

COVERING SECRET

P.01151

MR TURNBULL

MISC 99: DRAFT REPORT

The Lord President has authorised me to send you the attached draft of his report to the Cabinet as chairman of MISC 99. He has not yet seen it himself and will be looking at it over the weekend. The Prime Minister may nevertheless find it useful to see the draft in its present unfinished state because of her heavy commitments early next week.

2. The draft will need to be brought up to date to reflect the outcome of the Prime Minister's meeting this evening on defence. There are also a few gaps* where material has still to be provided and some passages in square brackets. In particular the words used to describe the overall position and how the small gap is to be bridged are being considered by Treasury Ministers over the weekend.

* eg. Annex D not yet available

3. The text will be finalised on Monday afternoon so that the report can be circulated to the Cabinet on Tuesday morning with a CMO marking.

PLG
P L GREGSON

4 November 1983

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Fourth Draft
4 November 1983

DRAFT MEMORANDUM BY THE LORD PRESIDENT OF THE COUNCIL

PUBLIC EXPENDITURE SURVEY 1983

The Cabinet agreed on 21 July that the objective for the 1983 Public Expenditure Survey should be to hold to the published totals for 1984-85 and 1985-86; and that total spending should be held at the same real level in 1986-87. The figures were to include adequate planning reserves. The Chief Secretary, Treasury was invited to hold bilateral discussions accordingly with spending Ministers (CC(83) 24th Conclusions, Minute 5).

2. The Chief Secretary's minute of 18 October to the Prime Minister reported progress in those bilateral discussions. Compared with the position in July, bids for additional expenditure had been substantially reduced. But significant bids were still outstanding. In order to achieve the Cabinet's objective they would have to be offset or withdrawn, and additional savings found. The gap to be bridged was some £1.1 billion in 1984-85, £1.7 billion in 1985-86, and £2.5 billion in 1986-87; the figure for 1984-85 assumed a reserve of £3.0 billion, that for 1985-86 a reserve of £3.5 billion, and that for 1986-87 a reserve of £5 billion. There were outstanding issues on defence, agriculture, foreign affairs, education, arts and libraries, and the nationalised energy industries; and agreement had not been reached on local authority current expenditure in 1985-86 and 1986-87.

3. In accordance with the Cabinet's conclusions on 20 October (CC(83)30th Conclusions, Minute 4) the Prime Minister established the Ministerial Group on Public Expenditure (MISC 99) under my chairmanship to try to resolve outstanding issues. This note sets out the Group's recommendations.

Agreed Programmes

4. After MISC 99 was set up, the Chief Secretary reached agreement bilaterally with the Ministers concerned on overseas aid and foreign affairs; arts and libraries; and local authority current expenditure in 1985-86 and 1986-87. The Group reached agreement with the Secretary of State for Energy on the nationalised energy industries; and with the Minister of Agriculture, Fisheries and Food on the agriculture and fisheries programme. The basis on which agreement was reached is summarised in Annex A.

5. There are two programmes on which either agreement has not been reached, or which raise issues which we feel should be drawn to the attention of the Cabinet: defence; and education and science.

Defence

6. The Group reached agreement with the Secretary of State for Defence on figures for 1984-85 and 1985-86; the Secretary of State is satisfied that

these can be defended as consistent with the Government's public commitment to increase the defence budget by 3 per cent a year in real terms. They are based on the same cash factors as for other programmes. Because, alone among public expenditure programmes, the Government's defence policy is currently expressed both in volume and cash terms, the Secretary of State ~~for~~ Defence asked for assurances in case inflation should differ from the cash factors. He and the Chief Secretary have reached agreement on this point.

Differences of interpretation will ~~be~~ needs to be brought out here

7.

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to be drafted

8. Further details are set out in Annex B.

Education and Science

9. On education and science the issues are as follows. Details are in Annex C.

i. Student grants. The Cabinet will wish to consider whether the changes proposed by the Secretary of State for Education and Science are politically acceptable. Some of our supporters will object to the proposed increases in parental contributions and to the reduction in the minimum award. Students will criticise the reduction in the real value of awards that will ensue unless inflation is lower than now assumed. But MISC 99 believe that savings are essential; and that the Secretary of State's proposals are the best that can be devised. We commend them accordingly to the Cabinet.

ii. University current expenditure. MISC 99 believe that reductions in university current expenditure of £50 million in 1986-87 are feasible. Baseline provision for this item is nearly £1,450 million. The Secretary of State himself agrees that reductions are feasible, though not on this scale; and he considers that any savings that may be achievable should be used to offset unavoidable cost increases and to fund improved provision elsewhere in the education programme. He also believes that the reductions we propose will be regarded as inconsistent with an assurance given by the

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Prime Minister during the Election campaign.
However, MISC 99 recommend that the reductions should be made and the programme reduced accordingly.

Overall position

[10. The figures for all the programmes so far agreed, including those on which the Chief Secretary reported agreement in his minute of 18 October are set out in Annex D. If our recommendations on education and science are accepted, then the total of programmes and reserve will be [£ million] in 1984-85; [£ million] in 1985-86; and [£ million] in 1986-87. These differ from the existing planning totals for 1984-85 and 1985-86 by [£ ¹³⁰ ~~125~~ million] and [£ 400 million] respectively; and from the Survey baseline in 1986-87 by [£ ³⁸⁰ ~~200~~ million]. Treasury Ministers consider that these gaps can be bridged, though admittedly with some difficulty. They will report in more detail orally to the Cabinet.]

Latest
HMT figures

Breakdown between capital and current expenditure

11. The Chief Secretary was invited by the Cabinet on 20 October to ensure that information was available on the distribution of current and capital expenditure. A note provided by Treasury officials is attached as Annex E.

Issues for the Cabinet

12. The Cabinet are invited:

(i) To endorse the totals for agreed programmes, listed in Annex D.

(ii) To consider the issues arising on the defence and education and science programmes in the light of the Group's recommendations.

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AGREED PROGRAMMES

This annex describes the agreements reached on the five programmes listed in paragraph 4. The figures show the agreed changes from the baseline in Cmnd 8789.

Arts and Libraries

<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
	£m	
+ 6	+ 10	+ 13

It was agreed that provision should be increased by half the amounts sought by the Minister for the Arts. This would allow the work on the new British Library building to go ahead.

Local Authority Current Expenditure (England) 1985-86 and 1986-87

<u>1985-86</u>	<u>1986-87</u>
£m	
+ 500	+ 500

Additional provision has been made on grounds of realism. In 1985-86, £350 million of the £500 million is to be allocated to services, in proportion to shares in the baseline. For 1986-87, £300 million of the £500 million would be allocated to services, again distributed in proportion to shares in a revised baseline for 1986-87, except for an agreed transfer of £50 million from the DES programme to DHSS personal social services provision.

Department of Energy: Nationalised Industries

<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
	£m	
- 352	- 940	- 1704

The agreed savings are based on improved efficiency in the gas and electricity industries; 3 per cent increases in electricity prices in 1984-85 and in 1985-86; and a reduction in National Coal Board investment. A figure of £800 million for NCB investment will be published for 1984-85; figures of £784 million in 1985-86 and £748 million in 1986-87 will be reflected in the published aggregate External Financing Limits for all nationalised industries. It was also agreed that domestic gas prices should rise by 5 per cent in January 1984; and that the industrial gas price freeze would end in April 1984.

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FCO (including ODA)

<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
	fm	
+ 5.8	+ 8.5	+ 21.3

The agreed additional amounts will be devoted to the British Council and the BBC's External Services. The bids for additional provision for the aid programme have been withdrawn.

Agriculture, Fisheries and Food

<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
	fm	
- 4.2	- 24.1	- 38.4

It was agreed that there should be additional expenditure on grants for marginal land, glasshouse restructuring and fish marketing. Capital grants under the Agriculture and Horticultural Grant Scheme will be reduced, saving some £30 million a year: with the exception of the grants in less-favoured areas for field drainage, hedges and walls, no grant will be at a rate of more than 50 per cent. Grants for arterial drainage will be reduced: and savings will also be found from the R and D programme.

THE DEFENCE PROGRAMMETHE INITIAL POSITION

The Survey baseline is as follows.

	<u>£ million</u>			
	<u>1983-84</u>	<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
	15719.6	17178.0	18214.4	18192.2
(of which Falklands)	(624.0)	(684.0)	(552.0)	-

During bilateral discussions the Chief Secretary, Treasury accepted a bid of £450 million for expenditure in 1986-87 in respect of the Falklands.

2. The Secretary of State for Defence advanced bids for additional provision to meet the extra cost in all years of the 1983 Pay Review Bodies' awards; and to compensate for forecast inflation higher than the agreed cash factors.

Inflation compensation	-	+ 59.3	+ 240.0	+ 508.8
Pay awards	+ 90.4	+ 93.1	+ 96.8	+ 99.7

3. The Chief Secretary rejected these bids. He also proposed that the real rate of growth in 1984-85 and 1985-86 should be limited to 3 per cent from the provision in 1983-84 after the reduction in cash limits imposed in July this year (but excluding Falklands provision).

-	- 267.6	- 280.7	- 289.1
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THE GROUP'S RECOMMENDATIONS

a. 1984-85 and 1985-86

4. In discussion with the Group, the Secretary of State for Defence agreed to withdraw the bid relating to the excess cost of pay awards. He also agreed to withdraw the bid in respect of inflation compensation if he and the Chief Secretary were able to reach agreement on a form of words dealing with the possibility that inflation might turn out to be different from the agreed cash factor. The two Ministers subsequently agreed on the following.

"Alone of its public expenditure programmes, the Government's defence policy is currently expressed both in ~~volume~~^{real} and cash terms. In order to fulfil the Government's commitments up to and including 1985-86, the cash provision will be reconciled year by year in the light of the ~~volume~~^{real} requirement and of the most up-to-date forecasts of inflation, and appropriate adjustments made."

5. In view of the general public expenditure position, the Group considered that some reduction in the defence budget, consistent with the Government's public commitments, was desirable. They accordingly proposed to

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the Secretary of State for Defence that the starting point for provision in 1984-85 should be the baseline figure for 1983-84; from this would be subtracted the expenditure on the Falklands Islands; the result would then be enhanced by 5 per cent (the cash factor) and then 3 per cent (the growth factor); and planned expenditure on the Falklands Islands in 1984-85 would be added to give a revised figure for that year of £17,010 million. The same procedure, using the relevant cash factor, would be adopted for 1985-86, giving a revised figure of £18,040 million. The Secretary of State accepted this proposal.

b. 1986-87

6. The NATO target of 3 per cent a year real growth, to which the Government is committed, expires in 1985-86.

Overall effect

7. The overall effect of the above is as follows.

	<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
Change from baseline	- 168	- 174	
New total	17010	18040	

The figures do not involve any change in agreed provision for the Falklands.

THE EDUCATION AND SCIENCE PROGRAMMETHE INITIAL POSITION

The Survey baseline, excluding local authority current expenditure other than student awards, is as follows.

	<u>£ million</u>		
	<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
	3258	3388	3489

2. During their bilateral discussions, the Secretary of State for Education and Science and the Chief Secretary, Treasury reached agreement on the following changes.

Additions

Student grants (increased numbers)	+ 40	+ 50	+ 45
Science (International subscriptions)	+ 6	+ 8	+ 7

Reductions

Grant-aided institutions	- 5	- 7	- 10
Student grants	- 20	- 40	- 50
Net effect	<u>+ 21</u>	<u>+ 11</u>	<u>- 8</u>

3. The Chief Secretary considered that the net cost of these changes in 1984-85 and 1985-86 should be met by further savings: the Secretary of State for Education and Science believed that this was not feasible. He also made the following bids for additional expenditure.

<u>Local authority capital expenditure</u>	+ 50	+ 50	+ 50
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mainly for buildings to facilitate school closures and mergers; and computers, other equipment and building for colleges.

<u>Science</u>	+ 29	+ 47	+ 68
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to maintain and strengthen the base of science research.

	<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
<u>Universities - capital</u>	+ 12	+ 12	+ 12

for medical and dental school projects, rationalisation, and laboratory equipment.

<u>Universities - current</u>	+ 18	+ 16	+ 18
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to accommodate inescapable cost increases, after allowing for efficiency savings.

4. The Chief Secretary rejected these bids. He also proposed that the baseline for university current expenditure in 1986-87 should be reduced by £75 million to encourage rationalisation as student demand declined.

THE GROUP'S RECOMMENDATIONS

5. The Group held two meetings with the Secretary of State for Education and Science and are greatly indebted to him for his help and co-operation. Our recommendations are as follows.

Local Authority Capital Expenditure

6. In view of the many other pressures on public expenditure in general, and the need to reduce local authority expenditure in particular, the Group do not feel able to support any increase in the provision for capital expenditure on schools and colleges of further education.

Science

7. Despite the arguments which the Secretary of State put forward for additional expenditure on science, and having regard to the conclusions of the Prime Minister's informal meeting on 19 October, recorded in her Private Secretary's letter of the same date, the Group do not feel able to recommend any increase.

Universities - capital

8. The Group do not feel able to recommend any increase. They consider that priority expenditure should be accommodated within the existing programme.

Universities - current

9. The Group do not feel able to recommend any increase in provision. They agree with the Chief Secretary's view that it should be possible to find efficiency savings by 1986-87, and recommend a reduction of £50 million in that year.

10. The Secretary of State for Education and Science dissents from this recommendation. He does not deny that some efficiency savings are achievable; and his own proposals (paragraph 3 above) assume savings of £22 million (1½ per cent). But he does not consider that the further £50 million, making about 5 per cent in all, is realistic. Moreover, he believes that any savings that can be achieved will be needed to offset the unavoidable and externally-imposed cost increases which the universities face, and to fund desirable improvements elsewhere in the education programme. He also believes that reductions on the scale we recommend would be widely regarded as inconsistent with the Prime Minister's letter of 7 June to the Association of University Teachers. This said that "the period of contraction [in higher education] is now nearing the end"; and that "the intention is to hold the level [of expenditure] steady in real terms after 1984-85".

Student grants

11. The proposals originally put forward by the Secretary of State for Education and Science for savings in this area included the abolition of the minimum award. We thought that this was unlikely to be acceptable to our colleagues, and invited the Secretary of State to advance alternative proposals. In reply, he indicated that he would be willing to accept the following, in preference to any alternative savings in the programme.

(a) Halving the minimum award from £410 a year to £205 a year.

(b) Steepening the scale of parental contributions.

At present no contribution is payable if residual income

(i.e. income after deduction of allowances such as mortgage interest) is less than £7,100; £1 in every £7 is payable between £7,100 and £9,000; £1 in £8 between £9,000 and £14,300; and £1 in £13 thereafter. The Secretary of State proposes that the parental contribution in future at points beyond £9,000 should be £1 in every £6. The effect of this change would be, for example, that those with residual incomes of £12,000 would be expected to make a contribution of £770 instead of about £650; and those with residual incomes of £18,000 would be asked to pay about £1,770 instead of £1,220.

(c) The current value of grants should be increased by only 4 per cent for 1984-85, 3 per cent for 1985-86, and 2 per cent for 1986-87, instead of 5 per cent, 4 per cent and 3 per cent respectively.

12. These proposals would produce savings of £25 million, £45 million and £50 million in the three years under discussion. We believe that they are politically and otherwise defensible and commend them to our colleagues.

Overall recommendations

13. In view of the difficulties which the Secretary of State for Education and Science faces in his programme, the Group do not think that he should be required to find further savings to offset the agreed changes outlined in paragraph 2 of this Annex. They also consider that an adjustment should be made to reflect the fact that the changes in student grants now proposed by the Secretary of State provide rather higher savings in the first two years than his original proposals. To that extent, the Secretary of State should have discretion to apportion these changes as he thinks appropriate. The net effect of our recommendations, as compared with baseline, is therefore:

<u>1984-85</u>	<u>1985-86</u>	<u>1986-87</u>
+ 21	+ 6	- 58

CAPITAL AND CURRENT EXPENDITURE

At its meeting on 20 October the Cabinet asked the Chief Secretary to bring before the Cabinet information on the distribution of public expenditure as between capital and current expenditure, and the effect on this distribution of the reductions agreed in the 1983 Public Expenditure Survey.

2. Before the 1983 Survey planned capital expenditure represented some 10½ per cent of total public expenditure in each of the three years 1984-85, 1985-86 and 1986-87. The Treasury has carried out an analysis, with the help of spending Departments, of the changes to these percentages which result from decisions so far taken in the Survey. Most Departments are not yet able to say how the changes agreed for their programmes will affect their capital/current ratio. It is not yet possible, therefore, to calculate how the aggregate percentages above will be changed by the Survey.

3. In the areas in which the distribution of agreed changes between capital and current has already been decided the changes go in both directions: for example, the additions agreed for the Prison Building programme will increase the Home Office capital spending programme, and the reductions agreed for the Departments of Employment and Health and Social Security will reduce their current spending and add to capital. The Housing reductions, however, will show wholly as large capital cuts, although some £300 million of the total represents council house sales which count as negative capital expenditure. There are, too, large increases in current local authority spending. Against this, almost all of any lower provision which is agreed for defence expenditure will go towards reducing the proportion of total expenditure classified as current.



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Prime Minister ②

This has been sent to you to give you an idea of the shape of the MISC 99 report.

It will need to incorporate the outcome of this evening's meeting on Defence.

You will want to reflect on two points on Education

(i) whether to support KJ's attempt to protect university current by reference to your AUT letter

(ii) whether to accept the grants package.

I am preparing notes on both.

PTD

The Treasury Annex^P referred
to in para 10 will
simply record the
plans and minutes on each
programme. Thus no details
of ~~prog~~ measures taken on
programmes not going to
MISC 99 will be reported
to Cabinet.

Ferdie is considering
whether there is a risk that
colleagues will want to
see Norman Foulers social
security measures and if
so how this should be
handled.

AT

+111