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CABINET

PUBLIC EXPENDITURE SURVEY 1984

Memorandum by the Lord President of the Council

At their meeting on 5 July the Cabinet decided that the public expenditure planning totals should be £131.7 billion for 1985-86, £136.3 billion for 1986-87, and £140.4 billion for 1987-88, and invited the Chief Secretary, Treasury to pursue bilateral discussions of expenditure programmes with the Ministers responsible. On 4 October the Chief Secretary, Treasury reported progress. The Prime Minister invited me to be the Chairman of the Ministerial Group on Public Expenditure (MISC 106) to consider and make recommendations on those issues which had not been resolved by the Chief Secretary, Treasury and the spending Ministers concerned (CC(84) 25th Conclusions, Minute 5; CC(84) 32nd Conclusions, Minute 9).

2. This memorandum sets out the recommendations of MISC 106. I should like to express my gratitude both to the members of the Group and to the spending Ministers who have appeared before us for the care and thoroughness which they have brought to the task.

AGREED PROGRAMMES

3. Most expenditure programmes were agreed in bilateral discussions between the Chief Secretary, Treasury and the spending Ministers concerned. The resulting effects on the survey baseline are set out in Annex A; brief descriptions of the policy implications (subject to resolution of minor details in some cases) are in Annex B.

4. MISC 106 were able to reach agreement with the spending Ministers concerned on the recommendations to be put to the Cabinet on all programmes which they considered, apart from the External Financing Limits (EFLs) of the gas and electricity industries, and housing. The recommendations are summarised in paragraphs 5 to 13 below; further details are given in Annexes C to G. All figures are in £ million unless otherwise stated.

DEFENCE

5. MISC 106 have agreed with the Secretary of State for Defence that

provision for 1985-86 should be increased by £105 million in order to honour the Government's commitment to plan for 3 per cent real growth up to that year. For later years, the baseline figures should remain unchanged, apart from an agreed addition of £300 million for Falkland Islands expenditure in 1987-88. The Secretary of State for Defence points out that the resulting figures will show a decline in the real value of defence provision, apart from the Falkland Islands, of 0.5 per cent in 1986-87, and a further 0.7 per cent in 1987-88. It would be helpful presentationally to accompany their publication by a statement indicating that they are subject to review. An agreed form of words is in paragraph 3 of Annex C.

#### FOREIGN AND COMMONWEALTH OFFICE

6. MISC 106 and the Foreign and Commonwealth Secretary have agreed that there should be no change in combined baseline provision (apart from certain minor agreed adjustments). The Foreign and Commonwealth Secretary points out that this entails that it may be necessary to reduce the aid programme in order to accommodate unavoidable increases in expenditure on the Diplomatic Wing.

#### AGRICULTURE

7. MISC 106 have agreed the following recommendations with the Minister of Agriculture, Fisheries and Food: reductions in capital grants; savings on agricultural research and development and the Agricultural Development and Advisory Service (ADAS), the amount of the savings to be reviewed in the light of developments, including the Government's eventual decisions on the recommendations in a recent report on the ADAS by its new Director General, Professor Bell; and savings on arterial land drainage. With agreed adjustments to baseline and other minor changes, the recommendations produce net savings on baseline of:

- 36                      - 78                      - 112

#### OTHER ENVIRONMENTAL SERVICES

8. Provision for Other Environmental Services is net of receipts. There are indications of a significant shortfall in receipts. If this occurred, adherence to baseline provision would entail severe cuts in gross expenditure. MISC 106 recommend additions to the adjusted baseline of:

+ 17                      + 10                      0

Implying changes to the original baseline of:

- 29                      + 9                      - 1

The Secretary of State for the Environment is prepared to endorse this

recommendation, on the assumption that actual receipts will be at the level in the baseline. In his view, provision will need to be reviewed next year when the receipts position is clearer.

#### URBAN PROGRAMME

9. MISC 106 recommend reductions of:

- 30                      - 55                      - 55

The Secretary of State for the Environment is reluctantly prepared to acquiesce in this. He points out, however, that cuts on this scale will be very strongly criticised as the Government turning its back on the problems of the inner cities, and will worsen relations with inner city authorities. Against this, the Urban Programme has doubled in real terms since 1978-79, a larger increase than for any other programme.

#### HEALTH AND PERSONAL SOCIAL SERVICES

10. There are large and virtually unavoidable bids for additional expenditure on both the cash-limited parts of the programme (such as the hospital and community health service) and the demand-determined family practitioner services. They total:

+ 353                      + 498                      + 886

11. The Group, jointly with the Secretary of State for Social Services, recommend the following main changes: an increase in prescription and dental charges for non-exempt groups, with a corresponding increase in season ticket charges; changes in the Pharmaceutical Price Regulation Scheme; restrictions on the availability on the National Health Service of minor drugs; reductions in provision for capital spending. The changes yield savings of:

- 105                      - 160                      - 216

With savings agreed in the bilateral discussions, total savings are:

- 155                      - 211                      - 289

#### SOCIAL SECURITY

12. There are large and virtually unavoidable bids stemming mainly from changed economic assumptions and higher take-up of benefits. They amount to:

+ 737                      + 881                      + 2,062

13. The Group, jointly with the Secretary of State for Social Services, recommend the following main changes: legislation in the current Session

to extend the payment by employers of statutory sick pay from 8 to 28 weeks (with certain offsetting reductions in employers' National Insurance Contributions); action on housing costs; postponement of the abolition of the retirement pensioners' earnings rule; reduction in the level of special payments under the supplementary benefit scheme; and measures to be announced following the social security reviews now underway. The changes yield savings of:

- 218                      - 585                      - 735

#### DISAGREED PROGRAMMES

14. The two programmes on which MISC 106 could not agree recommendations with the spending Ministers concerned were:

- a. the EFLs of the British Gas Corporation and the electricity supply industry (England and Wales): the issues are discussed in paragraphs 15 to 18 below and Annex H;
- b. the housing programme: the issues are discussed in paragraphs 19 to 28 and Annex I.

#### GAS AND ELECTRICITY INDUSTRIES

15. The survey baseline is as follows:

	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>
Gas	- 396	- 495	- 507
Electricity	- 1,022	- 1,337	- 1,370

The industries submitted bids for additions to their EFLs totalling:

Gas	+ 159	+ 237	+ 389
Electricity	+ 24	+ 298	+ 570

A significant part of these bids was to finance higher payments of corporation tax.

16. MISC 106 asked the Secretary of State for Energy to explore with the industries a package of cost savings and price increases with the aim of agreeing reductions in their combined EFL bids of £2,200 million over the survey period.

17. The Secretary of State for Energy held discussions with the Chairmen of the industries and advised the Group that he believed he could, with

great pressure and difficulty, persuade the industries to produce savings of the following amounts, after allowing for the effects of corporation tax.

Gas	- 115	- 212	- 272
Electricity	- 130	- 408	- 472

The savings would be found by a combination of efficiency and other measures and price increases. The price increases required to meet these figures would be primarily a matter for the commercial judgment of the industries. But the Secretary of State for Energy thought it possible that there would be increases in electricity prices of 4½ per cent in 1985-86 and later years and increases in gas prices at a higher level through the period.

18. The net effect of these savings and the bids from the industries would be:

- 62	- 85	+ 215
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MISC 106 do not consider this adequate. In their view, it should be possible to find savings to the extent they originally suggested. If, for purposes of illustration, the additional savings resulting from this proposal were spread evenly over the survey period, the net effect on the baseline would be:

- 167	- 265	- 91
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#### HOUSING

19. The survey baseline is as follows:

Gross expenditure	3,807	3,876	3,940
<u>less</u> receipts	<u>- 1,300</u>	<u>- 1,300</u>	<u>- 1,300</u>
Net expenditure	2,507	2,576	2,640

It is common ground between the Secretary of State for the Environment and the Group that the estimates of receipts should be increased, yielding savings of:

- 300	- 100	0
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There are also certain agreed adjustments to the baseline, including an additional £30 million a year private sector finance for the Housing Corporation.

20. The Secretary of State for the Environment proposes increases in gross provision of:

+ 250                      + 350                      + 400

He points out that in 1985-86 the increase would be more than offset by higher receipts and private sector financing of the Housing Corporation. How the increase in gross provision would be distributed between the components of the programme would be governed largely by how local authorities used their capital allocations; but he believes that a likely distribution is as follows:

New dwellings and conversions	+ 50	+ 50	+ 50
Renovation and repairs	+ 200	+ 300	+ 350
Home improvement grants	0	0	0

21. MISC 106 propose reductions in gross provision of:

- 380                      - 470                      - 560

They believe that a likely distribution is as follows:

New dwellings and conversions	- 200	- 300	- 400
Renovation and repairs	+ 50	+ 50	+ 50
Home improvement grants	- 230	- 220	- 210

The Secretary of State accepts this as plausible for 1986-87 and 1987-88; but in 1985-86, for reasons explained in Annex I, he believes that expenditure on home improvement grants would be reduced by less, and that expenditure on renovation and repairs would consequently fall.

#### NEW DWELLINGS

22. The Secretary of State for the Environment argues that there are severe shortages of dwellings for those who cannot afford owner-occupation; and that new dwellings are needed each year in view of the rapid growth in new households and the decline of the private rented sector. In his view, 75,000 new starts a year in the public sector are necessary to cater for this irreducible need. He accepts that in present economic circumstances this cannot be afforded, but considers that if the number of new starts fell below the present level (about 40,000 a year), homelessness and overcrowding would increase to a politically unacceptable level. The 40,000 starts would be divided about equally between housing associations and local authorities.

23. MISC 106 consider that the figure of 75,000 new households allows for many categories who have no strong claim to housing in the public sector. In their view, a level of public sector starts between 15,000 and 20,000 a year is adequate.

#### RENOVATION AND REPAIR

24. The Secretary of State for the Environment points out that besides normal needs for renovation and repair of the public housing stock recent developments have brought to light a substantial new need for repairs to industrialised and system-built housing of the 1950s and 1960s, some of which present risks to health and safety. In his view the provision for renovation suggested by MISC 106 would lead to the further deterioration of the public sector stock; in 1985-86 the proposals would lead to a reduction in expenditure, which would be wholly indefensible.

25. MISC 106 agree with the Secretary of State for the Environment that an increase in expenditure on renovation and repair is desirable. They note that he accepts that their proposals would allow this, at least in 1986-87 and 1987-88. They do not believe that the increase in provision recommended by the Secretary of State for the Environment can be afforded; they also believe that within a gross programme of over £1 billion a year there is room for a good deal of essential safety work to be done.

#### HOME IMPROVEMENT GRANTS

26. The Secretary of State for the Environment considers that expenditure of some £600 million a year is necessary to prevent a deterioration of the privately-owned housing stock over the survey period; but he is willing, in present economic circumstances, to live with the baseline provision of £450 million a year. He regards the political consequences of reductions below baseline as serious. Many people on low incomes have been induced by the Government's policies to become owner-occupiers and cannot afford to undertake heavy expenditure on repairs. The outcome would be a serious deterioration in the condition of the housing stock, which would be revealed by the 1986 English House Condition Survey.

27. MISC 106 agree that expenditure on home improvement grants is desirable if it can be afforded. But it cannot be afforded on the scale desired by the Secretary of State for the Environment. The public purse has no obligation to subsidise repairs and improvements to owner-occupied housing. The Group's proposals would allow expenditure to continue at broadly the same level as before the upsurge in 1982-83 and 1983-84.

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EFFECTS ON THE PLANNING TOTALS

28. Allowing for additional receipts and agreed adjustments, the proposals of the Secretary of State for the Environment would add the following to baseline:

+ 103                      + 368                      + 480

The Group's recommendations would produce the following reductions on baseline:

- 527                      - 452                      - 480

OVERALL EFFECT

29. If the recommendations in the preceding paragraphs are accepted, there will be a prospective excess over the planning totals agreed by the Cabinet of:

+ 243                      + 231                      + 843

If, however, the proposals of the Secretary of State for Energy and the Secretary of State for the Environment were accepted, then, allowing for the consequential effects on territorial block budgets, the prospective excess would be:

+ 1,030                      + 1,427                      + 2,332

RECOMMENDATION

29. I invite the Cabinet:

- a. to endorse the recommendations in paragraphs 5 to 13 above;
- b. to decide the appropriate level of savings to be sought from the British Gas Corporation and the electricity supply industry (England and Wales) in the light of the considerations set out in paragraphs 15 to 18 above;
- c. to decide the appropriate provision for the housing programme in the light of the considerations set out in paragraphs 19 to 28 above.

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Privy Council Office

5 November 1984

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SECRET

ANNEX A Table 1

£ million (a)

PES 1984: SCORECARD

	1985-86			1986-87			1987-88		
	Programmes considered by MISC 106			Programmes considered by MISC 106			Programmes considered by MISC 106		
	Programmes considered outside MISC 106	Dept Proposal	MISC Proposal	Programmes considered outside MISC 106	Dept Proposal	MISC Proposal	Programmes considered outside MISC 106	Dept Proposal	MISC Proposal
Defence									
FCO/ODA		+105	+105		0	0		+300	+300
EC		+2	+2		0	0		-1	-1
IBAP(land CAP prefunded)	+200			+40			+215		
Domestic Agriculture(c)	+131			-34			-40		
Forestry	-36	-36		-78	-78		-112	-112	
Regional Policy(e)	-4			-4			-4		
DTI Other	-6			+127			-100		
ECGD	+102			+57			-39		
Energy	+293			+396			+231		
Employment	-21			-33			-50		
Transport	-111			-155			-213		
Housing(c)	-94			-97			-111		
PSA	+103	-527		+368	-452		+480	-480	
DOE-Other(c)	+15			0			-5		
Urban Programme	-29	-29		+9	+9		-1	-1	
Ordnance Survey	-30	-30		-55	-55		-55	-55	
Home Office	0			+1			+3		
LCD	-10			-5			+10		
DES	-10			-8			+14		
OAL	-12			-14			-13		
Health and PSS	+3			+3			+5		
Social Security	+198	+198		+286	+286		+597	+597	
Superannuation	+519	+519		+296	+296		+1327	+1327	
	-56			-46			+37		
Scotland, Wales, NI									
- Formula (approx)(b)	-14	+52	0	-13	+166	-30	-15	+253	+30
- Other (excl RP)	+68			+52			+113		
Other Departments	-16			+2			-14		
Nationalised Industries									
- Gas + Elec		-62	-167		-85	-265		+215	-91
- Other EFLs									
- RMPS	+14			-71			-449		
LA current(d)	+122			+23			+27		
Reserve	+979			+1169			+1050		
Pay clawback(d)	-750			-750			+131		
Asset Sales	-115			-120			-125		
1987-88 Uplift	-500			0			+50		
CHANGE FROM	0			0			-1379		
ANNUALLY TARGET									
	+208	+822	+35	+520	+907	-289	-671	+1003	+1514

(a) All changes from original Survey baseline  
 (b) Figures for some programmes, notably Health and Housing, are on an England basis. The Scottish, Welsh and Northern Irish programmes are automatically adjusted in line with any changes in the provision on comparable programmes for England.  
 (c) Figures for these programmes include both agreed adjustments to baseline and proposed further changes.  
 (d) LA current expenditure and pay clawback will be allocated to departments in the Autumn Statement figures  
 (e) Figures on a GB basis

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## SURVEY BASELINES

(excluding nationalised industries' external finance and local authorities' relevant current expenditure)

£ Million

	1985-86	1986-87	1987-88
1 Defence	17,998	18,614	18,619
2 FCO other	602	602	618
3 ODA	1,264	1,299	1,320
4 EC	550	600	615
5 IBAP (and CAP prefunded)	1,304	1,311	1,343
6 Domestic Agriculture	753	762	781
7 Forestry	56	57	59
8 Regional Policy	491	478	489
9 DTI other	782	752	773
10 ECGD	30	-159	-163
11 Energy	321	324	332
12 Employment	3,158	3,184	3,264
13 Transport	2,176	2,257	2,311
14 Housing	2,507	2,576	2,640
15 PSA	-109	-117	-120
16 DOE Other	654	673	689
17 Urban Programme (DOE only)	277	281	287
18 Ordnance Survey	18	18	19
19 Home Office	1,023	1,070	1,096
20 LCD	547	581	595
21 DES	3,353	3,432	3,518
22 OAL	286	330	338
23 Health and PSS	13,954	14,657	15,024
24 Social Security	39,407	41,521	42,559
25-26 Superannuation	1,130	1,226	1,256
Scotland (excl Regional Policy)	3,904	4,067	4,170
Wales (excl Regional Policy)	1,521	1,589	1,629
27 Northern Ireland	4,213	4,390	4,500
28-29 Other Departments	2,121	2,185	2,238
30 Nationalised Industries	1,063	10	10
31 RMPS	269	288	295
32 LA relevant current	24,754	25,179	25,576
33 Reserve	3,750	4,750	4,869
34 Pay clawback	0	0	0
35 Asset Sales	-2,000	-2,000	-2,050
3% Uplift	0	0	1,379
TOTAL*	131,671	136,294	140,383

\* excludes double counting

## SUMMARY OF CHANGES ON PROGRAMMES NOT CONSIDERED BY MISC 106

3. EC (EUROPEAN COMMUNITY)

<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>
+200	+40	+215

The latest projection of the United Kingdom's (UK) net payments to EC institutions, following the agreement reached by the European Council at Fontainebleau on a system for abating UK payments of Value Added Tax in future years. The main reason for higher projections is that receipts from abatement of VAT are less than implied by the stylised assumptions in the last Public Expenditure White Paper (Cmnd 9143).

4. IBAP (INTERVENTION BOARD FOR AGRICULTURAL PRODUCE) AND OTHER PRE-FUNDED CAP EXPENDITURE

+131	-34	-40
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The latest estimated cost of unavoidable additional demand-determined expenditure on Common Agricultural Policy market support. The 1985-86 forecast reflects the 1984 cereals harvest which is expected to produce a very large surplus.

6. FORESTRY

-4	-4	-4
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Savings resulting from improved trading performance including increases in productivity and efficiency, and reductions in planned new planting and land purchase.

7. REGIONAL POLICY

-6	+127	-100
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These figures represent for Great Britain as a whole the impact of the decisions reached by E(A) on 3 October on the Secretary of State for Trade and Industry's proposed new structure for regional industrial incentives and subsequent settlement of the assisted areas map. They also include the estimated effects of the Secretary of State's decision to introduce a four month moratorium during 1985-86 on applications for RDGs under the present scheme; to be unwound in 1986-87.

8. DTI (OTHER)

+102	+57	-39
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Additions, mainly for launch aid and shipbuilding, offset by reductions in the general level of industrial support. The precise allocation to individual sub-programmes has not yet been settled.

9. ECGD

+293	+396	+231
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The main addition is the unavoidable increase in the cost of interest support due to higher interest rates. This cost is offset to some extent by the transfer of further refinance to the banking sector.

10. ENERGY

1985-86	1986-87	1987-88
-21	-33	-50

Savings resulting from reduced requirements for industrial support, and from reductions in expenditure mainly on nuclear research and development; final savings from the Review of the Atomic Energy Authority still to be settled.

11. EMPLOYMENT

-111	-155	-213
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The reductions largely reflect lower than expected take up of existing special employment measures and a cut in the rebate to employers from the Redundancy Fund, partly offset by an expansion of some measures particularly the Enterprise Allowance and Technical and Vocational Education Initiative and by an increase in demand determined expenditure on Redundancy Payments.

12. TRANSPORT

-94	-97	-111
-----	-----	------

Savings resulting from the transfer of public trust ports to the private sector, additional receipts on vehicle licensing and testing schemes, and reductions in local authority capital expenditure (mainly on roads and ports). These reductions are partly offset in the later two years by provision for the introduction of rural bus grant.

14. PROPERTY SERVICES AGENCY

+15	0	-5
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Increase in provision for major new works (including a new building for Computerisation of PAYE), maintenance of the civil estate, and "spend to save" projects in the first year. This increase is partly offset by a reduction in the last year.

17. ORDNANCE SURVEY

0	+1	+3
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Small net increases in the baseline provision to cover extra work on digital mapping and core activities.

18. HOME OFFICE

-10	-5	+10
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The changes include increases for control of immigration, non-custodial measures and after care, community programmes and Passport Department computerisation; and reductions on police central services, magistrates courts building (in the first year) and sales of police houses. There are net reductions on prisons in the first 2 years and a net increase in the third for the prison building programme.

19. LORD CHANCELLOR'S DEPARTMENT

-10	-8	+14
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Savings resulting from reductions in the court building programmes in the two years, partly arising from involuntary slippage of some schemes. The increase in the third year reflects the rising volume of legal aid, partly offset by further reductions in court building.

20. DEPARTMENT OF EDUCATION AND SCIENCE

-12	-14	-13
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Savings from cuts in local authority capital spending and student awards. The net savings on student awards reflect an increase in gross costs, more

than offset by revised scales for parental contributions, the extension of those scales to tuition fees, and the ending of the minimum £205 awards. Much of the overall savings will be redeployed, mostly on the Assisted Places Scheme, the Science Budget, and, on a selective basis, for equipment in universities.

21. OFFICE OF ARTS AND LIBRARIES

	1985-86	1986-87	1987-88
	+3	+3	+5

Precise details of how the net changes in provision will be allocated have yet to be settled.

24. SUPERANNUATION

	1985-86	1986-87	1987-88
	-56	-46	+37

Reduced requirements resulting from lower levels of retirements and a change in re-employment policy are partially offset by a loss of receipts following privatisation of the Royal Ordnance Factories. The increase in 1987-88 reflects the continuing growth in the number of pensioners.

26. SCOTLAND, WALES AND NORTHERN IRELAND

	1985-86	1986-87	1987-88
	+68	+52	+113

The territorial departments have some expenditure outside the block arrangements which has increased principally due to higher interest rates affecting the Scottish and Welsh housing programmes and revised economic forecasts affecting the Northern Ireland Social Security programme. Cuts in the Scottish and Welsh housing improvement grant baselines for 1986-87 of £16 million and £23 million made in the 1983 survey have been restored for 1987-88.

27. OTHER DEPARTMENTS (Chancellor of the Exchequer's and Small Departments)

	1985-86	1986-87	1987-88
	-16	+2	-14

Reduced requirements on the Rating of Government Property Department have offset additional bids, notably £10 million in 1985-86 for a National Audit Office headquarters building, and £15 million and £25 million in 1986-87 and 1987-88 to cover initial costs of the new Independent Prosecution Service. The changes also reflect savings on currency. Costs of the recently announced increases in Customs and Excise manpower to combat drug smuggling are also included.

29. OTHER EFLS

	1985-86	1986-87	1987-88
	+14	-71	-449

In 1985-86 a significantly increased provision for BSC is offset by savings from other industries, principally British Rail; British Shipbuilders (as a result of the expected sale of the warship building yards); and Water. In the following years major savings from Water, the South of Scotland Electricity Board; and the National Bus Company (as a result of expected privatisation) considerably more than offset the additional provisions required for the British Steel Corporation; the Post Office; British Shipbuilders; the British Airports Authority; and the North of Scotland Hydro-Electric Board. Pending review after the current dispute, provision for the National Coal Board is unchanged for all years.

30. REDUNDANT MINEWORKERS PENSION SCHEME

	1985-86	1986-87	1987-88
	+122	+23	+27

Mainly increased provision for the Redundant Mineworkers Pension Scheme

agreed during the Investment and Financing Review.

31. LOCAL AUTHORITY CURRENT EXPENDITURE

1985-86	1986-87	1987-88
+979	+1169	+1050

The increases for 1985-86 were agreed by E(LA) in July with the aim of setting realistic provisional targets for local authority spending. Revised totals have been set for 1986-87 and 1987-88.

32. THE RESERVE

1985-86	1986-87	1987-88
-750	-750	+131

Cmd 9143 provided reserve figures of £3.75 billion and £4.75 billion for 1985-86 and 1986-87; and the initial "baseline" 1987-88 was £4.75 billion + 2 1/2 per cent. Cabinet on 5 July agreed revised figures of £3 billion, £4 billion and £5 billion.

33. PAY CLAWBACK

1985-86	1986-87	1987-88
-115	-120	-125

The reductions follow Cabinet's decision on 4 October to adopt a pay factor of 3 per cent for 1985-86, rather than the 4 per cent which had been provided for in earlier plans. Departmental baselines will be reduced accordingly.

34. ASSET SALES

1985-86	1986-87	1987-88
-500	0	+50

The latest forecast of asset sales in 1985-86 of £2.5 billion provides an extra £500 million receipts. An addition of £50 million in 1987-88 is needed to remove the mechanical 2 1/2 per cent increase in the survey baseline so a rounded figure of £2 billion can be published for both 1986-87 and 1987-88.

35. 1987-88 UPLIFT

1985-86	1986-87	1987-88
0	0	-1379

The initial mechanical calculation of the 1987-88 baseline for individual programme lines was based on 1986-87 plans plus 2 1/2 per cent. Cabinet agreed on 5 July that the aggregate planning total increase should be 3 per cent; this provides a sum available to offset against bids for additions to original baselines.

DEFENCE

	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>
Survey baseline (after pay clawback)	17955	18564	18567

MISC 106 have agreed with the Secretary of State for Defence that £105 million should be added to the provision for 1985-86 on account of inflation assumptions and the 1984 pay award following the recommendations of the Armed Forces Pay Review Body. This addition is necessary in order to meet the Government's commitment to 3 per cent a year real growth up to 1985-86.

2. For later years, MISC 106 and the Secretary of State for Defence have agreed that the adjusted baseline figures above should remain unchanged, apart from an agreed addition of £300 million in 1987-88 for provision for the Falkland Islands.

3. The Secretary of State for Defence points out, however, that the resulting figures will show a decline in the real level of the Defence Budget (excluding Falklands provision) after 1985-86. MISC 106 have therefore agreed that when the figures are published they should be accompanied by a statement in the following terms.

'The provision for 1985-86 meets the Government's commitment to plan to implement the NATO aim of real increases in defence spending of 3 per cent per annum up to that year. The cash provision for later years will be kept under review in the context of the Government's expenditure plans, taking account of our military commitments and all other relevant factors'.

FOREIGN AND COMMONWEALTH OFFICE PROGRAMMES

The Survey baseline is as follows.

	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>
Overseas Development Administration	1264	1299	1320
Diplomatic Wing	602	602	618

Overseas Development Administration (ODA)

2. This programme has fallen by 14 per cent in real terms since 1979. Because of increases in United Kingdom subscriptions to multilateral aid programmes, the funds for bilateral country programmes have fallen by 30 per cent. If the baseline provision is not increased, it is likely that bilateral programmes will decline by 1988 by a further 10 per cent in real terms. The Foreign and Commonwealth Secretary estimates that additions of £25 million in 1986-87 and £35 million in 1987-88 would be needed in order to maintain bilateral aid programmes at their 1984-85 level.

Diplomatic Wing

3. This programme faces substantial cost increases because of the decline in the exchange value of sterling. There are also numerous items, relatively small individually but significant in total, such as the external services of the British Broadcasting Corporation, the British Council, and the Moscow/London Embassy sites, on which additional expenditure will have to be incurred for reasons largely beyond the control of the Foreign and Commonwealth Secretary.

Overall judgement

4. Nevertheless, the Foreign and Commonwealth Secretary accepts that, given the very difficult public expenditure situation, it would not be right to increase the combined provision for the two programmes, apart from certain minor agreed adjustments; and MISC 106 so recommend. The Foreign and Commonwealth Secretary points out that because of the difficulty of accommodating the increases referred to in paragraph 3 above it may be necessary to transfer funds from the ODA programme to the Diplomatic Wing; and that this is likely to have the effect of still further reducing our bilateral aid programmes.

5. The minor agreed adjustments mentioned above total:

+ 1.8	- 0.3	- 0.7
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# AGRICULTURE

	1985-86	1986-87	1987-88
Survey baseline	777	785	805

MISC 106 have agreed the following recommendations with the Minister of Agriculture, Fisheries and Food.

## Capital grants

2. There are two main schemes of capital grants for agriculture: the Agriculture and Horticulture Development Scheme, which implements the mandatory provisions of the relevant Community Directive; and the Agriculture and Horticulture Grants Scheme, which gives national aid at lower rates to those farmers who either cannot meet the strict eligibility conditions of, or elect not to participate in, the AHDS. Expenditure in the UK on the two schemes combined, with some smaller measures for assisting investment, amounts to about £180 million a year.

3. A new Community agricultural structures regulation is expected to take effect during 1985-86. The Minister of Agriculture, Fisheries and Food considers that the likely full year cost of a scheme of grants satisfying the minimum requirements of the new regulation is of the order of £82 million. He also considers that it will be politically and otherwise essential to have a national scheme of grants directed particularly to environmental and conservation objectives: this might cost about £8 million in 1987-88. Although the new schemes will replace the existing AHDS and AHGS, there will be a transitional period during which existing commitments under those two schemes will have to be honoured.

4. Against this background MISC 106 recommend that provision for capital grants should be reduced by:

- 40                      - 50                      - 50

The announcement of the reductions should be accompanied by a statement reassuring the agricultural industry that they are not part of a policy of phasing out support for capital expenditure, but paving the way for new schemes as envisaged by the Minister of Agriculture.

## Research and Development and Advisory Services

5. The Agricultural Development and Advisory Service (ADAS) provides free advice and services to farmers. It is the subject of a recent report by the new Director General, Professor Bell, which recommends economies through greater efficiency and a wider use of charging. The Minister of Agriculture, Fisheries and Food accepts the broad thrust of the recommendations, the implementation of which will involve primary legislation. He also agrees that attempts should be made to secure a greater measure of funding of research and development by the agriculture and food industries. These developments will take time to yield savings; but the Minister agrees that it would be reasonable to offer the following savings 'on account':

0                      - 10                      - 40

It would be made clear when the expenditure figures were published that they were provisional and subject to review in the light of these reviews and other developments.

Arterial land drainage

6. Given the very high level of central Government financial support to arterial drainage and flood protection it would be reasonable to look for savings. MISC 106 recommend:

- 10                      - 15                      - 15

They recognise that the reductions will have a disruptive impact on the work programmes of drainage authorities, and that the forthcoming Green Paper should not imply that further cuts are envisaged.

Overall effect

7. After agreed adjustments and minor changes, the recommendations yield the following savings:

- 36                      - 78                      - 112

ENVIRONMENT

## 1. OTHER ENVIRONMENTAL SERVICES

	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>
Survey baseline (excluding local authority current expenditure)	653	672	688
Agreed adjustments to baseline	- 46	- 1	- 1
Total: adjusted baseline	607	671	687

The above figures are net of receipts. The Secretary of State for the Environment believes that there is a prospective shortfall of receipts. If this occurred, and baseline provision were not increased, there would be heavy pressure on provision for gross expenditure. Moreover, there is an inescapable addition for the Nature Conservancy Council to fulfill its statutory obligations, and increases for expenditure on research on radioactive waste disposal and acid rain.

## 2. MISC 106 recommend increases on the adjusted baseline of:

+ 17	+ 10	0
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The Secretary of State for the Environment is prepared to endorse this recommendation, on the basis of the existing, possibly optimistic, forecast of receipts. He would, however, wish to review the position next year when the outlook for receipts will be clearer.

## 3. II. URBAN PROGRAMME (including expenditure by other departments)

	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>
Survey baseline	366	372	379

In the light of the conclusions of the meeting of the Ministerial Group on Urban Policy on 16 October (MISC 104(84)2nd Meeting, Item 2) MISC 106 recommend the following reductions:

- 30	- 55	- 55
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The Secretary of State for the Environment is reluctantly prepared to acquiesce in this. He points out however that cuts on this scale will be very strongly criticised as the Government turning its back on the problems of the inner cities; and that they will worsen relations with inner city authorities. Against this, the Urban Programme has doubled in real terms since 1979, a larger increase than for any other programme.

SOCIAL SERVICES

## 1. HEALTH AND PERSONAL SOCIAL SERVICES (HPSS)

	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>
Survey baseline (excluding local authority current expenditure)	13954	14657	15024

In their bilateral discussions, the Secretary of State for Social Services and the Chief Secretary, Treasury, agreed that there would be additions to baseline in respect of the cash-limited parts of the HPSS; and that there were substantial and virtually unavoidable additional bids on the demand-determined family practitioner services. The total of the net bids from these sources was as follows:

+ 353	+ 498	+ 886
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These figures assumed greater efficiency savings than in previous years.

2. Although the Secretary of State had offered savings in the bilateral discussions, MISC 106 considered that in view of the general public expenditure situation it was necessary to look for more. After discussion, they agreed with the Secretary of State that they would jointly recommend to the Cabinet measures producing savings of £105 million in 1985-86, £160 million in 1986-87 and £216 million in 1987-88. With the savings agreed in the bilateral discussions, total savings are:

- 155	- 211	- 289*
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\* In addition savings measures agreed for these years in earlier surveys but still to be announced amount to about £90 million in each year.

3. The main sources of these savings are as follows:

(i) Changes in the Pharmaceutical Price Regulation Scheme to reduce allowable costs (including sales promotion) and profits from the sale of drugs to the NHS.

(ii) A new system of restrictions on the availability of minor drugs, tranquillisers and sleeping pills under the NHS.

(iii) A substantial increase in income in 1985-86 from NHS prescription and dental charges, including a restructuring of dental charges. These changes will not affect those categories of patients currently exempt from charges. The question of charging policy for later years will be considered in the review of primary care currently underway.

(iv) Reductions in net provision for capital spending.

## II. SOCIAL SECURITY

	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>
Survey baseline (excluding local authority current expenditure)	39410	41521	42559

In their bilateral discussions, the Secretary of State for Social Services and the Chief Secretary, Treasury, agreed that there were large and unavoidable increases to be met, mainly because of changes in economic assumptions and higher take-up of benefits. The total of bids was as follows:

SECRET

1985-86

+ 737

1986-87

+ 881

1987-88

+2062\*

\* including £520 million accepted by the Chief Secretary as not requiring offsetting savings.

4. Although the Secretary of State had offered savings in the bilateral discussions, MISC 106 considered that it was necessary to look for more. They thought it reasonable not only to seek savings from specific measures to be announced shortly but also to ask the Secretary of State to find further savings once he had completed his review of the social security system.

5. The Secretary of State for Social Services has agreed to commit himself to finding the following level of savings within the social security programme; MISC 106 join with him in recommending them to the Cabinet:

- 218

- 585

- 735

6. The main sources of these savings are as follows.

(i) Legislation in the current Session to extend the payment by employers of statutory sick pay from 8 to 28 weeks with effect from April 1986. The Chancellor and the Secretary of State have agreed that the current arrangement under which employers are charged National Insurance contributions on statutory sick pay should be ended from April 1985. This will reduce employers' existing costs by £35 million a year.

(ii) Action on housing costs (particularly for young people on board and lodging accommodation, but also better control of the costs of residential care for elderly people).

(iii) Postponement of the abolition of the retirement pensioners' earnings rule.

(iv) Changes in invalidity benefits giving net savings after restoration of the present 5 per cent abatement.

(v) Measures to be announced following the Social Security reviews now underway.

SECRET

## BRITISH GAS CORPORATION (BGC) AND ELECTRICITY SUPPLY INDUSTRY (ESI)

## EXTERNAL FINANCING

	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>
Survey baseline			
- BGC	- 396	- 495	- 507
- ESI	-1022	-1337	-1370
Total	<u>-1418</u>	<u>-1832</u>	<u>-1877</u>

2. The industries submitted the following bids for additions to their external financing limits.

BGC	+ 159	+ 237	+ 389
ESI	+ 24	+ 298	+ 570
Total	<u>+ 183</u>	<u>+ 535</u>	<u>+ 959</u>

A significant part of these bids was to finance higher payments of corporation tax. The Chief Secretary, Treasury sought reductions compared to baseline of BGC and ESI combined as follows:

- 400	- 600	-1000
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3. The Secretary of State for Energy has held discussions with the Chairmen of the industries and considers that the bids could be reduced, by a combination of efficiency and other savings and price increases, to the following extent.

BGC	- 115	- 212	- 272
ESI	- 130	- 408	- 472
Total	<u>- 245</u>	<u>- 620</u>	<u>- 744</u>

These reductions would be likely to involve increases of 4½ per cent in electricity prices and 6 per cent in gas prices in 1985-86. The industries have not been explicit about price increases in later years; but the Secretary of State for Energy thinks it possible that there would be increases in electricity prices of 4½ per cent in both 1986-87 and 1987-88, and higher increases in gas prices.

4. The reductions in paragraph 3 would mean the following changes in the combined baseline for the two industries:

- 62	- 85	+ 215
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5. MISC 106 consider that these reductions fall short of the contribution which these two industries ought to make towards improving the overall public expenditure position. They consider that further cost savings ought to be attainable in industries with turnovers of the size of about £10 billion (ESI)

and about £7 billion (BGC). They consider that the industries should be asked to contribute reductions, after tax, of the order of £2.2 billion over the survey period, rather than the £1.6 billion which the Secretary of State for Energy has offered. If, for purposes of illustration, the additional savings were spread evenly between the industries and over the survey period, the savings would be increased to the following levels.

BGC	- 170	- 300	- 400
EST	- 180	- 500	- 650
	<hr/>	<hr/>	<hr/>
Total	- 350	- 800	-1050

6. The reductions in paragraph 5 would produce the following changes in the combined baseline for the two industries.

- 167	- 265	- 91
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## HOUSING

	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>
Survey baseline (excluding local authority current expenditure)			
- gross expenditure	3807	3876	3940
- less receipts	-1300	-1300	-1300
Net expenditure	2507	2576	2640
Agreed adjustments*	+ 153	+ 118	+ 80
Adjusted baseline	2660	2694	2720

\* Including - 30 a year on account of increased private sector finance for the Housing Corporation.

Although the survey figures for the housing programme are net of receipts, the better measure of activity under the programme is gross expenditure. For this reason the discussion in paragraphs 2 to 10 below is largely in terms of gross expenditure. However, it must be remembered that how local authorities (the main spending authorities) distribute expenditure within their capital allocations is a matter for them. The figures in this Annex for individual components of the programme therefore represent best estimates of how local authorities would actually behave, not control figures which the Government can be certain will be delivered.

Overall position

2. Overall, the Secretary of State for the Environment bids for additional gross provision of:

+ 250	+ 350	+ 400
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He would expect this to be distributed broadly as follows.

New dwellings and conversions	+ 50	+ 50	+ 50
Renovation and repairs	+ 200	+ 300	+ 350
Home improvement grants	0	0	0

3. MISC 106 recommend the following reductions in gross provision:

- 380	- 470	- 560
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They would expect these to be distributed broadly as follows.

New dwellings and conversions	- 200	- 300	- 400
Renovation and repairs	+ 50	+ 50	+ 50
Home improvement grants	- 230	- 220	- 210

4. The Secretary of State for the Environment agrees that this is a plausible distribution for 1986-87 and 1987-88, but not for 1985-86. He estimates that in 1985-86, allowing for mandatory grants and outstanding approvals for 1984-85, expenditure on home improvement grants will be at least £320 million, so that the maximum reduction on baseline (paragraphs 9 and 10 below) would be £130 million. Since it would not be possible further to reduce expenditure on new dwellings and conversions without a complete moratorium on starts in 1985-86, local authorities would in practice have to reduce expenditure on renovation. The outcome would then be a reduction, rather than an increase, of £50 million in such expenditure in 1985-86.

New dwellings and conversions

5. Gross expenditure consistent with the baseline provision would be:

1323

1327

1323

It would allow between 25,000 and 30,000 new starts a year. The Secretary of State for the Environment does not consider this adequate. In his view, within an overall increase of 190,000 households a year, there will be a net increase of 75,000 households a year who will have to look to the public sector for accommodation because they cannot afford owner occupation. In the light of the public expenditure situation he does not press for an increase in provision sufficient to allow this number of new starts; but he regards it as necessary to make provision allowing for upwards of 40,000 new starts a year.

6. MISC 106 do not accept this view. They consider that the estimate of 75,000 new households allows for many categories who have no strong claim to housing in the public sector. It is the Government's policy to switch provision from the public to the private sector. In their view, it would be sufficient to provide for between 15,000 and 20,000 starts a year.

Local authority renovation and repairs

7. Gross expenditure consistent with the baseline provision would be:

1020

1075

1130

The Secretary of State for the Environment regards a significant increase on this level as necessary. He points out that the local authority stock of housing is ageing. Moreover, it has recently come to light that some 125,000 prefabricated reinforced concrete houses in England are seriously defective, and that it will cost about £1.5 billion to deal with them. Some industrialised housing built in the middle of 1960s suffers from major structural defects. Serious design faults and bad planning have produced appalling housing conditions in the large council estates, such as Ronan Point type blocks.

8. MISC 106 agree that some increase in expenditure on renovation and repairs is desirable. But they do not believe that increases in expenditure on the scale proposed by the Secretary of State can be afforded. The existing provision covers expenditure on repairs and maintenance of lower priority which could be cut, if necessary, to allow essential safety work to be done.

Home improvement grants

9. Expenditure consistent with the baseline provision would be:

450

450

450

The Secretary of State for the Environment considers that £600 million a year needs to be spent in order to ensure that the condition of the privately-owned stock does not deteriorate over the survey period. In present economic circumstances he is prepared to live with the baseline provision, even though that would be likely, in his view, to lead to an increase over the survey period of some 100,000 dwellings in serious disrepair.

10. MISC 106 do not accept this view. They agree that expenditure on home improvement grants is desirable. But what is desirable must give way to what can be afforded. The State has no obligation to subsidise repairs and improvements to owner-occupied housing (mandatory grants for the addition of basic amenities are a different matter). Their proposals would allow expenditure on home improvement grants to continue at broadly the same level, in cost terms, as before the upsurge in expenditure in 1982-83 and 1983-84.

Receipts

11. It is common ground between MISC 106 and the Secretary of State for the Environment that the baseline estimates of receipts should be increased, yielding reductions in forecast net expenditure of:

- 300	- 100	0
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Effects on planning totals

12. Allowing for additional receipts and agreed adjustments, the Secretary of State for the Environment's proposals would involve additions to baseline of:

+ 103	+ 368	+ 480
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The Group's recommendations would produce reductions of:

- 527	- 452	- 480
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