



PRIME MINISTER

STAR CHAMBER

I thought that you would like to see for the weekend the attached draft report to the Cabinet on the work of the Star Chamber (MISC 120).

2. As you will see, a few passages are still provisional, since the Chief Secretary and I are still in discussion with one or two Ministers; and the detailed figures still have to be finalised. But, subject to my comments below, the picture is now substantially complete and you will see that, if our recommendations are endorsed by the Cabinet, the excess net bids above baseline with which we started of some £3.4 billion, £4.7 billion and £5.7 billion will have been reduced in the Star Chamber to £0.2 billion, £0.2 billion and £0.05 billion respectively. In achieving this, I have been greatly indebted to my colleagues on MISC 120 who have spent very long hours and taken a great deal of trouble in studying all the claims. I have also very much admired John MacGregor's performance as Chief Secretary.

3. Subject to the points that John MacGregor and I are still pursuing, this reflects agreement with the spending Ministers concerned on all programmes except housing. The most important development since my interim report to you of 25 October is settlement of the defence programme. Following my discussion with you yesterday, and subsequent consideration with my colleagues in the Star Chamber, I have agreed with Michael Heseltine that he should accept as his total Ministry of Defence baseline for the first two years the figures already in the 1985 Survey - that is, £18,560 million and £18,859 million respectively. For the third year, I persuaded him, as I suggested to you, to accept the baseline figure of £19,033 million without any



addition on top of that for the Falklands. This is not as large a reduction as the Star Chamber itself sought; and less still than the Chief Secretary's original proposal. But in the circumstances I do not think this is at all a bad settlement and it marks a decisive switch in the defence programme from the previous commitment to real terms growth to a genuine cash planning figure. In view of this, I hope I was right in telling Michael Heseltine that he did not need to come to Cabinet next Thursday and that he could keep to his original travel plans. I felt that there was very great advantage in getting this settled and out of the way before the weekend.

4. I have also been able to settle the overseas aid programme with Geoffrey Howe. The settlement falls short of his original bids, but will enable him to maintain the real value of the total aid programme, including the increase in the Aid and Trade Programme that we agreed in July.

5. At the time of preparing this report, the only outstanding issue is that of housing, and the draft assumes that this will remain in contention and will be a matter for the Cabinet to decide. The issues were summarised in paragraphs 12 and 13 of my minute to you of 25 October. I very much hope, however, that it might still be possible to persuade Kenneth Baker to drop his very large bids and accept the Star Chamber's proposal. I am sure you will agree that it would be most unfortunate, from a number of points of view, if he alone were to take a disputed issue to the Cabinet. He is away in the United States this weekend, but John Wakeham and I will be in touch with him first thing on Monday morning to try to reach a settlement with him. If we succeed, then we shall be able to put a fully agreed report to the Cabinet.



6. The outcome will, of course, still leave some excess over the baseline in each year. In addition, when we get to the autumn statement itself, I understand that the Treasury will need to take into account some further large estimating changes that are likely to arise on the social security programme. But my judgement is that the numbers are manageable and that they could not be reduced further without raising major political difficulties. The Chancellor and the Chief Secretary are considering how best to handle the gap and will be reporting to you separately.

7. I will, of course, let you know the outcome of my further contact with Kenneth Baker. In the meantime, if you have any comments on the draft report, I should be glad to know them. I imagine that you will not wish to circulate the report to Cabinet until next Wednesday.

Wells

A large, sweeping handwritten flourish or signature mark in blue ink.

Privy Council Office
1 November 1985



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DRAFT

PUBLIC EXPENDITURE SURVEY 1985

Memorandum by the Lord President of the Council

At their meeting on 11 July the Cabinet decided that the public expenditure planning totals should be £139.1 billion for 1986/87, £143.9 billion for 1987-88, and £148.2 billion for 1988-89, and invited the Chief Secretary, Treasury, to pursue bilateral discussions of expenditure programmes with the Ministers responsible. On 3 October the Chief Secretary, Treasury reported progress. The Prime Minister invited me to be the Chairman of the Ministerial Group on Public Expenditure (MISC 120) to consider and make recommendations on those issues which had not been resolved by the Chief Secretary, Treasury and the spending Ministers concerned (CC(85) 24th conclusions, minute 4; CC(85) 28th conclusions, minute 4).

2. This Memorandum sets out the recommendations of MISC 120. I should like to express my gratitude both to the members of the Group and the spending Ministers who have appeared before us for the care and thoroughness which they have brought to the task.

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A large number of programmes were agreed in bilateral discussions between the Chief Secretary, and the spending Ministers concerned. The effects on the Survey baseline are set out in Annex A; brief descriptions of the policy implications are in Annex B. MISC 120 were, however, left with an unprecedentedly large number of programmes to consider, with aggregate bids above the agreed baseline in the three years remaining at some £3.4 billion, £4.7 billion and £5.7 billion respectively, after allowing for the lower Reserves and large additional asset sales proposed by the then Chief Secretary in July and for changes agreed bilaterally between the Chief Secretary and spending Ministers.

4. In order to assist the Group's substantive discussions on the individual programmes, the Chief Secretary, Treasury reconsidered the prospects for receipts from asset sales and the size of the contingency reserve it would be prudent to keep in hand. He also considered whether it would be appropriate, in the light of the latest projection of inflation to make some small adjustment to the planning total for 1988-89 consistently with the Government's determination to hold that total broadly constant in real terms. He concluded that the following changes, though not without risk, would be possible.

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	£ billion		
	1986-87	1987-88	1988-89
Reduction in Reserve	0.5	0.25	0
Increase in receipts from asset sales	0	0.75	0.5
Increase in Planning Total	0	0	0.5

5. The Group have made major strides towards removing the outstanding excesses. The total agreed reductions in the additional bids amount to about £1.5 billion in each of the first two years, and £2.5 billion in the third. Changes in the economic projections reduced the social security additional bids by about £0.2 billion, £0.7 billion and £0.7 billion in each of three years, so somewhat reducing the extent of the Group's task. On the basis of the Group's proposals there would be excesses of about £0.2 billion in each of the first two years, and a small excess in the third year. Excesses of the order of £1 billion would remain in each Survey year if the main outstanding additional bid on housing were allowed. Since the Group discussed the Social Security programmed it has become clear that later estimating changes reflecting later assessments of claimant numbers and of the rate of take up of benefits, will add further to our problems, perhaps by as much as £¹/₂ billion by the third Survey year. There thus remain difficulties in holding to the agreed public expenditure planning totals.

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6. The Group have reached agreement with the spending Ministers concerned on the recommendations to be put to the Cabinet on all the programmes which they considered, except Housing. The recommendations on the agreed programmes are summarised in paragraphs 7 to 21. All figures are in £ million unless otherwise stated, and further details are provided in annexes to . A particular question arises about Scotland which is summarised in paragraph 15.

AGREED PROGRAMMES

Defence

The Survey baseline is as follows -

	18560	18859	19033
<i>of which</i>			
<i>Falklands</i>	442	292	192

These figures of course include a declining path for Falklands expenditure

The Secretary of State for Defence had proposed the following additions to baseline -

+ 422	+ 595	+ 897
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In discussion with the Group he accepted that, with the ending of the NATO commitment to 3 per cent real annual growth, there need be no question of further real increases in the defence programme. In these circumstances the future size of the defence programme should reflect on the one hand the requirement to maintain a defence capability sufficient

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Provision (ATP) agreed by the Ministerial Committee on Exports (EX(85) 3rd meeting, Item 1; EX(85) 4th Meeting, Item 1). Part of the cost of the latter will be met during the survey period by transfers from the Votes of other Departments interested in promoting the new facility.

Energy (Departmental Programme)

9. MISC 120 and the Secretary of State for Energy have agreed on savings on £5 million per annum from the nuclear research and development programme which will be found across the whole programme.

Department of the Environment: Other

10. Following discussions with the Group, the Secretary of State for the Environment and the Chief Secretary, Treasury have agreed the following reductions below baseline in the DOE "Other" programme -

-20

-20

-15

These figures are net of a substantial increase in receipts from the sale of new town assets. The urban programme which is an element in DOE Other is assumed to remain at baseline, pending further discussions among Ministers of possible Government policy responses to the recent disturbances in inner cities.

Education and Science

11. MISC 120 have agreed with the Secretary of State for Education and Science to recommend that the following additions should be made to his Department's Survey baseline:-

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Changes agreed bilaterally	28.5	23.5	8.0
Science and Universities	25	25	25
Local Authority capital	27	25	25

The changes agreed bilaterally primarily reflect spending on mandatory student awards and (in the first two years) expenditure on the "switch" transferred from other programmes to enable universities to increase their output of graduates in science and technology. The other additions will enable the Secretary of State to allocate some additional resources to key areas in science and the universities without relaxing the pressure on the latter for greater efficiency; and also provide some greater flexibility in essential local authority capital expenditure.

Arts and Libraries

12. MISC 120 have agreed with the Minister of State, Privy Council Office (Minister for the Arts) on the following net additions to the baseline provision for the arts and libraries:

7	9	12
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These figures include additional provision for the Arts Council of

14	9	8
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The Minister of State, Privy Council Office, believes that this will be sufficient to meet the requirements and political pressures arising from the abolition of the Greater London Council and the Metropolitan

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Councils, and to maintain the Arts Council's regional development strategy. The larger addition in 1986-87 reflects the need to ensure that there are no immediate adverse effects through abolition. In later years the Minister for the Arts expects to be able to secure more substantial contributions from the successor authorities towards the costs of the performing arts.

Health and Personal Social Services

13. There were large bids for additional expenditure on both the cash-limited parts of the programme (principally the hospital and community health services) and the demand-determined family practitioner services, which are not at present subject to a cash limit. They total -

409	487	870
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14. Following a re-examination of these bids the Secretary of State for Social Services has identified further savings that could be made by intensifying the campaign for increased efficiency in the hospital and community health services; and changes in provision for certain centrally financed services and for family practitioner services administration. These changes yield the following savings on the bids set out above -

159	184	270
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SC 120 and the Secretary of State for Social Services jointly recommend them. The agreed additions to baseline then become

250

300

600

This will allow an increase of 2 per cent in real terms on hospitals and community health services current spending in 1986-87.

Scotland

15. The Group would like to have secured savings on the Scottish block of the order of -

100

150

200

reflecting their judgement that public service provision in Scotland is now generally too high in relation to comparable provision in England and Wales. For example Scottish local authority rents are 30 per cent lower as a proportion of average earnings than those charged in England, and health expenditure per head is over 25 per cent higher than the English average. Furthermore it is noteworthy that the population of Scotland has fallen by 1.5 per cent relative to England since the underlying base for the Scottish block was set in parallel with a needs assessment based on 1976 data. The Secretary of State for Scotland, however, considers that in general no changes can be made in the overall block provision

SECRET

other than as a result of the application to Scotland of variations in English programmes, by means of the automatic "formula" which regulates such marginal changes. The only other reductions the Secretary of State will contemplate are those which could not be readily detected by critics well-versed in the formula, or which could be justified by reference to particular Scottish circumstances. He has offered reductions in respect of lower rate fund contributions to housing revenue accounts.

Is it wise to be this explicit?

8.7 20.7 9.6

[Allowing for other changes agreed bilaterally,] the net changes to the Scottish programme are

[-28] -2 -20

The Group do not recommend further reductions on this occasion. They believe, however, that the present position is unsatisfactory, and should not be allowed to continue indefinitely. There is a clear case for a fresh assessment of need to serve as the basis for the allocation of public provisions as between England, Scotland, Wales and Northern Ireland. The objective would be to establish new baselines for the territorial block provisions, and a new mechanism for adjusting those baselines in the light of future economic, demographic and other relevant changes. The Group recommend that this fresh assessment of need be undertaken in time to be taken into account in decisions on the 1986 public expenditure survey; the work should be undertaken on a

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confidential basis within Government, but Ministers would need to be ready to explain that the assessment was required to take account of changes over the last decade throughout the United Kingdom and implied no prejudgements about the conclusions.

Electricity Industry

16. The Survey baseline is as follows -

-1447 -1487 -1524

Following substantial reduction of the electricity supply industry's initial bids, the Secretary of State for Energy sought the following changes in the baseline provision -

+169 -124 +568

After re-examination of the scope for further savings, and some rephrasing of working capital requirements from 1986-87 to 1987-88, and given that, on the latest available evidence, the timetable for construction of the Sizewell PWR is likely to slip a year, the Group and the Secretary of State for Energy have agreed to recommend the following changes from the above baseline -

+31 -198 +243

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The Chief Secretary, Treasury has agreed that if, contrary to expectations, it were possible to begin construction of Sizewell next year, as previously hoped, any resulting additional expenditure above the baseline should be met from the Reserve.

Water

17. Following discussion with the Group, the Chief Secretary, Treasury and the Secretary of State for the Environment have agreed that there should be no increase in the baseline provision during the survey period. This is consistent with maintaining planned investment at broadly the same levels as envisaged last year, and an average increase in domestic charges of about 8 per cent, or slightly lower, next Spring. The Group recommend that the figures should be settled on this basis, while noting the concern of the Secretary of State for the Environment at the potential political problems when the House of Commons is asked to approve the necessary Rate of Return Order next January or February. They also note that a settlement on the proposal basis represents some relaxation of the rate of improvement in the water industry's financial performance sought by E(NI) last year.

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Treasury are trying
hard to settle this
without your
intervention.

Coal and Gas Industries

18. [It is not possible to provide well considered figures about the coal industry, since the NCB has yet to produce a corporate plan following the ending of the miners' strike. Considerable uncertainty remains about the rate at which capacity can be reduced. The Chief Secretary's best view of the likely requirements of the coal industry for external finance indicates increases above baseline of

[318]

[158]

[-2]

The Secretary of State for Energy does not wish to propose alternative figures, but warns that the state of the market and the rate of pit closures could require additional expenditure of £150-200 million in each survey year.]

19. For the British Gas Corporation, which is due to be privatised next autumn, the Chief Secretary, Treasury and the Secretary of State for Energy have agreed that the baseline negative external financing requirement of £470 million should be revised to £420 million to cover the period before privatisation takes place. This figure will not be separately identified in the Autumn Statement or in the forthcoming White Paper.

Social Security

20. There are large additional bids stemming mainly from changed economic assumptions and higher take-up of benefits which are inevitable without policy changes. Following the Chief Secretary's bilateral discussions,

SECRET

and taking account of further revision to the figures in the light of the autumn economic forecast, the bids above the Survey baseline totalled -

+982 +459 +1144

21. After a careful and detailed examination of options for further savings, including possible accelerated implementation of some of the measures in the Social Security Reviews, the Group, with the agreement of the Secretary of State for Social Services, recommend the following further savings -

	1986-87	1987-88	1988-89
No uprating of Child Benefit in July 1986, but full uprating in April 1987. Further savings in 1988-89	16	-27	23
A new drive against social security fraud	25	30	30
Reduction of help with mortgage interest from July 1986	10	*	*
Further restrictions on single payments	40	80	160
Delay abolition of retirement pensioners' earnings rule until April 1989	-	30	105
Require employers to take over payment of maternity allowance on the same basis as Statutory Sick Pay	-	140	170
Introduce selective provision to replace maternity and death grant.	-	25	*
Adjustment required to reach agreed provisional total for the programme	-	-	276
Total Savings	91	278	764

* Saving already scored in base figures

The total for expenditure on social security in 1988-89 has been calculated by adding to the adjusted 1987-88 baseline the £380 million needed to meet the cost of a full $3\frac{1}{4}$ per cent uprating of benefits in April 1988, reflecting the latest projections of the course of the Retail Prices Index, rather than the $2\frac{1}{2}$ per cent increase assumed in the baseline. It should be emphasised that the 1988-89 figures are provisional, and will depend on decisions still to be taken in the context of the social security Review.

The agreed changes from baseline on social security are thus -

+891	+181	+380
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DISAGREED PROGRAMME: HOUSING

22. The Group have not been able to reach agreement with the Secretary of State for the Environment on the housing programme.

The baseline provision is as follows -

1986-87	1987-88	1988-89
2424	2526	2589

In discussion with the Group the Secretary of State for the Environment has insisted on the following net additions to the baseline -

+679	+968	+892
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24. These additions include agreed amounts of £144 million, £158 million and £57 million to meet the unavoidable effect of interest rate changes on housing subsidy and rate fund contributions and on option mortgages. The remainder of the bid is made up as follows -

New provision for rent	+ 50	+ 50	+ 50
Renovation of public sector stock	+550	+850	+850
Other changes	- 55	- 85	- 65

On housing renovation the Secretary of State bases his case on the report compiled from information supplied by local authorities which indicates a backlog of £19 billion of repairs and improvements which are urgently required. To forestall further dilapidation and cost escalation, he considers that sufficient resources should be provided to reduce the backlog very substantially over a period of 10 years.

He also seeks increases for new housing provision by local authorities and the Housing Corporation; this would allow the construction of 36,000 houses each year in 1986-87 and 1987-88 and 28,000 in 1988-89.

23. The Group considered these bids very carefully, particularly in relation to housing renovation. They do not, however, accept the case for a public sector housing renovation programme on the scale suggested. They believe that the Government's record on public sector housing is a good one, and they doubt whether taxpayers should be asked to fund improvements to the public sector stock which would be beyond the reach

SECRET

SECRET

of the occupiers if the houses were in owner occupation. However, they recognised the need to respond constructively to the report and they proposed to the Secretary of State for the Environment the following increases above baseline provision for housing renovation which, together with existing provision, would be enough to finance a £15 billion renovation programme over 11 years -

+100 +200 +200

24. They believe, however, that such priority for renovation can only be justified if lower priority is accorded to new construction. They therefore suggested to the Secretary of State for the Environment reductions in expenditure on new public sector build consistent with the maintenance of 30,000 starts in 1986-87 and 1987-88, and 28,000 in 1988-89. This would involve reductions below baseline of -

- 70 -190 -120

so producing overall net changes in the housing baseline of -

+120 +100 + 80

25. The Secretary of State for the Environment made it clear that he could not accept these proposals and that in particular in his view the additional provision for public sector renovation was not an adequate response to the needs he perceives. He also argued that gross capital expenditure on housing in 1986-87 should not be lower than the expected out-turn for 1985-86 of £3300 million (an overspend of £250 million on the White Paper provision), and that capital allocations should be

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maintained at not less than the current year's level of £1600 million, which would require an increase in provision above baseline of £300-350 million in addition to the agreed bids noted in paragraph 23. The Group, however, do not feel that it would be appropriate, given the overall constraints, to go beyond the additions they have suggested for housing renovation, and they consider that the changes they recommend are a reasonable and constructive response to the established needs.]

Local Authority Current Expenditure and the Reserve

26. Inevitably a major concern remains about the future course of local authority current expenditure. In general the Government must rely on indirect means to control this expenditure, and the outcome is likely to be influenced also by changes in the political complexion of individual authorities. A major uncertainty remains about whether or when the authorities might be in a position to call on the additional resources held out by the Government for restructuring teachers' pay following an agreement on teachers' duties and on the better management of the teaching force. There is a risk, in the present climate, that any figures put in would only be regarded as a challenge to be exceeded; and to give in the White Paper a breakdown between services of an aggregate the Chief Secretary could accept in advance of negotiation with the authorities would almost certainly show lower expenditure than Government policy would indicate on, for example, police and personal social services. The Chief Secretary has therefore agreed with the Environment Secretary and the Ministers responsible for the main services that the

SECRET

agreed 1986-87 figures (without any addition for teachers' pay) should be projected forward unchanged in cash terms for the following two years, with a clear proviso that future expenditure provision will be determined in the context of each successive year's Rate Support Grant settlement, and that regard has been had to this in determining the size of the Reserve. The Reserve has accordingly been increased above the level at which it would otherwise have stood by £0.25 billion, £0.75 billion and £1.5 billion for the three years, principally on this account. Taking into account the other changes set out in paragraph 4 above, the Reserve thus now stands at £4.75 billion, £6.5 billion and £8 billion for the three years.

RECOMMENDATIONS

27. I invite the Cabinet -

- a. to endorse the agreements reached, as summarised in paragraphs 7 to 21 above.
- b. To decide the appropriate provision for the housing programme in the light of the considerations set out in paragraphs 22 to 25 above.
- c. To agree that a fresh assessment of need be undertaken, on a confidential basis within Government, to serve as the basis for the allocation of public provision as between England, Scotland, Wales and Northern Ireland.

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MISC 120 : PROGRAMMES PREVIOUSLY AGREED

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SCORECARD

£million

EX		1986-87		1987-88		1988-89	
		Baseline 999,999	AGREED 99,999	Baseline 999,999	AGREED 99999	Baseline 999,999	AGREED 99999
+	1. FCO-OTHER	603	38	619	43	635	63
+	2. EC	640	10	830	320	850	100
+	3. IBAP/AFF CAP	1,277	272	1,304	334	1,337	336
+	4. AFF domestic	713	8	699	5	717	3
+	5. FORESTRY	53	0	54	0	56	0
+	6. TRADE/INDUSTR	1,162	-13	980	12	1,004	-25
+	7. ECGD	78	200	-43	213	-44	138
+	8. EMPLOYMENT	3,704	-74	3,901	-207	3,999	-125
+	9. TRANSPORT	1,955	27	1,995	33	2,045	52
+	10. DOE-PSA	-120	7	-128	0	-131	0
+	11. LCD	574	21	610	39	625	73
+	12. HOME OFFICE	1,061	43	1,104	44	1,131	55
+	13. CIVIL SUPER	1,114	65	1,226	86	1,257	147
+	14. WALES	1,708	-1	1,735	-1	1,779	-4
+	15. N. IRELAND	4,464	53	4,603	76	4,717	105
+	16. CHANCELLOR'S	1,825	163	1,842	169	1,888	143
+	17. OTHER (inc ter consequences)	366	170	396	170	406	205
	NAT IND						
+	20. Settled	1,495	-4	1,265	-77	1,299	-459
+	21. RMPS & SRP	309	194	318	-41	326	-50
+	23. BGC			-390	390	-400	400
+	24. LA REL CUR(UKA)	26,032	646	26,301	359	26,959	-323
+	25. SPECIAL SALES OF ASSETS	-2,250	-2,250	-2,250	-2000	-2,250	-1750
+	26. RESERVE	6,000	-1,250	7,000	-500	7,000	1000
+	27. 3.3 % increase in 1988-89					1,627	-1627
+	28. less double counting	-254		-247		-258	
=+	TOTAL AGREED	52,509	-1,675	53,724	-533	56,574	-1543

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MISC 120 : PROGRAMMES CONSIDERED BY THE GROUP

	1986-87		1987-88		1988-89	
	Baseline	MISC 120 PROPOSALS	Baseline	MISC 120 PROPOSALS	Baseline	MISC 120 PROPOSALS
+ MOD(1)	18,560	0	18,859	0	19,033	0
+ FCO-ODA/ATP	1,296	21	1,317	29	1,350	37
+ ATP contributions from other depts		-4		-11		-11
+ ENERGY	294	22	293	32	300	35
+ DOE-HOUSING	2,424	120	2,526	100	2,589	80
+ DOE-OTHER	848	-20	860	-20	882	-15
+ DES	3,418	81	3,505	75	3,593	60
+ OAL	333	7	342	9	350	12
+ HEALTH & PSS	14,945	250	15,622	300	16,012	600
+ SOCIAL SEC.	41,547	891	43,553	181	44,642	380
+ SCOTLAND	4,300	-27	4,373	-1	4,482	-18
+ Territorial consequences NAT IND		90		110		185
+ Electricity	-1,447	31	-1,487	-198	-1,524	243
+ Water E&W	123	0	15	0	15	0
+ Coal	382	318	392	158	402	-2
+ BGC	-470	50				
+ TOTAL AGREED IN BILATERALS	52,509	-1,675	53,724	-533	56,574	-1543
= PLANNING TOTALS	139,062	155	143,894	231	148,700	43
NET ADDITION SOUGHT BY THE ENVIRONMENT SECRETARY		559		868		812
plus further territorial consequences		112		174		162