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Ref. A084/2989

PRIME MINISTER

Public Expenditure Survey 1984
(C(84) 32 and 33)

BACKGROUND

FMGA At their meeting on 5 July the Cabinet decided that the public expenditure planning totals should be £131.7 billion in 1985-86, £136.3 billion in 1986-87, and £140.4 billion in 1987-88 (CC(84) 25th Conclusions, Minute 5). Since then there have been extensive bilateral discussions between the Chief Secretary, Treasury and spending Ministers and, more recently, in the Ministerial Group on Public Expenditure (MISC 106) under the chairmanship of the Lord President of the Council.

FMGA 2. The results are summarised in the memorandum by the Lord President (C(84) 32). On the great majority of programmes agreement has been reached with the spending Minister. The net effect, compared with the survey baseline and hence on the planning totals, is as follows. (All figures in this minute, unless otherwise indicated, are in £ million).

	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>
Agreed by Chief Secretary	+ <u>208</u>	+ <u>520</u>	- <u>671</u>
Agreed recommendations by MISC 106	+ 729	+ 458	+ 2055
Total	+ 937	+ 978	+ 1384

The main reasons for these additions are changed economic assumptions and revised estimates of demand-determined programmes (ECGD; health; social security) and more realistic estimates of local authority current expenditure.

3. There are also two disagreed programmes: the external financing limits (EFLs) of the British Gas Corporation and



and the electricity supply industry in England and Wales (ESI); and housing. The implications for the planning totals are as follows.

MISC 106 proposals

Agreed programmes (paragraph 2 above	+ 937	+ 978	+ 1384
Gas and electricity	- 167	- 265	- 91
Housing	- 527	- 452	- 480
Territorial consequentials	0	- 30	+ 30
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Totals	+ 243	+ 231	+ 843

Spending Ministers' proposals

Agreed programmes	+ 937	+ 978	+ 1384
Gas and electricity	- 62	- 85	+ 215
Housing	+ 103	+ 368	+ 480
Territorial consequentials	+ 52	+ 166	+ 253
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Totals	+ 1030	+ 1427	+ 2332

4. So, in broad terms, if the recommendations by MISC 106 are accepted, there is a gap of about £1/4 billion still to be bridged in each of 1985-86 and 1986-87. For 1987-88, the excess over the Cabinet's target is about £850 million; but there is no published planning total for that year, except the £141.5 billion in Table 2.4 of this year's Financial Statement and Budget Report. By contrast, the proposals by the Secretaries of State for Energy and the Environment imply overruns of over £1 billion in 1985-86, rising to over £2.3 billion in 1987-88.

Para C 5. The Secretary of State for the Environment has circulated a memorandum (C(84) 33) in support of his proposals on housing.



MAIN ISSUES

6. The main issues before the Cabinet are as follows:
- a. Are the recommendations agreed between MISC 106 (or the Chief Secretary) and spending Ministers acceptable?
 - b. What changes, if any, should be made to existing provision for:
 - gas and electricity EFLs;
 - housing?
 - c. In the light of the conclusions on a and b above is the outcome of the 1984 Public Expenditure Survey satisfactory? What is to be done to bridge any remaining gaps between the recommendations in C(84) 32 and the planning totals?
 - d. Announcements.

Agreed Programmes

7. The recommendations agreed between MISC 106 and spending Ministers are set out in Annexes C to G of C(84) 32; in addition, Annex B gives brief details of changes agreed bilaterally between the Chief Secretary and spending Ministers.

8. The items which seem most likely to attract comments and questions from members of the Cabinet are as follows:

a. Regional Policy

The figures assume a four-month moratorium during 1985-86 on applications for regional developments grants. The Chief Secretary, Treasury has recently written to the Secretaries of State for Scotland and Wales about this. The Secretary of State for Scotland has expressed some doubts.



b. Education and Science

The figures assume additional parental contributions to student awards, the extension of contribution scales to tutorial fees, and the ending of the minimum award.

c. Foreign and Commonwealth Office

The effect of keeping total provision unchanged is likely to be a cut in the aid programme.

d. Agriculture

The recommendations in C(84) 32 include severe reductions in capital grants.

e. Health

The recommendations include significant increases in prescription and dental charges, and an extension of the 'grey list' of drugs whose availability on the National Health Service is restricted.

f. Social Security

The recommendations include what is virtually a complete transfer to employers of responsibility for sick pay, and postponement of abolition of the earnings rule.

Gas and Electricity

9. The industries have submitted the following bids for additions to their EFLs.

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

About 88 per cent of the total of these bids is to finance additional payments of corporation tax, due partly to the changes announced in this year's Budget, and partly to the profits of the two industries resulting from decision taken in last year's Public Expenditure Survey.



10. The Secretary of State for Energy proposed to MISC 106 that the industries should be asked to reduce their bids by a total of £1.6 billion after allowing for the effects of cost savings and price increases on profits, and hence on corporation tax payments. MISC 106 regard this as inadequate and propose total reductions of £2.2 billion on the bids from the industries. The essential point of difference is the total of reductions which should be sought: this year-by-year pattern suggested in C(84) 33 is explicitly only illustrative.

11. The exchanges between the Secretary of State for Energy and MISC 106 were complicated and may unfortunately give rise --- to recriminations. In case this should happen, I attach a brief chronology of the exchanges at Annex A to this minute.

12. The Cabinet will wish to consider the following main points.

a. The industries are very large, and should be able to make substantial reductions in their financing requirements. The annual turnover of the BGC is about £7 billion and of the electricity supply industry about £10 billion. Their total capital requirements are about £1 billion a year each.

b. It is difficult to be more specific, because Mr Walker did not provide MISC 106 with a detailed breakdown of the sources of savings in his own proposals. But on prices the ESI appears to be planning for a reduction in real terms (increases of 4½ per cent a year compared with the industry's inflation assumption of 5 per cent a year). The BGC has indicated large price increases; but this may be a tactical move intended to deter Ministers from looking for more savings. As for rates of return on assets, the ESI does not apparently expect to earn more than 3 per cent (real) until 1987-88, even after the price increases indicated. Although



Renovation and Repairs

c. There is no doubt that local authorities will have to spend more money on repairing system-built houses from the 1950s and 1960s. If this is at the expense of other repairs, some dwellings (the Secretary of State for the Environment estimates 30,000 a year) will fall into disrepair.

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d. On the other hand, MISC 106 do envisage an increase in expenditure on renovation and repairs. The English House Condition Survey 1981 showed that local authority housing was in a significantly better state of repair than the owner-occupied sector. Ministers may feel that this fact does not support a case for further increasing public expenditure on repairs and renovation.

Home Improvement Grants

e. As the Secretary of State for the Environment says, there is something of a conflict of philosophy here. It is estimated by Departments that expenditure of about £200 million a year in 1983-84 cost terms would be sufficient to bring all dwellings falling below a minimum public health standard up to that standard, but would make no provision for grants to dwellings about the minimum standard but in disrepair. In effect, MISC 106 argue that so long as minimum health standards are satisfied, there is no obligation on the State to subsidise house repairs, any more than any other item of personal expenditure.

f. On the other hand, it can be argued that there is a wider public interest in ensuring that the nation's housing stock, whether in public or private hands, is properly maintained.

g. There is also bound to be considerable criticism if the level of home improvement grants is cut to about one quarter of the level it had reached in 1983-84.



15. At his meeting with you this morning the Secretary of State for the Environment indicated that he would be prepared to reduce his bids to some extent. His officials subsequently gave the Cabinet Office the precise figures. In relation to the figures for gross provision in paragraph 20 of C(84) 32 the effect would be as follows:

Original DOE proposals	+ 250	+ 350	+ 400
Concession	- 150	- 250	- 300
Revised DOE proposals	+ 100	+ 100	+ 100

[NB: These proposals are confidential to you and will not be tabled until the Cabinet discussion takes place.]

16. The Chancellor of the Exchequer has also told you in confidence how far he is prepared to scale down the reductions sought by MISC 106. In relation to the figures for gross provision in paragraph 21 of C(84) 32 the effect would be as follows:

MISC 106 proposals	- 380	- 470	- 560
Concession	+ 250	+ 350	+ 350
Revised Treasury proposal	- 130	- 120	- 210
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17. A considerable gap will remain between Mr Jenkin's revised proposals and the Treasury's final position, ie:

230 220 310

The task will be to persuade Mr Jenkin to move this extra distance and to accept the revised Treasury proposals in paragraph 16 above.

18. As a condition of reaching an agreement Mr Jenkin may make two requests.

- a. that there should be no clawback in 1985-86 of this year's capital overspend (possibly amounting to £172 million);
- b. that he should be able to announce the new regime for capital spending at the same time as the Autumn Statement.

On a. the attitude of Treasury Ministers will no doubt depend on the level of savings conceded by Mr Jenkin. On b. both they and



other Ministers with local authority responsibilities are likely to take the view that it would be unrealistic to try and settle such a complex matter, on which several Ministers have differing opinions, by next Monday.

Outcome of the 1984 Survey

19. Even if the recommendations of MISC 106 are accepted as they stand, there are still significant excesses over the agreed planning totals in prospect, particularly in 1987-88. You have discussed the overall position with the Chancellor of the Exchequer. No doubt he will indicate to the Cabinet how he believes it should be dealt with.

Announcements

20. Unless the Cabinet judge that the outcome of the 1984 Survey is unsatisfactory, the results will be reflected in the Autumn Statement, which the Chancellor of the Exchequer intends to publish on Monday 12 November; further details will appear in due course in the 1985 Public Expenditure White Paper. As you know, the timing of the Autumn Statement is bound up with the timing of the British Telecom flotation.

21. You will also wish to settle a form of words to be used in reply to the questions from the media that are bound to follow immediately on tomorrow's Cabinet.

HANDLING

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

- a. general situation and agreed programmes;
- b. gas and electricity;
- c. housing;
- d. outcome of the Survey and announcements.

The discussion of the general situation could be opened by the Lord President of the Council introducing his memorandum. You



2 could then invite the Chief Secretary, Treasury to add his comments. This part of the discussion will offer an opportunity to members of the Cabinet to question any of the agreed recommendations from MISC 106, or features of the bilateral agreements between the Chief Secretary, Treasury and spending Ministers, though you will not wish to encourage the reopening of agreements.

3 23. You might then invite the Secretary of State for Energy to speak on the EFLs of the gas and electricity industries. The Lord President of the Council, the Chancellor of the Exchequer, and the Chief Secretary, Treasury are likely to be the other main contributors to the discussion.

4 24. The discussion on housing could then be opened by the Secretary of State for the Environment. Again, the Lord President of the Council and the Chief Secretary, Treasury will wish to contribute. The Secretaries of State for Scotland and Wales will no doubt wish to speak as Housing Ministers; and the Secretary of State for Scotland was also, of course, a member of MISC 106.

25. The final section could be introduced by the Chancellor of the Exchequer, who could give an outline of the general economic situation and the main likely features of the Autumn Statement. He would also be able to explain how the conclusions of the Cabinet on the 1984 Survey fitted into the Statement.

CONCLUSIONS

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

- a. Are the recommendations agreed between MISC 106 and the spending Ministers concerned, and summarised in paragraphs 5 to 13 of C(84) 32, endorsed?
- b. What savings should be sought from the British Gas Corporation and the electricity supply industry (England and Wales)?



- c. What changes, if any, should be made to housing provision?
- d. In the light of the conclusions of a. to c., is the outcome of the 1984 Public Expenditure Survey satisfactory?
- e. If so, the main features of the Survey will be reflected in the Autumn Statement, with further details given in the 1985 Public Expenditure White Paper. What guidance should be given in reply to immediate enquiries from the media?

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Approved by
ROBERT ARMSTRONG
and signed in his absence.

7 November 1984

SECRET

ANNEX A

CHRONOLOGY OF EXCHANGES BETWEEN MISC 106 AND THE SECRETARY
OF STATE FOR ENERGY

Friday 19 October First meeting. Essentially a preliminary exchange, since the Secretary of State for Energy had not discussed the Chief Secretary, Treasury's proposals for savings with the industries, though he had explored the scope for specific savings. MISC 106 invited the Chief Secretary to set out detailed proposals for savings from efficiency improvements, and the Secretary of State for Energy to consider what savings might be achievable.

Friday 26 October Second meeting. The Secretary of State for Energy did not, as he had been invited at the first meeting, suggest what savings might be achievable, but proposed that MISC 106 should give him discretion to reach an agreement with the industries on the basis of his judgement, in the light of his discussions with them, of the maximum achievable reductions. He would report the outcome to MISC 106 by 2 November. MISC 106 did not accept this way of proceeding. Instead, they invited the Secretary of State for Energy to explore with the industries a package of cost savings and price increases with the aim of securing reductions on the EFL bids of £2,200 million.

Wednesday 31 October Third meeting. The Secretary of State for Energy reported that the industries had initially offered reductions of £700 million, ignoring corporation tax. He had managed to secure agreement to reductions in the combined EFL bids of £1.6 billion. He believed that this could be improved to a reduction of about £1.9 billion, but no higher if the agreement of the industries was to be retained. MISC 106 invited the Secretary of State to return to the industries with the aim of securing reductions in their combined EFL bids of £1.9 billion.

SECRET

SECRET

Thursday 1st November

The Secretary of State for Energy wrote to the Lord President of the Council saying that he 'made it clear' at the previous day's meeting that the figure of £1.9 billion was pre-tax, and setting out equivalent post-tax figures totalling £1.6 billion. These post-tax figures are those on which the proposals attributed to Mr Walker in C(84)32 are based.

Friday 2 November

The Lord President of the Council replied saying that MISC 106 'were all under the clear impression that the £1.9 billion referred to the actual reduction in the EFL bids in the same way as applies to other industries'.

Monday 5 November

You met Mr Walker in the morning. It was understood at that meeting that his proposals for 1985-86 and 1986-87 (reductions below baseline of £62 million and £85 million respectively) would be accepted if he would use his best endeavours to persuade the gas and electricity industries to find further savings to remove the prospective excess of £215 million over baseline in 1987-88. Later that day, Mr Walker suggested that there should be no reductions on baseline in 1985-86 or 1986-87, but that the excess in 1987-88 could be reduced to £48 million. This was not regarded as acceptable. The figure of £1.6 billion (to be precise £1609 million) offered by Mr Walker had been increased by only £20 million. Moreover ~~the~~ rephrasing worsened the problems in the two earlier years. You and the Lord President of the Council instructed the Cabinet Office to prepare the report of MISC 106 on the basis adopted in C(84)32.

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