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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Malcolm Rifkind QC MP
Secretary of State for Scotland
Scottish Office
Dover House
Whitehall
London
SW1A 2AU

28 January 1986

Dear Malcolm,

PUBLIC EXPENDITURE: 1985-86 OUTTURN

Your letter of 17 January pressed the merits of some of the considerable number of claims on the Reserve this year. In addition to those covered in your letter there are several other bids associated with Supplementary Estimates from Scotland.

Regional policy

You argue in your subsequent letter of 20 January (not copied to others) that the additional receipts expected to accrue to the Scottish Development Agency and the Highlands and Islands Development Board are not windfall receipts but the result of vigorous new efforts from top management. In the circumstances I should be prepared to accept that the benefit of these receipts should be retained by those bodies as part of an overall settlement of your claims. The point of principle will need to be addressed in the forthcoming review of each body.

You also refer to the possibility of calling into play underspends on the Department of Trade and Industry's provision for Regional Development Grants. This possibility was also raised in Nicholas Edwards letter of 9 January. The overriding need to protect the Reserve means that any solution will have to ensure that sufficient savings are identified overall to meet all the extra calls on the Reserve. If Paul Channon will agree to find elsewhere from his provision the necessary offsets to cover claims on the Reserve then I could accept your argument for offsetting under and overspends on the three departments' regional assistance votes. However without Paul's agreement I shall have to insist, as had been explained to your officials, that the overspend arising on your votes should be constrained by offsetting action on them.

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I could in the same way accept a reallocation now of regional assistance provision for 1986-87 as you have suggested in your letter of 17 January to the Secretary of State for Trade and Industry (not copied to all). However any proposal for offsets between the departments once an overspend on any one department's regional assistance provision is in prospect will need to be considered in the light of other likely calls on that department's overall provision.

Housing

Your letter refers to my request for offsetting savings to meet an increased requirement for Housing Support Grant (HSG) and to the conditions I placed in my letter of 18 December on the issue of £7 million further allocations for expenditure covered by your SO/LA2 cash limit. (I understand that the further £1 million for the Housing Corporation is not now required). We also have to resolve the question of meeting the Scottish Special Housing Association's (SSHA) tax liability, should they fail in their appeal, now that any payment will not be made until 1986-87.

I recognise the difficulties that you face in finding offsetting savings, and that it would be difficult to avoid making the £7 million allocations (and that they will not affect outturn). Equally, you have recognised the problems I face on the Reserve. I am therefore prepared to agree to a compromise on the following lines which meets some, but not all, of both our concerns.

Provided you are prepared to:-

- i. surrender as an offsetting saving the £3.5 million or so that would remain unallocated from SO/LA2 after issuing the further £7 million in allocations;
- ii. assure me that you can find no other offsetting savings;
- iii. undertake that the remaining £16.8 million required for HSG should be a first call on any underspend in 1985-86 on cash limits SO/LA2 or SO/LA1, so reducing or eliminating end year flexibility into 1986-87. (I understand SO/LA2 is currently forecast to underspend by some £8.5 million after adjusting for the unallocated £3.5 million referred to above).
- iv. agree to meet the SSHA's tax liability, if any, within your PES provision for 1986-87 and subsequent years;

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I am prepared to agree to:-

- (a) a claim on the Reserve of the balance of the £20.3 million in respect of the requirement for HSG;
- (b) your issuing further allocations of £7 million under the SO/LA2 cash limit.

LA capital

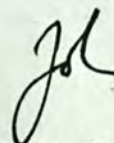
Your letter also expresses concern about overspending on LA capital, which I share. But there is no case in equity for compensating Scotland for this lapse in control. The existing rules clearly allow for adjustments to the Scottish block when provision for comparable English programmes is changed. There are no agreed arrangements for ensuring overspend (or underspend) in England automatically leads to adjustments in the size of the territorial blocks. Nor has a case for such arrangements on the grounds of need been made.

As I made clear in my letter of 21 November to Nicholas Edwards, the solution to English overspending is not to validate it but to bring it under control. We did make strenuous efforts to make the provision for LA capital spending in England more realistic in last year's Survey. As a result provision was increased on previous plans by £145 million and Scotland received its formula increase despite the fact that allocations to English local authorities in 1986-87 will be £200 million lower than in 1985-86.

We do of course need to take steps to ensure the LA capital control system in England is improved and I hope that you and other colleagues will support Kenneth Baker's proposal to legislate for this purpose in the 1986-87 session. But I cannot agree with any implication that overspending on one programme can be used to justify other overspends. Nor do I think it correct to imply Scottish spending in 1985-86 is suffering because of overspending on English LA capital. This prospective overspend was one of the reasons why the Chancellor had to increase the Reserve by £2 billion in his 1985 Budget. The loss has been to our fiscal objectives for the economy as a whole. And the fact remains that in 1985-86 net capital spending per head in Scotland was £114 compared with £65 in England (£145 compared with £108 gross).

I am copying this letter to the Prime Minister, Nicholas Edwards, Kenneth Baker, Paul Channon, other members of E(A) and Sir Robert Armstrong.

Yours ever,



JOHN MacGREGOR

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