CC - NO.

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SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

Prime Minister

MCS 30/3

SECRET

Prime Minister

1. In your minute of 4 February you asked for a report by 31 March on the possibilities of securing a substantial reduction in public expenditure in the longer term. As you will appreciate, much of the expenditure for which I have responsibility has to be considered in consultation with my colleagues with parallel responsibilities since some of the issues which arise can only be considered on a GB or UK basis. I have seen in draft the responses of some of these colleagues. Because I wanted to see as many of these as possible it has taken me a little longer than I would have wished to respond to your minute.

2. The Scottish programme amounts in total to £6,384m in 1983-84 (figures as given in Cmnd 8789). Of this total 54% is expenditure by local authorities and 27% is expenditure on the NHS. The balance includes expenditure on services such as agriculture, assistance to industry, new towns, trunk roads, prisons, higher education (other than universities), the Highlands and Islands - and much else.

3. I shall continue to examine critically the purposes and projects to which my public expenditure is directed and to ensure that maximum value for money is obtained; but I see great difficulty in achieving a radical reduction in the total. In Scotland in particular we suffer from disadvantages of remoteness, sparsity of population and - for some purposes - an inhospitable environment. I have always believed that these disadvantages should be to some extent offset through public expenditure; and this has been reflected in our policies. Unless I were to abandon this approach I see little prospect of substantial reductions in my programmes.

4. My comments on the main elements of my programme are as follows. There will of course be opportunities for economies. There may also be scope for major policy changes in some of the smaller programmes: I will pursue these in the course of the annual reviews of public expenditure.

Agriculture

5. My programme in 1983-84 totals £166m broken down as follows:

	£m
Market regulation and production support	26
Improvement of efficiency and productivity	75
Support for special areas	45
Fisheries	20
Total	166

I agree generally with Peter Walker's response. I would add only that this programme exemplifies well the arrangements mentioned above for redressing the natural disadvantages of many areas of Scotland. About half the total GB expenditure on support for agriculture in special areas comes to Scotland. This is an important ingredient in the rural economy and is an area of expenditure generally where I foresee a need over the coming years for greater rather than fewer resources to be directed. In particular I have in mind that we await the proposals of the European Commission on an Agricultural Development Programme for the Highlands and Islands.

6. I have a particular interest in fisheries. Assistance to the industry will now fall to be given within the Common Fisheries Policy and we must not lose the opportunity to put the industry on a viable footing by way of assistance for restructuring measures.

Roads and Transport

7. On this I agree with the general point made by David Howell - reductions in expenditure must mean tackling transport subsidies. We have, as in England, a published roads programme for much of the 1980s. Both new construction and maintenance have economic and environmental advantages. Rail and road transport will require continued support, particularly in the more remote areas of mainland Scotland, if we are not to be faced with acute problems of depopulation. It is tempting to look for savings in services where direct costs and revenues are widely out of line, but experience suggests that the political repercussions of doing so are disproportionate to the number of people directly affected. The implications for this in terms of public expenditure will depend on the

results of further work on the Serpell Report, and on what is to be done about the bus operations of the Scottish Transport Group, which provides almost all the services in our countryside. I also have a direct involvement in the offshore shipping services provided by a number of operators and which are supported financially by me. Continuing support will be necessary, not only from year to year on fares but also over the next few years on new ships and improved piers.

Housing

8. On housing there is one major step which I wish to take. I would propose to take power, in the next Parliament, to control the amount of the rate fund contributions (RFC) Scottish local authorities can make to their housing revenue accounts. I see this as a most important step in our objective of curbing local authorities current expenditure on housing: even with the moderating influence of our housing expenditure limits machinery the RFCs of Scottish local authorities have in total continued to rise, in cash terms and even more so in relation to overall housing expenditure, to the extent that they seem likely in 1983-84 to amount to about £125m ie about one-fifth of total PES resources available for the Scottish housing programme. My aim is eventually to eliminate RFCs; this is unlikely to be possible for all authorities in the very short term, but I want to start by establishing a limit on RFCs which would force authorities either to adopt more realistic rent policies or to secure economies in expenditure in the management of their housing stock.

Education

9. In general I agree with the assessment which the Secretary of State for Education and Science makes of the possibilities for savings in education. In particular, I agree that teaching costs, being much the largest single element in education expenditure, is the most likely area in which to look for significant savings. The two assumptions which he proposes (keeping pupil-teacher ratios at 1980-81 levels and holding the real value of teachers' pay at current levels) would each produce savings of about £30m (at 1980-81 costs) in the level of expenditure in Scotland in 1990-91 which would otherwise be forecast on present policies. A return to 1980-81 PTRs would entail a real reduction in staffing standards because no allowance would have been made for diseconomies of scale; and my present powers would not enable me to determine the real value of teachers' pay. Significant savings in higher and further education would imply both the containment or

reversal of the present trend towards increased participation rates and the abandonment or reversal of some current policies, particularly those relating to vocational training for the 16-18s. I shall continue to examine the scope for efficiency savings and for faster than previously planned reductions in expenditure on areas such as school meals, but I doubt whether we can find any major additional savings by these means.

Law, Order and Protective Services

10. We may achieve some constraint on growth of expenditure on the police and prison services, but I do not envisage scope for significant reduction of public expenditure as long as it is our policy to strengthen the administration of law and order generally. I am examining with the Law Society of Scotland possible extensive changes in the various legal aid schemes (which have developed piecemeal) with the aim of improving their administration. This should help to contain costs and to bring about tighter overall control on expenditure.

Health

11. For the Health programme, Norman Fowler is considering carefully what measures might be put forward as practicable possibilities for implementation after the election to reduce long term net expenditure on the NHS. We examined this matter in H Committee last year, after receipt of a report on Alternative Methods of Financing the NHS, and we identified then a number of possible lines of action. We recognised also that most of the options available for reducing expenditure would require careful assessment of their political consequences as well as their administrative difficulties. Although the NHS in Scotland operates against a different background - there is for example still only a negligible private health service - any new measures would have to be introduced in a UK context. I am therefore content that Norman should take the lead in this matter, but of course I would want to look carefully at any specific proposals he may put forward in his response.

Copies of this minute go to the Home Secretary, the Secretaries of State for Transport, Environment, Education, Social Services, Wales and Northern Ireland, to the Minister for Agriculture Fisheries and Food, to the Lord Chancellor and to the Chief Secretary to the Treasury.

G.Y.

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30 March 1983

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SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

RECEIVED IN
29 MAR 1983
PRIVATE OFFICE

The Rt Hon Leon Brittan QC MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
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29 March 1983

Dear Leon,

I write to bring to your attention the conclusions I have been drawing from a review of the likely outturn in the current year on my cash block SO/LA2 (capital expenditure on housing). Though the evidence is by no means fully up-to-date, and conclusions should not therefore be regarded as firm, it looks as if we shall finish up with an under-spend of about £50 million on a cash limit of just over £450 million.

This has happened in spite of a letter sent by the Prime Minister last Autumn to the Convention of Scottish Local Authorities urging them to spend up to their allocations, and to use all the available receipts; in spite of the sustained efforts of the Scottish Special Housing Association and the Housing Corporation in Scotland (now both under our appointees) to spend their available resources (including receipts); and in spite of our removing (with your agreement) all restrictions from expenditure by local authorities on improvement and repairs grants this year.

I regard it as very disappointing that notwithstanding all our efforts there should still be underspending, and I have been reviewing the causes with my officials. Because of the steps taken, as described above, and because of the generally favourable weather, I have come to the conclusion that what we are witnessing is not an isolated, and perhaps accidental, phenomenon; it looks much more like an inherent defect in the system. And I take it extremely seriously, because it seems so clear that what we have done is to produce the same effect as we would have produced if we had set out to impose an additional cut of £50 million from the outset. And in relation to the generality of our PES procedures, and to the degree of unemployment in the construction industry, that all seems such a nonsense.

There are two particular causes of the trouble in my mind. The first is the earnestness with which, for reasons that were borne in on us very strongly at the time, we decided a year or two ago to attach dramatic and overwhelming emphasis to the importance of avoiding overspend in all circumstances. Having been found to be less than wholly blameless in the past myself in that respect on SO/LA2, I took steps, in the detail of which you and your officials took a good deal of interest, to bring home to those concerned that there must never be overspend again. The result is that virtually all the Scottish housing authorities separately, and the appointed bodies, set out to underspend by at least a small margin: this produces cumulatively, a massive underspend.

The second particular cause of trouble is the extent of the uncertainty which we have passed to local authorities over the amount and timing of net receipts for house sales that will accrue to them. My department made very clear before net allocations were imposed on us for 1982-83 (a year later than in England) that we foresaw trouble, but the Treasury view was that the advantages of removing the uncertainty from our net figuring were overriding. The percentages of private finance which some of our authorities have been able to attract have been gratifyingly high - certainly higher than we had foreseen: but the public expenditure benefit we derive has to be set against the damage that substantial underspend does to the effectiveness of our allocation system and the working of the right to buy.

I have been considering what might be done, within the obvious need to retain a proper control of expenditure (a major achievement of this Government which cannot be allowed to slide), to tackle this problem. It seems to me that there are two possible palliatives which I should be grateful if you would consider:-

(a) a recognition, in carefully worded terms, that Departments operating systems with a built-in tendency (of the kind I have described) to underspend should be able, with Treasury agreement, to build in a prudent measure of deliberate over-allocation to their management systems (and to pass something of that discretion on to their NDPBs as they see fit); and

(b) a concession, specifically related to circumstances where significant volumes of receipts come to hand, often quite late in the financial year, for a degree of carry forward from one year to the next. Without wishing to open up all aspects of annuality, I do wonder whether there is not something that we could do in the housing field?

I am sending copies of this to Tom King, Nick Edwards and Jim Prior.

Yours ever,

George.