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## 10 DOWNING STREET

From the Principal Private Secretary

20 February 1986

Dear Joan,

## THE TERRITORIAL FORMULA

The Prime Minister held a meeting this morning to discuss the territorial formula. Those present were the Lord President, the Lord Privy Seal, the Chancellor of the Duchy of Lancaster, the Secretaries of State for Wales, Northern Ireland, Scotland, Environment, the Chief Secretary to the Treasury and the Chief Whip. The meeting had before it the Chief Secretary's letters of 20 December and 7 February and the minutes from the then Scottish Secretary of 6 January and from the present Scottish Secretary of 19 February.

Opening the discussion, the Lord President said that the origin of today's discussion lay in the 1985 Star Chamber's conclusion that the territorial formula was unfair to England and Wales and should be examined.

The following points were then made in discussion.

It was argued that the Government's priorities for public expenditure generally could not be achieved unless there was progress in restraining Scottish block expenditure. The Scottish block had, it was suggested, some £6 billion "excess" provision since 1979, partly because of an over-generous base line at the inception of the formula. A 1983 Treasury study, which had been disputed by the Scottish Office, suggested that excess provision amounted to £900 million that year. Since then the Scottish economic position had improved relatively to some of the regions in England and Wales. The block arrangements envisaged a periodic review of the formula. It had last been reviewed 6 years ago. A review was essential now since block provision was, by definition, given free of scrutiny. Broad figures supported the case for over provision: for example, per capita public expenditure in England was £1632 compared to £1861 in Wales, £2058 in Scotland and £2461 in Northern Ireland. It had been argued in the Star Chamber that Scottish provision was falling. But this was only true if both block and non-block expenditure, including the South of

Scotland Electricity Board's repayment of loans, were taken into account. It was suggested, that the Scottish block grant was increasing at the same rate as in England and Wales.

Against this, it was argued that the Scottish public opinion did not believe that Scotland had avoided the cuts in public provision which had been experienced in England. Treasury numbers, it was argued, were random and arbitrary. Nor should Ministers enter into a highly controversial scrutiny of the formula without considering whether this was the right time to do it. It had been agreed last year not to open the formula because of doubts whether the exercise would produce much and because of the political risks. These risks were still there. If the study concluded that there was over provision in Scotland, then it had to follow that public expenditure in England and Wales should increase or be reduced in Scotland. Neither course was, it was suggested, politically feasible. Nor could the inquiry be kept quiet. It would take at least two years at a particularly crucial juncture of the Government's fortunes. Reductions in Scottish expenditure were not easily made. Some 40 per cent of the Scottish block comprised local authority current expenditure which was not within central Government's direct control. Much of the rest went on the National Health Service.

In further discussion it was argued that

- (i) Absolute cuts in expenditure were not necessary to reduce any excess provision in Scotland. This could be achieved by a lower rate of increase.
- (ii) The work of the 1985 Star Chamber had been made more difficult by some Ministers' resentment about what they perceived as over provision in the Scottish block. This had led the Star Chamber to resort to unsatisfactory expedients for trying to absorb certain expenditure, eg. ATP within the Scottish block. Experience had shown that such expedients were of extremely limited value.
- (iii) The formula system served the territorial departments well. It could only be defended if it was reviewed from time to time to confirm that it still reflected need.
- (iv) Since the outcome of a needs study would be politically controversial and would be subject to expert scrutiny, its methodology and data would have to be on a demonstrably sound basis. Such a study could not be completed before the next PES round. Even though the previous study had taken 2 - 3 years its methodology, it had been argued, had been flawed in certain respects. On the other hand, any study should avoid becoming over refined

since there was evidence that complicated formulae did not produce better results than had simpler ones.

Summing up the discussion the Prime Minister said that the Cabinet Office should arrange, in strict secrecy, for an urgent study of the existing figures of public expenditure provision within the block in England, Scotland, Wales and Northern Ireland. The Cabinet Office would also report on what flexibility there might be in the next PES round for taking any remedial action which might be agreed. The group would then resume its discussion on a possible new needs assessment in the light of the Cabinet Office report.

I am sending a copy of this letter to David Morris (Lord Privy Seal's Office), Andrew Lansley (Chancellor of the Duchy of Lancaster's Office), Colin Williams (Welsh Office), Jim Daniell (Northern Ireland Office), Robert Gordon (Scottish Office), Robin Young (Department of the Environment), Richard Broadbent (Chief Secretary to the Treasury's Office), Murdo Maclean (Chief Whip's Office), and Sir Robert Armstrong and Brian Unwin (Cabinet Office).

*Yours sincerely*

*Nigel Wicks*

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Miss Joan MacNaughton,  
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17 March 1986

*Dear Nigel*

Thank you for your letter of 20 February on the outcome of the recent meeting of Ministers on Public Expenditure matters.

The letter agrees generally with the Secretary of State's recollection of what was decided. There is, however, a possible ambiguity which he feels might give rise to future misunderstanding, namely the reference to identifying "what flexibility there might be in the next PES round for taking any remedial action which might be agreed."

Mr King is quite clear that the short-term exercise was to be limited to checking the expenditure facts and was not intended to make the value judgements by which the need for 'remedial action' or the flexibility available for taking that action might be determined. It was recognised that any changes in relative expenditure shares would be highly controversial and would have to be seen to be grounded in an in-depth, objective study of relative need if it were in due course decided to undertake it.

It may be that we are reading into your letter more than was intended. But the Secretary of State wishes it to be clear that his officials are participating in the Study on the basis set out above.

*Yours sincerely  
Jim Daniell*

J A DANIELL

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