancellor of the Duchy has already argued, price increases rising only with inflation would surely be acceptable politically. And it seems unlikely that any decently run private sector company would deliberately forego the opportunity of increased profitability because it has done better than expected in the past.

6. It is hard to say at this stage how far you might be able to go. You may, as with Mr Younger, be able to try out a no commitment compromise and ask Mr Walker to reflect on it.

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4

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Mr Roberts

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P 02282

From: J B UNWIN
14 October 1986

LORD PRESIDENT

STAR CHAMBER: SCOTTISH BLOCK

As we have discussed, this is an extremely difficult one. The Scottish Secretary is still bidding for very large amounts indeed - £245, £249 and £291 million in the 3 years. He has made no concessions at all.

2. You will clearly need to look at the various issues on their merits. You will, however, wish to bear in mind both the teachers' pay issue (if Main is accepted there will be large further additions to expenditure in Scotland for which there is no present provision) and last year's tortuous exercise to find savings by revising the territorial block formula. As you know, we were not able to secure a specific conclusion to this but the Prime Minister's last word was that "Although she has not come to any firm conclusions, she does think, on the basis of these papers, that there is a case for reductions in the Scottish provision" (Mr Wicks' letter of 29 July).

HANDLING

3. I suggest that you start by inviting the Chief Secretary to set out the background as he sees it, and then ask Mr Rifkind to reply generally. You might then take the issues in the following order:-

1. Non-block items:-

(a) the forecast overspend on regional assistance;

(b) the Scottish Development Agency (SDA) bid for funds

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for derelict land;

(c) SDA efficiency savings;

2. Local Authority (LA) current expenditure: the "excess" formula consequentials;

3. The proposal (which was the main recommendation in my report) for a population-related adjustment to the baseline, giving savings of £133, £163 and £190 million.

ISSUES

4. The following notes briefly cover the main individual items.

5. Industry: Regional assistance. The Chief Secretary will point out that the forecast overspend (35 per cent in 1987-88) is not matched by bids from DTI or Welsh Office and he seeks offsetting savings on cash limited votes. Mr Rifkind will argue that it is not right to offset demand-led expenditure by savings elsewhere and that in any case Scotland is not getting a fair share of this programme. But it would not be unreasonable to ask him to find this from within his block.

6. There is also an issue on derelict land. The Chief Secretary will argue that it should be met from existing provision by reordering priorities. Mr Rifkind will argue the political necessity of dealing with the backlog of cases. The backlog appears to have been increased by funds diverted to the Garden Festival in Glasgow.

7. Industry: SDA. A review was undertaken following last year's bilateral. It accepts that the SDA has made an important contribution to the Scottish economy but indicates areas for more efficient performance. The Chief Secretary's proposed reductions amount to 5%, 11% and 10.5% of current SDA provision. Mr Rifkind will argue that any savings that can be generated must be reserved to counter the impact of industrial closures in Scotland. But

there must be a strong case for pressing him to be ready to deliver some savings to the Treasury.

8. LA consequentials. This is a very tricky one and bears directly on the disputed formula arrangements. Mr Rifkind argues that if applying the formula to the provision agreed for local authorities in England given an excess over what he himself is providing for local authorities, the balance should be available for redeployment elsewhere in his block. This is, of course, correct according to the normal rules applying to the block. But the Chief Secretary's argument is that:-

(a) the Scottish block is already overprovided;

(b) if Scottish authorities overspend, there is an automatic claim on the Reserve; while the formula anyway allows Scotland an uncovenanted bonus on provision for the remainder of the block programmes (health etc).

How far you push this must be linked to the further issue discussed below. But it is worth noting that Mr King has already accepted one half of the excess consequentials, although Mr Edwards has rejected a broadly similar deal. If Scotland received more than a half there would be expensive repercussions in the other territories.

9. Population baseline settlement: as noted above, this is the issue brought out in the study I did earlier this year. The conclusion of that was that if Ministers wished to make a substantial real terms cut in the Scottish provision, the best course might be to amend the baseline to reflect changes in population since it was established. We calculated that this would produce savings of £133 and £163 million in 1987-88 and 1988-89 respectively, to which the Chief Secretary has now added an estimated £190 million for 1989-90.

10. You will recall the discussions at the time. Mr Rifkind strongly opposed the proposal, arguing that it had not been demonstrated that Scotland was over provided. He added also for good measure that if any changes were made for population reasons, it would be right only to take account of population changes in Scotland, and not of the comparable changes in England and Wales also (ie the overall relative position). In the end the Prime Minister did not force matters to a conclusion, but summed up against Mr Rifkind in the terms quoted in paragraph 2 above.

11. The Chief Secretary's proposal simply wheels out again the proposal described above. Mr Rifkind will reject it for the same reasons. I doubt whether there is much profit in pressing these precise numbers or this precise formula. It may be better to use them more as a general justification for asking Mr Rifkind to consume his own smoke on the various specific items set out above so as to move back at least 70:30 in the Chief Secretary's direction. A settlement at baseline would not do this. It would be necessary to end up with net reductions on his programme of something like £-70, £-100 and £-130 million.

12. I shall have with me at the meeting the relevant background papers on the formula squabble should you need to refer to them or to show Mr Rifkind that you have not overlooked them.

J B UNWIN

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PERSONAL: Re Norgrove

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Mr Musgrove 3

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P 02284

From: J B UNWIN
14 October 1986

LORD PRESIDENT

STAR CHAMBER: DEFENCE PROGRAMME

I think it would probably be sensible to suspend judgement on the defence programme until the Group have reviewed the position on all the outstanding programmes. They will then be able to judge whether to press hard for savings on defence to allow more resources to be allocated to higher priority programmes. It is also a programme on which I imagine you will particularly want to take the Prime Minister's mind before you decide how hard to press.

HANDLING

2. I suggest, therefore, that on this occasion you should keep discussion for the most part at the level of the defence budget as a whole and avoid getting drawn into too many detailed issues. You could start by asking the Chief Secretary to explain why he is looking to defence for savings, and why he believes they can be made without damaging defence capabilities. You could then invite Mr Younger to reply. It would then be very helpful to see how far you can press or lure him into revealing his true position . I think it is very doubtful whether he is seriously pressing his above baseline bids of £131 and £148 million in the first two years; and I am sure he will come down substantially from the bid of £456 million in the last year. He might, for example, be prepared to accept an addition of £292 million, comprising £198 million for the Falklands (on which I frankly think the Treasury are trying it on) plus £94 million for a "1/2 per cent uplift" (ie to meet the 3 per cent GDP deflator rather than the 21/2 per cent uplift factor that the Treasury have applied to this and other programmes across the board).

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ISSUES

3. The following notes deal briefly with the individual issues that might come up.

4. Mr Younger's AFPRB bid (£95, £99 and £102 million) has been made and rejected in previous years. To accept it would be in conflict with the agreement reached by Ministers in May this year that the presumption should be that costs of Review Body awards should be found within existing resources. To accept the bid would weaken the Government's position vis-a-vis Review Bodies.

5. Dockyard pensions bid. This is a case of another rejected bid being resubmitted. The Treasury argue that MOD get the benefit in terms of greater efficiency and should meet the initial costs, bearing in mind that the Treasury are already faced with PSBR costs of up to £200 million to cover transfer of accrued pension rights.

6. 1989-90. This is the real issue this year. Mr Younger argues:-

(a) that the Treasury are deducting the Falklands cost twice. They should either stick to the methodology of having a separate Falklands addition or should have created a new baseline by uplifting the Falklands inclusive provision for 1988-89 (which you agreed with Mr Heseltine last year) which subsumes the £142 million of Falklands costs;

(b) baselines for 1989-90 were established by increasing 1988-89 figures by 2½ per cent. An extra ½ per cent is needed to achieve "level funding" in real terms.

7. The Treasury will argue against this:-

(a) MOD figures show that the actual cost of Falklands in 1989-90 will be £127 million;

(b) the cost of the Falklands is now down to a level which, given public expenditure pressures, can be absorbed (in addition to a cut of £300 million);

(c) there can be no principle of level funding in real terms. Any settlement must be in cash with no form of commitment to level funding in future;

8. As indicated earlier, I am bound to say that I do not think the Treasury case on the Falklands is a fair one. But equally Mr Younger's bid is far beyond anything the Group can reasonably accept.

OTHER POINTS

9. You may also like to bear in mind the following points:-

(i) Even with the Chief Secretary's proposed reductions, the Defence Budget will show 17 per cent real increase on 1978-79. Defence as a share of GDP will still exceed that of our richer European allies (4.2 per cent compared with Germans' current 3.3 per cent);

(ii) you will recall the Ministerial decision in E(A) that defence research and development should be cut back. Mr Younger is contesting this, and it was explicitly without prejudice to the overall defence budget. But it remains a relevant consideration.

J B UNWIN

/PS

Cabinet Office

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PS At E(A) this afternoon there was support for advancing the minehunter programme. This would add £3, £11 and £12 million to the defence programme in the three PES years. The Defence Secretary said that he would be prepared to bear some, but not all this extra cost. The Prime Minister ruled that it should be considered further by the Star Chamber in the context of consideration of the defence programme as a whole.

You will therefore need to refer to this also tomorrow. I doubt whether it would make sense to try to earmark some specific amount for this. In practice I suspect that, as and when the Group put an overall proposal to Mr Younger, they will need to be able to claim that a share of the minehunter costs has been taken into account in the numbers they suggest.

The outcome on advancing frigates was not so clear cut. Further consideration will need to be given to this in the light of a more detailed assessment of the prospects for Swan Hunter, including the contingency liability on the Government should they fail. I do not think that this can sensibly be covered at this stage in the Star Chamber discussions.

J B UNWIN

CABINET OFFICE

With the compliments of

J. B. UNWIN

70 Whitehall, London SW1A 2AS
Telephone 01 233

R Maguire

bc Mr Wiggins
Dr Walker

SECRET

P 02280

From: J B UNWIN
13 October 1986

LORD PRESIDENT

N BPM

STAR CHAMBER: ARTS AND LIBRARIES

As the position paper (MISC 130(86)2 sets out, Mr Luce is seeking additions of some £20, £29 and £35 million in the three years respectively. Part of this is for the new British Library project and sundry items such as museum building and maintenance; but there are claims of £6.6, £9.8 and £10.4 million for the Arts Council to maintain their present level of activity and to undo the taper agreed last year in post-abolition central funding.

2. The claim for the Arts Council conflicts strongly in spirit, if not precisely in letter, with your deal with Mr Luce last year. I attach copies of your exchange of correspondence with him. You will see that you sought an assurance that he would "not make a fresh additional bid next year on account of the impact on the Arts Council and its clients of the local government changes". He replied that "I shall do everything possible to make this settlement stick so as to avoid having to make a fresh additional bid next year on the score of the impact which aboliton has had on the Arts Council and its clients."

HANDLING

3. I suggest you take the bids in the following order:

- British Library;

- grants in aid for arts and national museums and galleries (NMG);

- museum building maintenance;

- other bids.

ISSUES

4. British Library. The estimated cost of Stage 1A has been revised from £157 million to £207 million. Following bilaterals officials were asked to review:

(a) the scope for reducing and/or rephasing the estimate of costs of Stages 1AA and 1AB;

(b) the justification for Stage 1B and subsequent stages;

(c) the management of the project.

Reviews (b) and (c) will be completed by the end of the year. (c) does not involve PES decisions. On (a) a number of options have been identified which require further work. An £0.4 million order for steelwork is about to be placed, but thereafter no further orders are needed for 1AB until January 1987. The Chief Secretary has proposed that the current order should go ahead and that options to confine Stage 1AB to the Science Reference and Information Sevice (SRIS - a large science reading room) or deferring fitting out of 1AA and 1AB be worked up. Both on (a) and on (b) the Chief Secretary argues that the bids can be withdrawn as re-examination may make them unnecessary. If Mr Luce agrees, he may seek a guarantee about access to the Reserve if decisions on the future of the project require provision over baseline. The Chief Secretary will resist. But if Mr Luce would settle otherwise, you may wish to see if a formula could be found.

5. Grant in aid for the Arts and NMGs. As noted above, Mr Luce is seeking to abandon the taper agreed last year and to restore the squeeze from rising pay costs. He argues that more private funding can be secured if the Government gives generous support, particularly for recurrent costs. The Chief Secretary will point

in reply to improved fiscal incentives and the Government's general record. Given the difficult overall situation, and the absence of any overwhelming public pressure on this issue this year, you may feel that Mr Luce should be held to his last year's undertaking.

6. Museum building and maintenance. The Chief Secretary will argue that provision for new works represents about a quarter of the museum work programme, providing ample scope for phasing to allow adequate repair and maintenance. This seems entirely reasonable in current circumstances.

7. Minor bids can be swept up in any final settlement.

J B UNWIN

Cabinet Office

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Kenneth Baker MP
Secretary of State for Education and Science
Department of Education and Science
Elizabeth House
York Road
LONDON SE1 7PH

8 October 1986

NBHM.

Dear Kenneth,

1986 PUBLIC EXPENDITURE SURVEY

This letter records the basis on which we have reached agreement on your programme. The agreed changes are set out in the attached annex.

University pay restructuring

This does not of course feature in the annex, because you agreed to withdraw your Survey bid. You did so on the following basis, which has been spelt out in more detail in correspondence between our officials:

(a) You would be free to negotiate for a restructuring deal within the amounts in the bid (£40/56/71 million in the 3 Survey years). In doing so, you would not put these amounts on the table. You would indicate that extra money would be made available if a satisfactory deal could be reached, but would make clear that the amount was a good deal less than the CVCP and AUT had in mind. The Treasury would be consulted about what was to be said on these points.

(b) In considering whether any deal was satisfactory, your Department would not be expected to have secured concessions which are not in the present Committee A proposals, although that did not exclude the need to clarify uncertainties and ambiguities in a satisfactory way. But features which we would expect to see include provision to vary pay as between disciplines and to reflect

performance, as well as a clear expectation that the universities would actually use this flexibility, that the agreement would not lead to grade drift, and that it would be accepted by the AUT membership.

(c) If we agreed that the deal was satisfactory in those terms, you would have access to the Reserve for the amounts needed to finance it in 1987-88, while the costs in later years would be treated as a technical bid in the 1987 Survey. The amounts of £40/56/71 million would be maxima, and I would not be prepared or expected to make more available.

You indicated at our bilateral meeting on 25 September that what you could negotiate would depend on the general increase in funding for the universities. In the light of what we have agreed on that, as set out in the annex, I am assuming that you will have no difficulty on that score.

Universities

I agreed to the substantial additions shown in the annex on the basis that they would be clearly linked both in substance and in public presentation to the conditions set out in Sir Keith Joseph's statement of 20 May, and that no part of the addition would be publicly linked to additional pay. My agreement was also on the basis that a substantial proportion of the additional funds would be allocated for specific purposes as set out in your letter of 9 September, including the provision for equipment, building maintenance, and library expenditure there specified, together with provision for rationalisation, early retirement, and redundancy costs.

Science

I do not think that I need add any comment on this item.

Local authority and voluntary schools capital

We agreed that the increase in provision for local authority capital should be limited to the £57 million needed to give allocations in 1987-88 at the same level as in the current year. I separately agreed an increase of £10 million for voluntary schools capital expenditure.

City Technological Colleges

The amounts shown in the annex are maxima, based on the establishment of 20 schools. Expenditure can be expected to be lower if there are fewer schools and/or the timetable for setting them up slips. The figures include related provision for running costs, on the basis that DES will require an additional 50 staff for this purpose; but there again the figures are subject to review in the light of progress with setting up the schools and the extent of the additional work for your Department in running them.

Student awards

The agreed additions represent the fees element of your original bid. You also agreed that the £8 million estimating saving on student awards should be deducted from your programme.

Other bids

We agreed a figure of £8 million a year for you to allocate among your remaining bids. We also agreed that we would both resist any pressure to secure funds for the EC ERASMUS proposal.

Running costs

We are agreed that officials should discuss this further, with the aim of reflecting in the Survey years the broad consquentials of the increase of 30 in the manpower ceiling and of £1 million in running costs which we have agreed for the current year, as set out in my letter of 2 October.

General

Formally, of course, the agreement recorded in this letter is ad referendum to Cabinet. You will no doubt be considering how the changes in your programme might best be publicly presented, but, with the exception of City Technological Colleges, those changes will be for announcement in the context of the Autumn Statement once Cabinet has approved the outcome of the Survey. I know you regard it as really most important that selective information does not emerge at any earlier stage, and I fully share that view.

I am copying this letter to the Prime Minister, the Lord President, and the Secretaries of State for Scotland, Wales, and Northern Ireland.

Yours ever,

JOHN

JOHN MacGREGOR

ANNEX

AGREED CHANGES TO DES PROGRAMME

	1987-88	1988-89	£million 1989-90
Universities	65	72	81
Science	20	20	20
Local authority capital	57	57	57
Voluntary schools capital	10	10	10
City Technological Colleges	4	19	33
Student Awards	3	5	7
Student awards (estimating)	- 8	- 8	- 8
Other bids (excl running costs)	8	8	8
Total	159	183	208

SM2/36

CONFIDENTIAL

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

10 October 1986

David Norgrove Esq
Private Secretary
10 Downing Street
LONDON SW1

Prime Minister!

There are some uncomfortable figures here, but they seem inescapable. To be unrealistic would simply store up trouble for the future. Content? DCR 14/10

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 1987 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; and for increases in the RPI over the periods relevant to the April 1988 and April 1989 Social Security upratings.

MAIN ECONOMIC ASSUMPTIONS

	1986-87	1987-88	1988-89	1989-90
Unemployment, GB excluding school leavers (millions)	3.1	3.05	3.05	3.05
Average earnings (per cent change)	7½	6½	5½*	5*
GDP Deflator (per cent change)	3	3¾	3½	3

	Sept 1987 on Sept 1986	Sept 1988 on Sept 1987
RPI (per cent change)	3¾	3½

*Not Published.

3. These assumptions (apart from the earnings assumption for the two later years) will first be published in November, in the Autumn Statement. The Industry Act forecast published with the Autumn Statement will also include an RPI forecast for the fourth quarter of 1987.

4. The new unemployment assumption has the same profile as that published in the ~~1986 Public Expenditure~~ White Paper, but with a figure in each year of the Survey period that is 50,000 higher than in the corresponding year of the last Survey period. The average earnings assumption of 7½ per cent for this financial year is equal to the current underlying growth of average earnings (underlying average earnings growth was 7½ per cent in the last two financial years as well); the fall in earnings growth shown next year reflects an expected fall in pay settlements in the current pay round. The increase in the RPI shown over the year to September 1987 (3¾ per cent) is somewhat higher than the RPI increase expected in the year to September 1986 (close to 3 per cent). The higher growth of the RPI expected over the next year reflects the fact that we cannot count on benefiting over the next twelve months from reductions in mortgage interest rates such as those experienced over the last year.

Yours,
Alex.

A C S ALLAN
Private Secretary

MISC 130(86)1

10 DOWNING STREET

Prime Minister 2

These are the Treasury's marching orders to the Star Chamber. Paragraph 13 is the key. For 1987-88 it means, if achieved, that the increase in the planning total will equal the Reserve set for that year.

DCS
10/10

file to 71

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

Mr. Cloke

STAR CHAMBER

I understand that Mr. Edwards has not yet settled his programme with the Chief Secretary.

Lord Whitelaw wishes therefore to get the Star Chamber formally under way without bringing Mr. Edwards on to the Committee at this stage. The notice giving the membership of the Committee and other arrangements can therefore now be issued.

The Lord President will consider whether to recommend that Mr. Edwards should be a member of the Committee if and when he settles with the Chief Secretary.

DN

8 October, 1986.

JB.

3462/026

CONFIDENTIAL

PUBLIC EXPENDITURE SURVEY 1986: DEPARTMENT OF THE ENVIRONMENT

Note of a meeting held in the Chief Secretary's Room, H M Treasury at 5.00pm on Monday, 29 September

PRESENT

HM Treasury

Chief Secretary
Mr Butler
Mr Jameson
Mr Moore
Mr Turnbull
Mrs Brown
Mr Pirie
Mr Legg
Mr Meadows
Mr Tarkowski
Mr Pike

Department of the Environment

Secretary of State
Mr Heiser
Mr Fletcher
Mr Osborn
Dr Smith

Property Service Agency

Mr Chipperfield
Mr Hawtin

Welsh Office

Mr Jeremiah

Opening Remarks

The Chief Secretary proposed that water should be dealt with first, followed by PSA, Housing and DOE other.

2. The Secretary of State proposed that, except in the case of water, he should have discretion over the precise allocation of reductions across his programme within the total savings agreed. The Chief Secretary saw no difficulty in principle with this proposal provided the amounts involved were small.

3. The Secretary of State said that it was possible that County Hall might be sold bringing in receipts of about £60 million

which would be partially offset by the cost of re-housing ILEA. He proposed that, in view of the uncertainty, this should be considered outside the Survey. The Chief Secretary agreed, provided that the costs of rehousing ILEA were lower than the sale proceeds.

Water (excluding land drainage)

4. The Chief Secretary said that he was still looking for savings beyond those which had so far been offered. At their previous meeting the Secretary of State had argued against negative EFLs on the grounds that they would be seen as a tax. However, other industries had negative EFLs and there was no reason in principle why the water industry should not. He had earlier proposed that the level of real investment should not increase over the survey period, but he was now prepared to see some increase, provided that further savings in external finance were found.

5. The Secretary of State said that to some extent the level of investment was determined by outside pressures, such as EC Directives. The real question was how it should be financed. He was prepared to agree a negative EFL for 1989-90, but he could not go below baseline in 1988-89. For 1987-88 he was still seeking a small increase above baseline, in order to avoid a dip in real terms investment that year.

6. After discussion external finance (excluding land drainage) for the survey period of +£15 million, zero, and -£50 million was agreed.

7. The Secretary of State agreed to reconsider the position on 1988-89 and 1989-90 with a view to further reducing external finance, during the next IFR.

PSA (Office and General Accommodation Programme)

8. The Chief Secretary said that he did not feel able to increase his previous offer of a net addition of £40.0m a year, particularly

in view of the substantial accommodation bids from departments following the transfer of PES responsibility for major new works.

9. The Secretary of State proposed that the difference between the Chief Secretary's offer of £40.0m for 1987-88 and his amended bid of £62.5m should be split with corresponding adjustments to the later years. He considered that the Chief Secretary's offer was insufficient to provide for adequate maintenance of the estate and a minimal new works programme. He would maintain pressure on the disposal of surplus property but the prospects of additional receipts did not look good.

10. The Chief Secretary said that he could not increase his offer. He pointed out that PSA would also have the benefit of the reduced requirements (in section C of the bidding table letter) which he had agreed that the Agency could retain.

Housing

1987-88

11. The Secretary of State drew a distinction between the first and the later years of the Survey. In 1987-88 the 80% commitment and the lack of a new capital control system would restrict his ability to increase provision in his areas of high priority, UHRU and the Housing Corporation, and to meet unavoidable extra expenditure arising from the Housing Defects Act. He needed a minimum of £160 million in 1987-88 for these three areas - £80 million more than the Chief Secretary's last offer.

12. The Chief Secretary replied that his last offer already represented a substantial increase in spending over the settlement reached last year and he could not improve on his latest offer given the mounting pressures on the planning total.

Later years

13. The Secretary of State said that he had reviewed the position on receipts for the later years of the survey and now had evidence

that these could be substantially higher, perhaps by £200 million in both 1988-89 and in 1989-90. If he were allowed to retain these they would go a long way towards bridging the gap between his latest bid and the Chief Secretary's offer to settle at the existing net baseline.

14. The Chief Secretary replied that if he were to agree that the additional receipts could be retained, then, with the increase in baseline for 1987-88 he had already offered, the total gross expenditure on housing would be nearly £1 billion more than existing plans for the three years. He still saw no reason for increases in the baseline after 1987-88 when the 80% commitment came to an end.

15. In an attempt to reach a settlement, however, the Chief Secretary said he would be prepared to offer a further £20 million in 1987-88 and allow the Secretary of State to retain the additional receipts in later years. This would result in a gross capital baseline of:-

			£ million
1986-87	**1987-88**	**1988-89**	**1989-90**
3,384	3658	3408	3452

giving substantial increases over 1986-87 and over existing plans for the survey years.

16. The Secretary of State said that the offer would be insufficient to meet DOE's problems, especially in the first year. He would consider further.

DOE other

17. The Secretary of State did not accept that the offer of an additional £43m of PES in the Chief Secretary's letter of 25 September would enable him to meet the 80% assurance. He said that he needed a minimum of £51m for LES capital, which was £8m more than had been offered.

18. The Secretary of State was also concerned about the size of the gap between the Chief Secretary's position and his position on the remainder of the programme. The Secretary of State said his final position was:

£m (net)

	1987-88	1988-89	1989-90
LES	51	39	0
Urban	49	50	66
Other	27	26	26
NT receipts	-40	-30	-30
Reduced req.	-2	-17	-30
Change to baseline	85	68	32

19. The Chief Secretary said he was prepared to make the following offer, which was as far as he could go:-

£million

	1987-88	1988-89	1989-90
LES Capital	50	-	-
NT receipts	40	30	30
TOTAL ADDITION GROSS	**+90**	**30**	**30**
less NT receipts	-40	-30	-30
change to baseline	+50	0	0

20. The Chief Secretary said that DOE would also be allowed to keep the benefit of the reduced requirements of £2m, £17m and £30m, which made the total offer on gross spending £92m, £47m and £60m. The Secretary of State said that the offer did not go far enough to meet his essential requirements.

CONCLUSION

21. It was agreed that both sides would reflect on the offers made during the meeting and discuss them further the following day.

JILL RUTTER
Private Secretary

HM TREASURY
2 October 1986

Distribution
Those Present
PPS
Sir Peter Middleton
Mr Gray
Mr Norton

SRWAJS

pa public expenditure
2/10.

LINE TO TAKE WITH THE PRESS (for Bernard not Cabinet)

The Star Chamber is now being set up, as it has been for the past few years.

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 decided in July to work within the existing published planning totals. That remains the position.

(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 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 finally decided.

(vii) **When will the Autumn Statement be published?**
In November.

SRWAJS

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In November.

SECRET AND PERSONAL: CMO

SUBJECT CC MASTER

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

2 October 1986

Dear Lin,

PUBLIC EXPENDITURE

The Prime Minister held a short meeting yesterday evening with the Lord President and the Chief Secretary to discuss public expenditure. Professor Brian Griffiths and Mr. Brian Unwin were also present.

The Chief Secretary outlined the position reached so far in discussion of public expenditure bids. The Prime Minister commented that the presentation of the decisions would need very careful consideration. It would be right to put a large share of the blame on local authority mismanagement.

There was some discussion of the social security up-rating to be announced following publication of the September RPI on 17 October. The Prime Minister and the Lord President saw political attractions in an increase in the single pension of £1 or more (with the equivalent for a married couple) as against the 75p which would result from an increase in line with the RPI. However, this would cost £135 million and it was not easy to see where the money could be found: a decision not to uprate unpledged benefits would not provide enough even if that were itself politically acceptable.

In a discussion of other bids, the Prime Minister commented that she was not over-sympathetic towards bids for more resources for health: all the evidence showed increasingly the great scope for improving efficiency.

The Chief Secretary said he had drawn two conclusions from this year's discussions: the Government would need at some stage to take further major action towards changing social security, though without the brouhaha which had surrounded the social security review, and secondly, thought would need to be given to how local authority expenditure was scored in the planning total.

It was agreed that the Chief Secretary should refer at Cabinet today to the bilaterals and setting up of the Star Chamber. Public reference to the Cabinet discussion should be avoided if at all possible.

It was also agreed that the Star Chamber would comprise the Lord President, the Chancellor of the Duchy of Lancaster, the Lord Privy Seal, the Paymaster General and the Chief Secretary. The Secretary of State for Wales might be invited to become a member of the Star Chamber if his programme was settled in time after his return from the United States on 12 October.

I am copying this letter to Joan MacNaughton (Lord President's Office) and to Michael Stark (Cabinet office).

DAVID NORGROVE

Miss Jill Rutter,
Chief Secretary's Office,
H.M. Treasury.

CONFIDENTIAL

File

DG28KL

cc: Psg. Griffiths

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

SIR ROBERT ARMSTRONG

STAR CHAMBER

The Prime Minister has discussed with the Lord President and the Chief Secretary the composition of the small group of Ministers which is to be constituted to discuss outstanding Survey issues. The members proposed at present are as follows:

Lord President of the Council (Chairman)
Lord Privy Seal
Chancellor of the Duchy of Lancaster
Paymaster General
Chief Secretary, Treasury.

The Chief Whip should also be sent the papers and attend meetings as necessary.

The Secretary of State for Wales may be invited to become a member of the Group if his programme is settled in time after his return from the United States on 12 October.

The Prime Minister would be grateful if, following Cabinet, you would take the necessary informal steps to establish the Group, which is expected to begin its work in the week beginning 13 October. No formal notice to establish the Group should be circulated until a decision has been taken on whether the Secretary of State for Wales is to be a member.

David Norgrove

1 October 1986

CONFIDENTIAL

88

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Please type

~~DRAFT MINUTE~~

SIR ROBERT ARMSTRONG

STAR CHAMBER

The Prime Minister has discussed with the Lord President and the Chief Secretary the composition of the small group of Ministers which is to be constituted ~~[after Cabinet tomorrow]~~ to discuss outstanding Survey issues. The ~~proposed~~ members proposed at present are as follows:

Lord President of the Council (Chairman)
~~[Secretary of State for Wales]~~
Lord Privy Seal
Chancellor of the Duchy of Lancaster
Paymaster General
Chief Secretary, Treasury.

The Chief Whip should also be sent the papers and attend meetings as necessary.

2. The Secretary of State for Wales may be invited to become a member of the Group by his programme is settled in time after his return from the US on 12 October.

3. The Prime Minister would be grateful if, following Cabinet, you would take the necessary informal steps to establish the Group, which is expected to begin its work in the week beginning 13 October. No formal notice to establish the Group should be circulated until a decision has been taken on whether the Secretary of State for Wales is to be a member.

DRN

~~Private Secretary (No 10)~~

October 1986

DG28KL

PRIME MINISTER

PUBLIC EXPENDITURE AS A PROPORTION OF GDP

You already have Roy Jenkins' speech of 1976 which said that public expenditure greater than 60 per cent of GDP might threaten the plural society.

On the old definition public expenditure amounted to 56 per cent of GDP in 1975/76 and the Treasury statisticians believe it would have been around 55 per cent in 1984/85 on the same definition.

The 1984/85 figure does not include expenditure by corporations which were in the public sector in 1975/76 which have been privatised since 1979. I think this is right. Privatisation itself represents a policy change to reduce the extent of public sector economic control.

David Norgrove

1 October 1986

MJ2CKI

SRWAJU

POINTS TO MAKE IN SETTING UP THE STAR CHAMBER

1. We decided in July that it would be right if necessary to ask the Lord President to set up his Star Chamber again. The Chief Secretary's report shows that it will be necessary to do that.

2. A matter for regret. Ask colleagues to show restraint and to examine the need for their bids with the greatest possible rigour.

3. It is most important that information on the discussions so far or on the discussions in the Star Chamber should not be given to the media. All experience shows just how damaging and divisive those leaks can be. We are our own worst enemies on that.

4. 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.

SRWAJT

POINTS TO MAKE IF NECESSARY

1. Restraint of public expenditure is an essential part of our strategy for a more enterprising, productive and free society.

2. Our record is not good: more than 8% higher in real terms than when we took office. Had to restrain borrowing so taxes have risen as a proportion of GDP (2½%).

3. Have to demonstrate that this Government is capable of managing its affairs prudently. We expect businesses to perform. We must too.

4. Particularly important at this time of pressure in the financial markets.

5. We have to set our priorities and we have to look for greater efficiency. All studies, whether by Audit Commission, Efficiency Unit or others, show the scope for that.

1

Ref. A086/2755

PRIME MINISTER

Cabinet: Public Expenditure

The Chief Secretary's minute of 30 September reports briefly to you and to the rest of the Cabinet the current outcome of his public expenditure bilaterals. Without revealing any figures or details, he reports that he will be unable to resolve some major programmes bilaterally (he refers to Defence, Aid, the Scottish Office, and Health and Social Security) and suggests that you should now establish a small Group under the Lord President to consider outstanding issues and to make recommendations to the Cabinet.

2. Subject to the outcome of your discussion with the Lord President and the Chief Secretary this evening, you will want to ask the Chief Secretary briefly to speak to his minute and then to confirm that as agreed by the Cabinet at their meeting on 17 July (CC(86) 28th Conclusions, Item 7), you propose to establish a small Group under the Lord President, in accordance with recent practice.

3. You will want to avoid any substantive discussion at this stage. The Chief Secretary is still engaged in bilateral negotiations and it is too early to give any more detailed assessment. It is not customary either to discuss the composition of the Star Chamber at Cabinet (this is a matter for you to decide). You may, however, wish to take the opportunity to:

BRIABF

- emphasise the importance of sticking firmly to the established policy of strict public expenditure control, particularly in view of current economic and market uncertainties;

- ask colleagues to avoid any new spending commitments (other than those already collectively agreed) at the Party Conference;

- (if necessary) affirm that the objective of "working within the existing planning totals" remains and that it would be wrong to make any change while negotiations are continuing.

4. You may also wish (subject to your discussion with the Lord President and the Chief Secretary) to indicate that, so far as the press are concerned, no statement on public expenditure will be volunteered. However, if questions are asked, it will be confirmed that the Star Chamber has been set up in accordance with recent practice.

RA

ROBERT ARMSTRONG

1 October 1986

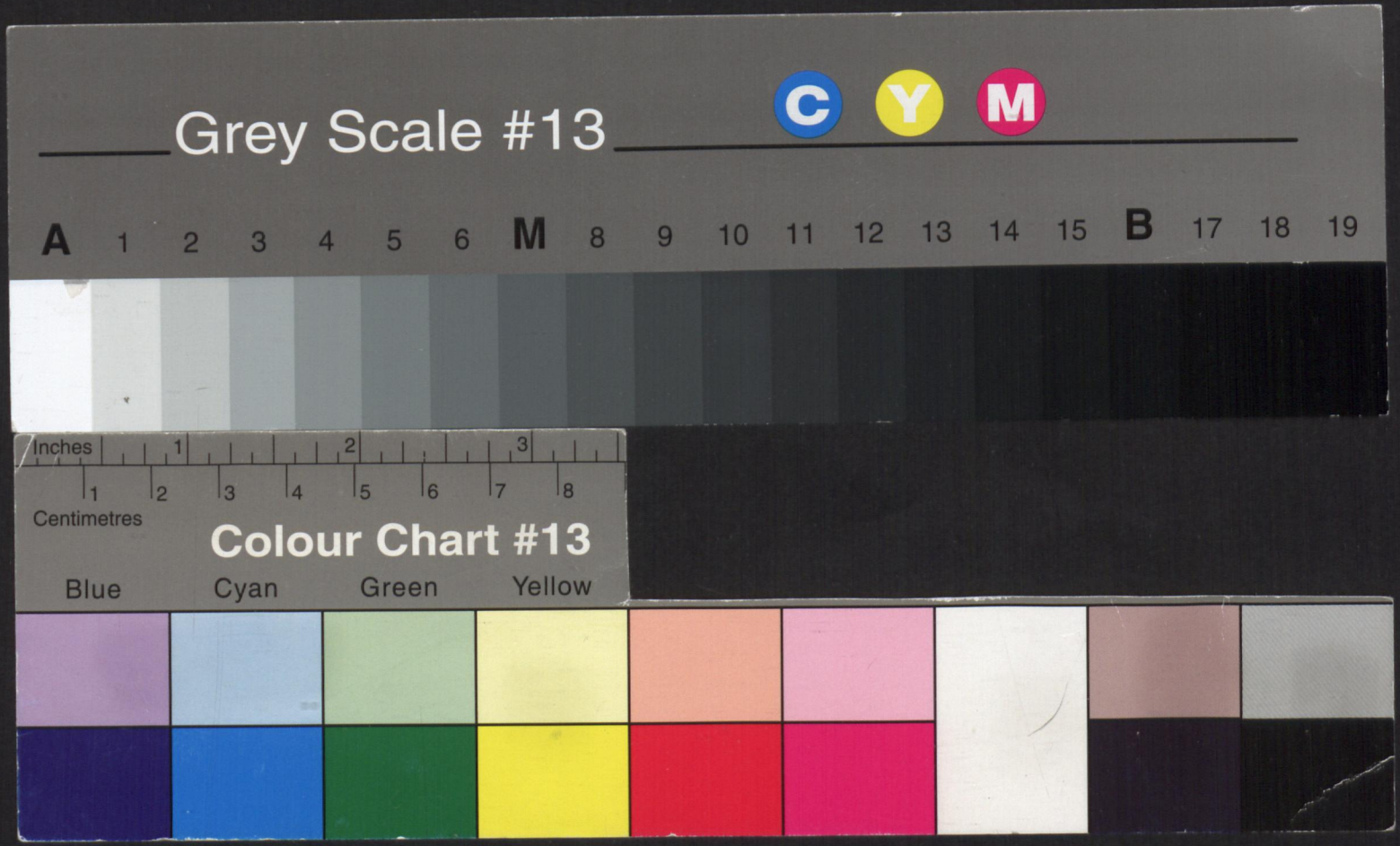
BRIABF

PART 35 ends:-

CST TO PM 30.9.86

PART 36 begins:-

RTA TO PM (A0842755) 110.V6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Colour Chart #13
Blue
Cyan
Green
Yellow