

PRIME MINISTER

PUBLIC EXPENDITURE

You discussed yesterday with the Lord President and Chief Secretary the handling of public expenditure next week and the problem of Mr. Heseltine's visit to the Far East.

The Lord President has thought further about this. He feels "very very strongly indeed" that defence should come to Cabinet with housing, both because it would be tactically right in survey terms, and because it would avoid ill-feeling about an apparently private deal.

The problem is that if Mr. Heseltine's trip goes ahead as planned he will miss the public expenditure discussion in Cabinet which is at present scheduled for Thursday next week, 7 November. Mr. Heseltine intends to leave for Malaysia on the evening of Tuesday 5 November, returning via Burma, Thailand and a meeting of the WEU in Rome on 14 November.

One option would be to hold Cabinet on Tuesday 5 November. Lord Whitelaw believes this would be terribly difficult for his group to prepare for, but just about possible. A number of Cabinet Ministers also have plans to be out of London that day. Cabinet on Thursday, as planned, would be far preferable.

There are apparently no specific reasons for Mr. Heseltine to go to Malaysia next week. So if he were required to attend Cabinet on Thursday, 7 November he could either switch Malaysia to the end of the tour and miss the WEU, or he could postpone Malaysia to another time. Either would be awkward given our relations with Malaysia and particularly the problems with tin. However, Mr. Heseltine's PPS seemed reasonably relaxed about the prospect of moving or postponing the Malaysian part of the trip and it might be possible to

smooth relations for example by a personal message from you to the Malaysian Prime Minister if that really seemed necessary. I do not know what what would be lost if he missed the WEU: FCO could not say.

Nonetheless, it seems right to press Mr. Heseltine very strongly on the need for him to be at Cabinet on Thursday, 7 November, unless he is prepared to settle with Lord Whitelaw before then. If he refuses, it would then be necessary to consider whether you wanted to insist, taking account of his reasons.

Content?

Yes not

DAN

David Norgrove
29 October 1985

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LOCAL AUTHORITY EXPENDITURE:

SCOTLAND - AGGREGATE EXCHEQUER GRANT (AEG) 1986-87 pa

The Chief Secretary and the Secretary of State have been discussing the appropriate level of AEG in Scotland for 1986-87. The Secretary of State has argued that AEG of up to £2025 million is necessary to avoid politically unacceptable rate increases. The Chief Secretary has suggested AEG of £2,000 million but has said he would accept a figure of £2015 million being announced, providing this was accompanied by tougher penalties for overspending than at present which would achieve an effect broadly similar to AEG of £2,000 million.

2 In his letter of 24 October, Mr Younger says he is prepared to accept the offer of £2015 million with tougher penalties (subject to some limiting of the penalties). However, he records his concern about the political consequences of the rate increases which he thinks will follow from a settlement at this level with the tougher penalty regime.

3 If the political problems of a settlement at £2015 million with a tougher penalty regime are felt to be overriding, an alternative would be to revert to the Chief Secretary's original proposal of AEG of £2,000 million with the present penalty system; and suggest to Mr Younger that he increases the level of AEG to £2025 million if that is what he judges is necessary by finding the extra £25 million from his block budget.

4 The effect of this proposal would be to create a £25 million saving on the block budget. Mr Younger would have to justify this by reference to the greater priority he attached to increasing AEG. There is a precedent for

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such a switch. A similar switch was made in respect of domestic rate relief following the rates revaluation in 1985-86. The amount involved was £26 million. Providing local authorities use the higher level of AEG to reduce rates rather than to increase expenditure the public expenditure saving will be carried through to outturn-taxes (in this case rates) will be that much lower. It is of course Mr Younger's case that authorities will not reduce expenditure below a certain level but will increase rates instead.

5 The saving would arise in 1986-87 only although in principle similar agreements could be reached in the annual RSG settlements in later years.

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