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PRIME MINISTER

TERRITORIAL EXPENDITURE

[Ad Hoc Meeting, Noon Thursday 22 May]

[Cabinet Office Report submitted with my Minute  
of 16 April to Mr Wicks]

MAIN ISSUES

1. The main issues for decision are:

1. Should there be a new study of the relative expenditure needs of the various territories? If so, what practical arrangements should be made, and on what time-scale?

2. Should any immediate action be taken (ie in the current PES round) to reduce the size of the Scottish block? If so, should the consequential changes be applied to Wales and Northern Ireland?

BACKGROUND

2. You chaired an informal meeting on 20 February to consider whether there should be a fresh study of the arrangements used to determine the amount of certain public expenditure in Scotland, Wales and Northern Ireland. You asked the Cabinet Office to arrange, in strict secrecy, for a study of the recent pattern of public expenditure provision in each territory, and also of what flexibility there might be in the next PES round for taking any remedial action that might be agreed. This study would form the basis for Ministers to resume their discussion on the possibility of commissioning a new needs study.

SECRET

The Case for a Needs Study

3. The Cabinet Office study was carried out under my Chairmanship and, after considerable argumentation, contains an agreed analysis. It concludes that since the "block and formula" arrangements were established in 1978 to 1980, the aggregate territorial expenditure blocks have moved roughly in line with the corresponding programmes in England. This is as one would have expected. It was not within our remit to assess how relative needs have changed, and this remains a matter of dispute. The Treasury argue that there is evidence to show that relative needs in Scotland have declined since the last systematic study, which was based on 1976-77 expenditure patterns, and even more so since the Scottish block was established in 1979. They have produced various statistics in support of this argument, but the Scottish Office have been able to produce, with no less obvious conviction, statistics to demonstrate the contrary, and the case seems infinitely arguable. My own conclusion is that there is simply not enough evidence to justify the Treasury assertion. Indeed, if the per capital GDP figure is regarded as a rough and ready proxy for relative needs, the Scots could argue that their position has slightly worsened between 1976 and 1984 (see Figure 1 attached to the report).

4. A full-scale needs study might throw further light on these issues and the intellectual case for it therefore remains strong. In practice, however, I have a good deal of doubt as to whether such a study would be helpful. It would take time and resources, and obviously risk stirring up political controversy. Further, it seems most unlikely that an unambiguous result predicated action would emerge; even if the methodology were agreed, it is difficult to believe that the analysis and conclusions would not be hotly disputed (as in the last study) to the bitter end. I doubt, therefore, whether it would actually produce any greater release of spare resources than could be achieved now by a readjustment of the baseline to reflect shifts in population (described in paragraph 8 below).

Practicalities of a Needs Study

5. If the meeting does, however, decide to commission a study, you will wish to consider how this can best be organised. A key issue will be time-scale. It would not now be possible to produce results in time for the current PES, and one year might be regarded as the minimum time (the Scots will argue for two or three). Alternatively, the study might proceed at a slower pace, with a view to implementing any changes in the first PES of a new Parliament. Or, if the case for a study is agreed in principle but it is judged inopportune to launch it at present, it could be agreed that the study itself should commence with the new Parliament.

6. As to the study itself, it could be carried out either by officials or by engaging an outside consultant. I see some advantage in using a consultant, if only because an independent outsider is likely to be more acceptable to the parties concerned than to try and construct a representative team of officials from the Treasury and the Territorial Departments. It might be sensible for him, however, to be under the supervision of an interdepartmental Steering Group, perhaps chaired by the Cabinet Office. The Treasury or Cabinet Office could be instructed if necessary to bring forward detailed proposals for consideration later.

7. If a study were launched, it would also be necessary to consider whether it should be publicly announced or acknowledged. Since it is likely that the fact of the study would emerge, it might be better to be prepared to acknowledge its existence if asked. Indeed, it would be easier to defend politically if it were represented as a low-key good housekeeping measure to re-examine the relative needs, which have not been looked at for a decade. Strict secrecy would imply that a judgement had already been reached that Scotland is over provided.

The Scope for Remedial Action

8. We were asked to identify the scope for any remedial action which could be justified without a new needs study. The report suggests, in paragraph 21, the possibility of adjusting the Scottish baseline to

reflect shifts in population since it was established in 1979. As table VIII shows, this would produce savings in the Scottish block of £133 m and £163 m in 1987-88 and 1988-89 respectively. I think this is by far the most promising starter. Although the Scottish Secretary will strongly oppose it, common perception of a linkage between population and expenditure should make it possible to justify such a change. Even after this reduction, total identifiable public expenditure per head in Scotland would still be higher than in England and no actual cash reduction in the Scottish block planning totals would be likely to be involved (the "cuts" would take the form of a lower rate of increase).

9. The Scottish Secretary has discretion to allocate his block resources as he sees fit, and it would not be appropriate for the meeting to take a view on where in detail he might make cuts. That is his job, in the light of his own judgement of priorities. But Treasury Ministers would not be happy with a reduction in local authority current expenditure unless it were clear that it would be delivered. The risk is that any reduction in provision would be offset by an equivalent overspend, and no advantage would be gained. The spending controlled directly by the Secretary of State accounts for only about £2 billion out of the £6.6 billion in the block, and the Scottish Secretary would have to find the savings from this. The bulk of that expenditure is on the health service.

10. Clearly it might not be easy to make cuts of this magnitude in a single year. A fall back would be to agree a 3 or 4 year transition, beginning with, say, £50 million in the first year.

11. If it is decided to proceed on this basis, the question arises of whether an early announcement should be made. Otherwise the change would not formally be apparent until the Autumn Statement. You will want to take the Scottish Secretary's views on this. He may need a public announcement in order to enable the Scottish Office to apportion the reductions between programmes and plan the changes. As a matter of internal PES procedures, the reductions would be brought to book, along with other reductions in increases, and the Chief

Secretary's report in the autumn .

12. The Scottish Secretary may, of course, resist very strongly and insist on putting the proposals to the Cabinet, in the context of the wider public expenditure scene, before being willing to accept any changes. If so, you will wish to consider whether it would be appropriate to do this at the July Cabinet, or to leave it until the autumn. The latter may be better, provided this meeting establishes at least a very strong presumption that savings of this kind should be made. The Chief Secretary could then advance the proposals in a context which made it clear that it was one of the few realistic options for substantial expenditure savings.

#### Implications for Wales and Northern Ireland

13. If a change is made in the Scottish baseline, it is for consideration whether the Welsh and Northern Irish provisions should be changed also. The change for Wales (a cut of about £10 million a year) could be argued to be marginal. The increase for Northern Ireland is, however, more significant at about £34 million a year. The level of public expenditure per head is higher for Northern Ireland already, and although they have special needs, they are probably already significantly over provided. I understand, however, that the Treasury would probably be prepared to agree to Northern Ireland receiving the consequential increase if this made it easier to achieve the reductions in Scotland.

#### Transferring Items to the Scottish Block

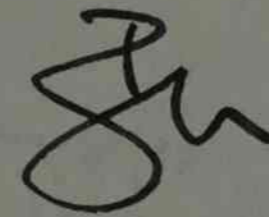
14. Paragraphs 24 to 26 of the report discuss the possibility of asking the Scottish Secretary to fund extra responsibilities out of his block without a corresponding increase in provision. Annex C lists a number of possibilities which (for reasons of security) we did not discuss with the lead Departments concerned. You may wish to seek views on these. I doubt, however, whether there is much mileage in them. I suspect that in almost all cases there would be strong departmental opposition to what is proposed; and there could be

SECRET

genuine difficulties from conflict between managerial control and financial responsibility. But we could certainly arrange more detailed study of any of the options if the meeting wished.

HANDLING

15. You may wish to ask the Chief Secretary to begin discussion of the report, and present the argument for a needs study. The Secretary of State for Scotland will wish to argue against. All other Ministers will wish to contribute. In inviting discussion you will no doubt wish to remind those present of the very difficult prospect for the forthcoming public expenditure round and the need to look very rigorously at all possible savings options, not least this one.



J B UNWIN

Cabinet Office  
20 May 1986

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