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PRIME MINISTER

STAR CHAMBER

I have now completed a full first and second round of discussions in the Star Chamber with spending Ministers on whose programmes a significant dispute remained with the Chief Secretary. The purpose of this note is to give you my summary assessment of where matters now stand. I will supplement this orally when we meet on Monday.

2. As you know, the remit given to the Group by the Cabinet on 11 July was to hold the public expenditure planning totals to the following baseline levels in the three years covered by the 1985 Survey.

	£ billion		
	1986/87	1987/88	1988/89
	<u>139.1</u>	<u>143.9</u>	<u>148.2</u>

The difficulty of the task facing us is shown by the fact that after taking account of agreements reached bilaterally between the Treasury and departments, the net bids above baseline in the three years remained some £3.4 billion, £4.7 billion, and £5.7 billion respectively, even after allowing for the lower reserves and large additional asset sales proposed by the Chief Secretary in July.

3. Although the Chief Secretary was able to provide just a little more room for manoeuvre by further adjustments to the Reserve, asset sales and to the planning total in the last year (totalling £0.5 billion in the first year, and £1 billion in each of the two later years), and the recent revision of the economic assumptions in the light of the autumn forecast has reduced somewhat the massive social security bids, the "gap" remained very large and it was clear that, in order to hit the targets, the Group would need to press for settlements very much in the Chief Secretary's favour.



4. The task I set the Group was to achieve this. To the extent that we could not do so, my aim was to clarify and narrow down the areas of disagreement so that the parameters were clearly set for consideration by you and by the Cabinet.

Programmes under discussion

5. The Group have discussed the following programmes:

Defence

Aid (including ATP)

Housing

DOE Other

Education and Science

Health

Social Security

Scotland

Electricity (England and Wales) and fast reactor research

Water

They have not so far discussed coal and gas, in which large sums are at issue. The Chief Secretary is still pursuing these with Peter Walker.

6. This is a far heavier load than in any previous year, and the gap to be filled, and the positions taken by the spending Ministers concerned, has been correspondingly harder too.

7. My general approach has been to try to get programmes back to baseline; and, in order to make some room for bids of the highest political priority, in some cases to seek substantial reductions below baseline. The largest such reduction we sought was, as you would expect, in the defence programme where the Group have been guided by the view expressed at our Chequers discussion on priorities that, with the ending of the commitment to 3 per cent real annual growth, some reductions in the planning



totals for this large programme should be feasible. I am also seeking to scale down the very large bids on Norman Fowler's health and social security programmes (his bids on social security alone totalled over £2.5 billion for the three Survey years, even after the effect of the revised economic assumptions). There are difficulties here which relate to the social security review and our MISC 111 discussions which I should prefer to explain to you orally.

8. I have therefore put to each of our colleagues proposals that, if accepted, would deliver the planning total, or thereabouts, in each of the three years. Negotiations are continuing, but we are still short of our target. However, although I was very depressed earlier this week, we have made some limited progress in the last day or two; but, alas, we are still faced with grave difficulties on some of the major programmes.

9. The overall picture is summarised in the attached table (although a number of the figures are still subject to further clarification). This shows for each year the baseline total, the proposal put forward by the Star Chamber, and (in the last column) an assessment of the current position of the Minister concerned (ie incorporating the reductions in bids he has so far been willing to offer). You will see that the totals in the last column are still some £1.8 billion, £2.0 billion, and £2.7 billion above the baseline.

*These are not a course forecast outcomes.*

10. On individual major programmes, I am glad to say that we have been able to reach a satisfactory settlement with Peter Walker on electricity and with Keith Joseph on the Education and Science programme, although there is still one political aspect of this programme that I should like to discuss with you. We are also within possible sight of an agreement with Norman Fowler on at least the two earlier years on health and social

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security - the third year of the latter will depend heavily on MISC 111. I am, however, still having difficulties with Geoffrey Howe on the aid programme and you and I may have to have a talk with him privately. I will, of course, explain the details to you. We have also been unable so far to resolve the problems on the following programmes.

Defence

11. As you will see from the attached table, Michael Heseltine is still seeking very large provisions above baseline. We thought it vital, however, to seek substantial reductions below baseline - although less than the Chief Secretary originally proposed - in order to provide some room for manoeuvre for higher priorities elsewhere. If the Group's proposals were accepted, real defence spending would still be over 20 per cent higher in 1988/89 than in 1978/79; and we think it entirely reasonable to look for rising defence output through increased efficiency. I must stress that the very strong feeling of the whole Group is that many of our difficulties would be substantially resolved if we could persuade Michael Heseltine to meet us. My strong recommendation to you at the moment is that decisions here should be brought to the whole Cabinet. I will explain to you why I take this view.

DOE Housing and other programmes

12. The main reason for the massive bids here - over £1100 million in the second year - is a claim for substantial extra resources for public sector housing renovation in response to the report commissioned by the Department from local authorities. As you know, this recommends a huge renovation programme of some £19 billion over the next ten years. We could not accept the case for this. The Government's record on public sector housing is a good one, and the case made in the report seems to us to be greatly overstated (as one would expect if the local authorities themselves are asked to state their own needs). However, we recognised the

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need to respond constructively to the report and proposed to Kenneth Baker increases of £100, £200, £200 million on this part of his programme for the three survey years. This would be enough to finance a £15 billion renovation programme over 11 years. This was, however, on condition that substantial offsets were made elsewhere in his housing programme (for example, we felt that both public sector new building and improvement grants should take a lower priority, although very large sums would still be spent); and that he agreed to settle his other programmes, including provision for the water industry, on average somewhat below the baseline.

13. We accordingly made an offer to Kenneth on this basis. He has not so far felt able to accept it, and I think that he will want to put his own case to the Cabinet.

Health and Social Security

14. We have not yet completed our discussions with Norman Fowler and will be seeing him again next week. I have no need to explain at length the basic problems. The figures speak for themselves. There are huge bids in each year, and the Government's public expenditure objectives cannot be obtained unless substantial reductions are made.

15. Very briefly, on social security, we have sought to trim the bids substantially. After a thorough examination of the options, including accelerating measures covered by the review, Norman has made some further suggestions that would help considerably in the first two years. But we need to examine these with him further and, as indicated above, there is still likely to be a big problem in the last year.

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Proposals now serious



16. On health, Norman has, in discussion with us, reduced his bids by around £100 million in each year. While very helpful, this is not enough and I have asked him to consider the possibilities further so that we can discuss them with him again next week.

Scotland

*— see flap C0D*

17. The amounts at issue here are not as large, but I think I should draw this problem to your attention. Although George Younger has not sought any significant extra provision, the Chief Secretary thought it right to ask him to reduce his programme by £100 million in each year below the baseline. The Group fully endorsed this approach. They believe that Scotland is over provided in public expenditure and that the block formula agreed in 1978 is excessively generous.

18. I do not think that George Younger seriously disputes this. In view of the political situation in Scotland, however, he has made it absolutely clear that he cannot contemplate any visible cuts in his programme. We have explored various possibilities by which, for example, it might be possible for Scotland to contribute to some other relevant programmes. None of them has so far proved feasible or acceptable to George. And, although we are still considering the possibility of a reduction in baseline to reflect population shifts since the late 1970s, we have been unable to settle this programme.

19. I shall be glad of the opportunity to discuss the next steps with you when we meet on Monday. I am optimistic that some further progress can be made. But some of the major issues referred to above will undoubtedly need to be discussed by the Cabinet on 7 November, and I am anxious that we should define and circumscribe the issues as far as possible in advance. I



*See page B*

must particularly stress my view that the defence issue should be argued by the Cabinet. I understand that there is some question of Michael Heseltine not being available the week after next owing to the Trip to the Far East. I strongly recommend that you should require his attendance at Cabinet when these issues are discussed.

20. I am sending copies of this minute to the Chief Secretary and to Sir Robert Armstrong.

A handwritten signature in blue ink, appearing to read "J. MacNaught".

(Approved by the Lord President  
and signed in his absence)

Privy Council Office  
25 October 1985

## SECRET AND PERSONAL - CMO

£ million

	1986-87			1987-88			1988-89		
	Baseline	MISC 120 Proposal	Departments' Present Position	Baseline	MISC 120 Proposal	Departments' Present Position	Baseline	MISC 120 Proposal	Departments' Present Position
TOTAL AGREED $\phi$									
SO FAR	52,509	-1726	-1726	53,724	-616	-616	56,574	-1531	-1531
	<i>18,053</i>						<i>18,840</i>		
DEFENCE	18,560	-200	+171	18,859	-300	[+362]	19,033	-208	[+655]
ODA (Incl ATP)	1,296	0	[+15]	1,317	0	[+15]	1,350	0	[+20]
ENERGY (Departmental Programme)	294	+22	+27	293	+32	+37	300	+35	+40
HOUSING	2,424	+120	[+790]	2,526	+100	[+968]	2,589	+80	[+892]
DOE Other	848	-25	-10	860	-20	[0]	882	-15	[0]
EDUCATION AND SCIENCE	3,418	+80	+80	3,505	+75	+75	3,593	+60	+60
ARTS & LIBRARIES $\pm$	333	-1	+15	342	+5	+23	350	+10	+27
HEALTH	14,945	+200	+301	15,622	+250	+382	16,012	+450	+766
SOCIAL SECURITY	41,547	+857	+941	43,553	+140	+181	44,642	+644	+816
SCOTLAND	4,300	-100	-2	4,373	-100	-1	4,482	-100	-19
ELECTRICITY*	-1447	+90*	+90*	-1487	-94*	-94*	-1524	+309*	+309*
WATER	123	0	+33	15	0	0	15	-60	0
COAL $\pm$	382	+400	+508	392	+283	+333	402	+150	+198
GAS $\pm$	-470	+160	+272	-	-	-	-	-	-
Territorial Consequences	-	+80	+320	-	+100	+380	-	+155	+480
TOTAL	139,062	-43	+1825	143,894	-145	+2045	148,700	-51	+2713

$\phi$  Includes additions to asset sales, lower Reserves and increase in 1988-89 planning total

$\pm$  Programmes not yet considered by MISC 120

\*Agreed figures, but subject to further reductions to reflect assumed slippage of Sizewell.

NB: Figures in square brackets reflect secretariat's interpretation of current Departmental positions.