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bcc David Willetts

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10 DOWNING STREET

From the Principal Private Secretary

22 May 1986

Dear Tom,

TERRITORIAL EXPENDITURE

The Prime Minister held an informal meeting of Ministers today to consider the report on territorial expenditure which was attached to Mr. Unwin's minute of 16 April. The Lord President, Lord Privy Seal, Chancellor of the Duchy of Lancaster, Chief Secretary, Secretaries of State for Scotland, Wales, Northern Ireland and Environment, Sir Robert Armstrong and Mr. Unwin were present.

The Chief Secretary said that the Cabinet Office study was unable to say whether territorial expenditure was properly related to needs. But the study did show that there was a strong case for adjusting the base line of Scottish block expenditure on the basis of population movements relative to those in the rest of the kingdom. He did not believe much could be gained by transferring further expenditure into the Scottish block, for which legislation might, in some instances, be required. It was quite inappropriate for a Conservative Government to continue to allocate expenditure on the basis of a formula settled by their predecessors in the late 1970s without strong justification that the formula was the right one. There was therefore a case for another needs study, though its timing was unclear. In his view, the best approach for the time being was for there to be a one-off change in the base line to reflect the change in population ratio since 1979, as recommended in paragraph 21 of the paper.

The Secretary of State for Scotland said that the Cabinet Office study had demonstrated that Scottish territorial expenditure had moved roughly in line with corresponding programmes in England. Their paper also showed that economic circumstances had not changed for the better in Scotland in the last few years relative to England; for example, the gap in GDP per capita between England and Scotland was larger in 1984 than in 1976. The same was true for personal disposable income and the percentage of those unemployed had increased in absolute terms in Scotland compared to England. Moreover, the paper did not suggest any acceptable basis for reducing Scottish block expenditure. It was not politically tenable in Scotland to argue that Scottish block expenditure should be reduced because Scottish population had declined by 30,000 between 1979 and 1985.

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Such an approach would overturn arrangements which could be traced back to the last century. He was, however, prepared to agree to a needs study if colleagues so wished.

The following points were made in discussion:

- (i) The Cabinet Office study, it was argued, demonstrated that the formula arrangement worked satisfactorily. The difficulty arose because of over-provision in the base line. This supported the case for adjusting the base line in the light of the increase in population on England and fall in Scotland.
- (ii) The Government could try to make a virtue of a needs assessment as a means of assessing whether there was over-provision. But more likely, such a study would cause great political difficulty. Its announcement would stoke up suspicions in Scotland; there was no guarantee that it would be any easier to adjust levels of territorial expenditure in the light of the findings of the study; and a finding of over-provision in Scotland would produce considerable pressure for compensating expenditure south of the border, especially in the North and West Midlands.
- (iii) Any needs study would need to compare expenditure in the different English regions with Scotland. It did not follow that, for example, Glasgow and Edinburgh should receive higher provision than counties in England with similar problems.
- (iv) It was suggested that the possible expenditure saving of £163 million in 1988-89, shown in Table VIII of the paper (derived from applying projected population ratios since 1979 to the base line in the planned year) ought to be achievable without enormous disruption in a Scottish budget of £7 billion, even though not all this sum was within the direct control of the Scottish Office. The savings might be achieved by adjusting expenditures between local authority capital and current when there had been overspending. Savings of the order of £163 million ought not to lead to an absolute reduction in expenditure, but a slower rate of increase.
- (v) It did not follow that higher provision for Scotland needed to be sustained over a period, since, it was argued, the higher needs would have been met by the effects of the over-provision implicit in the base line. Against this, it was argued that no evidence had been produced that Scotland had received public expenditure provision which was not fully justified on the merits of the Scottish position. In any event, redistribution on the scale advocated would make the political difficulties produced by the hospital RAWP process look small.

Summing up the discussion, the Prime Minister said that the group were not ready to come to any conclusion on the

options set out in the Cabinet Office study. In order to evaluate further possibilities, the Secretary of State for Scotland and the Chief Secretary should prepare a note on how to achieve in practice a substantial real terms cut in the Scottish provision through amendment of the base line to reflect changes in the population (i.e. the option referred to in paragraph 27(ii) of the Cabinet Office study). The two Departments should also consider how any such change - and the Prime Minister stressed that no such decision had been taken - could be presented so as to minimise adverse political reaction. The Departments' note should be prepared on the basis of expenditure savings which produced figures at, and somewhat below, the levels shown in Table VIII of the Cabinet Office paper. It should be ready for further discussion by Ministers in the second half of June. Other Departments should be consulted as necessary.

I am copying this letter to David Morris (Lord Privy Seal's Office), Andrew Lansley (Chancellor of the Duchy of Lancaster's Office), Jill Rutter (Chief Secretary's Office), Robert Gordon (Scottish Office), Colin Williams (Welsh Office), Jim Daniell (Northern Ireland Office), Robin Young (Department of the Environment), and to Michael Stark and Brian Unwin (Cabinet Office).

Yours sincerely

Nigel Wicks.

(N. L. WICKS)

Miss Joan MacNaughton,
Lord President's Office.