



CABINET OFFICE

With the compliments of

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From: J B UNWIN
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LORD PRESIDENT

STAR CHAMBER: MEETING WITH THE PRIME MINISTER

You may find the following notes helpful for your meeting with the Prime Minister this afternoon.

General Situation

2. The Prime Minister is familiar with the general position, both from my minute of last Friday and from the Chief Secretary's report at Chequers. You will, however, want to give her your general assessment of the exceptionally difficult position the Group are in, and leave her under no illusions about the stiff opposition you are facing and very small room for manoeuvre you have been left with. You might, if necessary, wish to consider hinting that the 70:30 settlement in favour of the Chief Secretary that you have been asked to achieve in the first year seems a good deal tougher than many of the settlements that the Treasury have already made bilaterally.

Individual Programmes

3. You will want to report to the Prime Minister the outcome of the discussions with Mr Fowler today on social security and health. On the former, it may be necessary to disabuse the Prime Minister of any lingering notion that very much more can be done, particularly next year, although Mr Fowler has agreed to consider further the possibility of reductions of £100 and £250 million in the two later years. On health, you will want to consider in the light of this afternoon's discussion, whether to seek her support for pressing Mr Fowler to go further than the modest savings of £95.5, 71 and 47 million he has offered. Would she consider a

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real growth profile of 2%, 1% and 1% defensible?

4. For the rest, I suggest you raise with her only the following programmes:-

(i) Electricity (England and Wales): the key issue is how far the Prime Minister is prepared to lend her support in pressing Mr Walker to moderate his bids of some £1050 million over the three years. Apart from an offer of £40 million in the first year, Mr Walker's position is that he cannot agree to any further savings, and even if he did, he could not deliver them. But the remainder of your discussions show how crucial electricity is. Despite the problems, it would be much preferable to make savings here than on, say, some of the extremely difficult and contentious social security proposals. I attach for convenience a copy of the Chief Secretary's suggested savings. These are predicated on a real tariff path of $-1/2$ per cent in the first 2 years, and 0 per cent in the last year. I think this is perhaps a little ambitious, and, as you have already acknowledged, the scope in the first year is more limited. But it really ought to be possible for Mr Walker to bring the numbers down substantially by making tougher assumptions about financial targetting in the last two years. This need not at this stage imply precise judgements on the tariff path; and the RPI effects in any case are not all that large - 0.03 per cent on the RPI for each 1 per cent increase in tariffs;

(ii) Scotland and Wales: the fundamental obstacle, which all the Group acknowledge, is the application of the formula consequentials to the local authority current settlement. In Wales, on top of the 1 per cent increase in real terms in 1987-88 already agreed, this would provide additions of 95, 97, and 98 in the three years (which the Welsh Secretary would use for other purposes). In Scotland, the amounts are smaller (67, 66 and 58) but the bids for non block purposes are larger (40, 10 and 33).

The Scottish and Welsh Secretaries have made it very clear that as a matter of principle they cannot agree to suspension of the formula arrangements. They argue that in a bad year, when things go wrong, they have to find extra money from within their block; so it is reasonable for them to take the "benefit" when things go the other way. There are now two main options. The first is to suspend the block arrangements this year for LA current, perhaps followed by a new enquiry into the relationship of LA spending to the block. The second, which you now favour, is to adjust the base-line once off to reflect the change in population ratios since 1979. This would save:-

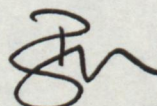
	£ million		
	1987-88	1988-89	1989-90
Scotland	133	163	190
Wales	8	8	8

Would the Prime Minister support this? In either case you would presumably reject the other non block bids.

(iii) Overseas Aid: the Prime Minister is aware of the Foreign Secretary's bid for £36, 73 and 117 million, which is related to maintaining the same GNP proportion. You will want to discover how far the Prime Minister would be prepared to support the Group in resisting this bid, though perhaps at the cost of some further small additions.

Tactics for Cabinet

5. In the light of discussion of the above you will also want to take the Prime Minister's view on how many, if any, issues she would be prepared to see come to Cabinet. It may also be necessary for her to be willing before then to engage in some "trilaterals" on some of the issues referred to above. You will no doubt in any case want to report to her again on progress at the end of this week.



J B UNWIN

MISC 130 : electricity

	1987-88	1988-89	1989-90	total
<u>Comparisons with baseline (£m)</u>				
A Outcome for all nationalised industries assuming later offer for ESI	+680*	+350	+260	+1290
<u>Electricity</u>				
B Bid net of agreed savings	+450	+171	+427	+1048
C Treasury position	+100	+50	-150	0
Savings available by real tariff path of $-\frac{1}{2}\%$	$-\frac{1}{2}\%$	$-\frac{1}{2}\%$	0%	
D	-240	-220	-420	-875
E Unspecified savings previously mentioned by Mr Walker	4 -60	-	-	-60
F Outcome with these savings = B-D-E (rounded)	+150	-50	0	+100

*subject to agreement for coal in 1987-88 and to a decision on the BAA entry for 1987-88.

Tougher deal w. Ruffkind.