

423/7.

Prime Minister

CCDG

Yes

- Agree ii in §4 below?

15

Yes

SECRET

- Shall I add the gloss in §6? ~~YES~~

From: J B UNWIN
25 July 1986

P 02199

MR WICKS - No 10

cc Mr Stark
PS/Lord President

Therbyson
mb

TERRITORIAL EXPENDITURE
(Letter of 23 July from the Chief Secretary's Office)

N. L. U.
25.7

At the Prime Minister's meeting on 22 May the Secretary of State for Scotland and the Chief Secretary were asked to prepare a note on how to achieve a substantial real terms cut in the Scottish provision through amendment of the baseline to reflect changes in population. The Cabinet Office study from which this proposal derived estimated that this would produce savings of £133 and £163 million in 1987-88 and 1988-89 respectively. The two Departments were also asked to consider how any such change could be presented so as to minimise adverse political reaction.

Below.

2. The result of this remit is the paper attached to Miss Rutter's letter to you of 23 July. As I have previously indicated to you, the paper has only been produced after lengthy bickering between Treasury and Scottish Office officials, with the latter in particular tenaciously defending their corner.

3. Although the paper has been approved by the Chief Secretary and the Scottish Secretary it is in no real sense a joint paper. It represents a dialogue of the deaf, with each assertion met with a counter assertion. For example, Annex A lists a number of areas in which in principle cuts could be made to deliver the required savings. But in each case reasons are adduced as to why such cuts would be undesirable. Annex B counters this by stating why, in the Treasury's view, the cuts would be feasible. Again, Annex C contains a suggested line by the Treasury for presenting the cuts in public. Annex D sets out a lengthy rebuttal of this by the Scottish Office.

Next Steps

4. I fear, therefore, that this paper does little to progress matters. The question for decision is how to take the issue forward. It seems to me that there are two broad options:-

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(i) for the Prime Minister to hold another small meeting and to seek to rule one way or the other;

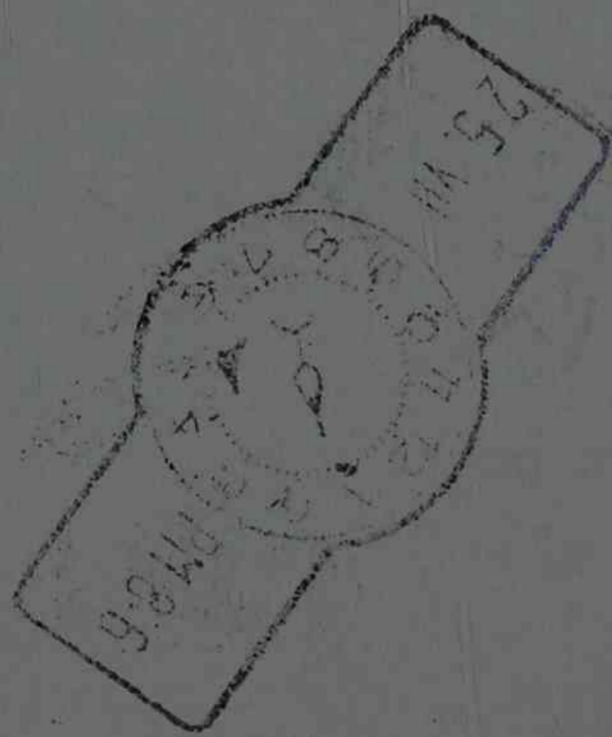
(ii) to remit the paper for consideration in the PES exercise in relation to other pressures and priorities (ie in effect in the last resort into the Star Chamber).

5. Unless the Prime Minister felt that she could rule decisively against the Scottish Secretary, I do not think (i) would be worthwhile. The last meeting created a very strong presumption that the only question now should be "how" rather "whether", but this has not prevented the Scottish Office from fighting their case as if from the very start. I am sure that this would happen again unless a decisive ruling were now made.

6. Remitting the issue to PES would, of course, resolve nothing, and the Scottish Secretary would still maintain his ground. But if in remitting it the Prime Minister were to make it clear that, on the basis of this paper, she thought that there was a case for reductions, this would at least strengthen the hand of the Chief Secretary and the Lord President when the final PES decisions came to be taken. There may well, for example, be circumstances in which it might be necessary to ask the Scottish Secretary either to forego provision (eg to deny himself the Scottish consequentials of decisions affecting England and Wales) or to be willing, as in other cases over the past year, to contribute from the Scottish Block to other items of expenditure.



J B UNWIN



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10 DOWNING STREET

From the Principal Private Secretary

29 July 1986

Jen Jill

TERRITORIAL EXPENDITURE

The Prime Minister has now studied your letter of 23 July to which were attached notes by the Scottish Office and Treasury on how to achieve in practice a substantial real terms cut in Scottish provision, and how any such change could be presented so as to minimise adverse political reaction.

The Prime Minister does not think it worthwhile now for Ministers to consider these papers collectively. But she would like these papers re-submitted for consideration in the PES exercise in relation to other pressures and priorities. Although she has not come to any firm conclusions, she does think, on the basis of these papers, that there is a case for reductions in the Scottish provision.

I am sending a copy of this letter to Joan MacNaughton (Lord President's Office), Robert Gordon (Scottish Office), David Morris (Lord Privy Seal's 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 Jill Rutter,
Chief Secretary's Office.

SECRET



Treasury Chambers, Parliament Street, SW1P 3AG

Nigel Wicks Esq
Principal Private Secretary
10 Downing Street
London
SW1

23 July 1986

Dear Nigel,

TERRITORIAL EXPENDITURE

Your letter of 22 May recorded that the Secretary of State for Scotland and the Chief Secretary were invited at the Prime Minister's meeting held on that day to prepare a note on how to achieve in practice a substantial real terms cut in Scottish provision, and how any such change could be presented so as to minimise adverse political reaction.

... I attach a note by Scottish Office and Treasury officials, which has been approved by the Chief Secretary and the Secretary of State for Scotland.

I am copying this letter to Robert Gordon (Scottish Office) and to Joan MacNaughton (Lord President's Office), David Morris (Lord Privy Seal's 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,

JILL RUTTER
Private Secretary

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TERRITORIAL EXPENDITURE**(Note by Scottish Office and Treasury Officials)**

At the informal meeting on 22 May, Ministers noted the conclusion of the Cabinet Office study that, since the territorial block budgets were established, their size has moved roughly in line with the corresponding programmes in England. In order to evaluate further possibilities, the Secretary of State for Scotland and the Chief Secretary were asked by the Prime Minister to prepare a note on:-

- (a) how to achieve in practice a substantial real terms cut in Scottish provision through amendment of the baseline to reflect changes in the population; and
- (b) how any such change could be presented so as to minimise adverse political reaction.

The Prime Minister stressed that no such decision had been taken; and asked that the 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 study.

2. The Secretary of State for Scotland had offered, at that meeting, to change the population-based formula as canvassed in paragraph 18-20 of the Cabinet Office study; but it was considered preferable to look beyond that to amendment of the baseline to reflect population change since the inception of the block and

formula system, as in paragraphs 21-22 and 27(ii) of the Cabinet Office study.

(a) How to achieve a cut in baseline provision to reflect population change

3. The Scottish block total is fixed by automatic formulae, designed to keep the overall trend of expenditure in line with that of comparable English expenditure. Within that total, the Secretary of State for Scotland has discretion in allocating resources to local needs, subject to certain specified grounds (eg wider repercussions) on which the Chief Secretary has a right to be consulted. The Secretary of State therefore has to live within a predetermined block total: how he does so is, in the first place anyway, entirely for him to decide.

4. On that basis, Annex A illustrates how, in the view of the Scottish Office, the cut in baseline provision, at any level up to that of Table VIII of the Cabinet Office study, might be apportioned between services; Annex B offers a Treasury comment on that. The cuts would be applied not to existing baselines, but to adjusted baselines - ie adjusted by Scotland's formula consequential of any changes to comparable English programmes agreed in the Survey. Very few block services can be held to be directly affected by small changes in total population. So if sizeable cuts were made, they would have to be applied across all, or most of, the services set out at Annex A.

(b) How to minimise adverse political reaction

5. In the view of the Scottish Office, any substantial reduction

in the Scottish block baseline which is not reflected in parallel changes in provision for England, Wales and Northern Ireland would have to be justified publicly on the basis of changes in absolute, not relative, need in Scotland alone. It would have to be argued that Scotland's needs have changed in recent years because of the change (approximately 0.8% in the last 8 years) in the size of the Scottish population: the Scottish public would neither understand nor accept that population increases in England should mean public expenditure reductions in Scotland. (The argument could not be confined to Scotland: the populations of Northern Ireland and Wales have also altered since 1978.) Cuts could only conceivably be justified on these grounds in those elements of public expenditure in Scotland where need is directly proportional to the size of the total population and where population-based reductions have not already been made.

6. The Scottish Office also consider that the adverse publicity, which changes of the order being examined will attract, particularly when no comparable changes were being made to English programmes or those of the other territories, would be likely to intensify public and expert scrutiny of the Scottish block and increase the risk of detection of the non-formula reductions which have already been made since 1980. The effect of these secret reductions has been to reduce the Scottish block baseline by about £70m in each of the next 3 years ie by percentage amounts greater than the percentage fall in Scotland's population, although less than the change in relative population would indicate. If, as seems not unlikely, this comes to light it would be extremely difficult to explain not only why the earlier changes had not been

announced but also why Scotland was being penalised for its fall in population twice over. We have been unable to identify convincing arguments which could be used publicly to justify the earlier cuts.

7. A draft prepared by the Treasury of the line for the Secretary of State to take in public is at Annex C. The Scottish Office do not consider that it addresses adequately the nature of the adverse political reaction which it is supposed to be trying to minimise and have recorded their reservations at Annex D.

ANNEX A

SOURCES OF ANY CUTSNote by the Scottish Office

THIS IS THE
SCOTTISH OFFICE
CASE WHY CUTS ARE
IMPOSSIBLE

In order to appreciate fully the perspective in which any cuts would be made, and to ascertain how far cuts in Scottish block programmes would be difficult to achieve, some key points should first be noted:-

- hospital waiting lists in Scotland are 12% longer than in England;
- morbidity and mortality rates are much higher in Scotland - Glasgow has the highest incidence of lung cancer in the world;
- 27% of Scottish children leave school with no qualifications against 10% in England;
- pupil-teacher ratios in nursery schools are 25% lower in Scotland than England;
- Scotland's land area is 60% of that in England, resulting in much higher requirements (based on relative population sizes) for roads, police, general medical practitioners etc;
- Scotland's housing - both public and private - is generally older than England's; there is a large backlog of improvement grant claims approved but unpaid.

The sources of any cuts in practice would have to be as follows:-

Local authority current expenditure accounts for £3bn or just under half the Scottish Block. It covers the services most directly related to population (eg half goes on education). Given that local authorities have consistently spent more than their

White Paper provision, it would be difficult to reduce that provision.

Roads and Transport This expenditure is for basic infrastructure services which are partly directed to the needs of industry and commerce and to the improvement of urban environment (eg bypasses) and are affected only in a limited way by small changes in population. Despite differences in land area, expenditure on roads in Scotland in 1985-86 was only 17.5% of that in England. Car ownership in Scotland is significantly lower than in England. Hence the need for higher expenditure on public transport. A moratorium on new starts in 1987-88 on motorways and trunk roads would require deferment of 14 schemes already announced costing more than £1m (most of which have already been the subject of statutory consultation procedures) plus a number of smaller schemes, mainly in Grampian, East Fife, Highlands, Borders and Dumfries and Galloway: in total these schemes cost about £70m over the Survey period. A one year moratorium on new local authority road schemes would defer at least £30m worth of activity also already publicly known including upgrading of roads in areas of major forestry activity as preparation for large scale extraction of timber.

Housing The bulk of housing capital expenditure is for rehabilitation of public sector stock and improvement grants to the private sector. New build (which has fallen in cash terms from £185m in 1980-81 to £130m in 1985-86) is for population movement rather than growth and to meet the special needs of the elderly and handicapped, and cannot be directly offset by savings where population has declined. A moratorium on new starts beyond existing approvals would defer at least £160m worth of housing activity in 1987-88 represented by 1,200 new public sector houses, overwhelmingly sheltered housing on housing for the disabled, and about 10,500 public sector houses which would not be improved or modernised. (Savings on renovation would be offset by about £3m extra repair/maintenance costs) Savings in private sector repair grants could be achieved by further deferment of payments to owner-occupiers (who in Glasgow and Edinburgh are already waiting

up to 3 years); £10m could be saved for each 2,500 grants (10% of the total) for which applicants would have to wait an extra year.

Other Environmental Services Expenditure by local authorities on water and sewerage is now directed predominantly to renewal and to major maintenance of existing essential infrastructure to meet the needs of industry and EC requirements for drinking water standards. A one year moratorium on new schemes would defer £20m worth of activity falling on provision of services for new industrial/commercial and private housing developments and major public sector schemes, unless consumers' contributions were increased correspondingly; but this could only be done through primary legislation. OES also contains the urban programme which is specifically directed to reversing population decline in areas of acute social and economic deprivation.

Law, Order and other Protective Services where the Government has manifesto commitments and where the pressures on prisons and courts are rising and unrelated to population changes. A moratorium on new capital starts in 1987-88 would produce savings of about £5.5m, £10.5m and £13m in the survey years requiring postponement of High Court projects in Parliament House and in Glasgow, Sheriff Courts at Airdrie, Falkirk, Dumfries and Edinburgh. the new Peterhead Prison (long announced) and major upgrading at Barlinnie and Perth. As for police and fire services, the much larger relative area that has to be covered in Scotland inevitably demands a higher level of resources.

Education where the central Government element is predominantly for higher education (students' awards and grant-aided bodies) and determined in the first place by student numbers (for which a slight fall has already been allowed over the PES period though numbers seem likely to rise again if unemployment remains high) rather than by total population. Differences in legislation and in structure, eg denominational schools, generate higher costs. A cut of £10m could be made by reducing entry to teacher training (matched by reducing local authority current provision) and rationalising Colleges of Education; staff/student ratios are already planned to worsen rapidly over the next three years.

Additionally, £8m could be achieved by a one year moratorium on all new school starts (more if a longer moratorium); savings are also possible on Central Institutions by rationalising courses or by slowing down the "switch". Cuts on local authority capital would affect "spend to save" rationalisation in response to falling pupil numbers.

Health accounts for a further 30% of the block, and the Government has repeatedly committed itself to maintaining the level of services while still meeting new demand, including the cost of relevant population growth in Scotland (11% in live births, 8% in over 75s by 1991) and new technology. There is a disparity in total beds per thousand population between Scotland and England due to long-stay provision, where a much higher proportion of beds is provided in Scotland by the NHS than by the local authority and voluntary sectors. Each £25m reduction in the Hospitals and Community Health programme could reduce hospital capacity by around 2.5%, which in total could represent the loss of hospital facilities for 23,000 in-patients pa, 220,000 out-patients, 50,000 accident and emergency patients and 16,000 day patients. Corresponding staff reductions would be 180 hospital doctors and dentists, 1,000 nursing staff, 150 professional and technical, and about 750 other staff. Rather than close a single hospital of the size this figure would represent, wards could be closed around the country and a freeze imposed on recruitment. Additionally, there could be a moratorium on new capital starts in 1987-88. This would save sums of about £12m, £17m and £25m over the survey period if applied to all projects on which contracts had not yet been let. It would have to include 7 major projects already announced as approved in principle, including 2 new hospitals in Ayr, the Edinburgh Dental Hospital and a new district hospital in Oban.

Further savings on the local authority capital element of these programmes could be achieved if section 94 consent letters were withdrawn and capital spending in future years ceased altogether. Any savings on capital programmes (of both central and local government) would be offset by consequent job losses in the construction industry in Scotland which is highly dependent on public sector contracts.

ANNEX B

COMMENT ON ANNEX A
(SOURCE OF ANY CUTS)

THIS IS THE
TREASURY REBUTTAL

Note by the Treasury OF THE SCOTTISH
OFFICE CASE

In the Treasury view, Annex A while not factually incorrect is misleading in the impression it gives that cuts in Scottish block programmes would be inequitable and difficult to achieve. The following puts it in perspective.

Local authority current expenditure. The Treasury takes the view that cuts in this area would be difficult to deliver.

Roads and Transport. As the proportion of motorway or trunk roads in the Scottish system is some 60% greater than in England, a deferment of new starts in 1987-88 would still leave Scotland with a high relative standard of provision.

Housing. Scottish expenditure on grants per private sector dwelling in 1985-86 was more than two-and-a-half times the level in England. A reduction of as much as £75m in expenditure on improvement grants could be justified, as bringing the rate of spend down to the level per private sector dwelling that is provided for in plans for England for 1987-88: such a large cut might be difficult politically, but a £25m reduction would be perfectly feasible.

Law Order and Protective Services. The pressure on prisons at least is less than in England, where overcrowding is appreciably worse (even though there is insufficient capacity in Scottish prisons for the current inmate numbers, and overcrowding among long-term prisoners is worse than in England).

Education. On the latest figures, unit costs for teacher training in Scotland are £3,711 pa as against £3,000 pa in

England, while the staff/student ratio is 8.5: 1 as against 11: 1 in England.

Health. Scotland already has 11.1 available hospital beds per 1,000 population as against 7.3 in England. There are 12.8 hospital doctors and dentists and 121 nurses and midwives per 100,000 population in Scotland, as against 8.8 and 86 respectively in England.

THIS IS THE CASE WHICH THE
TREASURY SUGGEST

ANNEX C

LINE TO TAKE IN PUBLIC COULD BE PUT FORWARD IN
PUBLIC FOR REDUCTIONS

(a) The present system. Most Scottish expenditure programmes - the main exceptions are industry and agriculture - are grouped within a block budget, which has been running for a number of years on the basis of a purely automatic formula. That is to say, Scotland gets a proportionate share of all changes in comparable English programmes, so that Scottish block and related English expenditure, overall, move broadly in line.

(b) The adjustment proposed. The system is fair so long as the underlying relativities do not change. But these things do change over time: and it is only right to take some account of that. Population change is clearly an important factor of this kind. Since 1979, Scotland's population has declined while England's has increased - and both these things are relevant. The Scottish block baselines have been adjusted by amounts that reflect the best available data about the change in population levels: that is to say, the percentage changes in population ratios since 1979 have been applied to the block budget baselines for the years covered by the Government's expenditure plans. Provision has been adjusted by £[133]m in 1987-88, £[163]m in 1988-89, and £[190]m in 1989-90.

(c) Comment. The purpose of this adjustment is to bring provision back into line with the real situation on the ground. It is a tiny adjustment in relation to a block budget of £7 billion but a fair one. The block total is still growing annually in cash terms. Scotland has for a long time enjoyed a substantially higher level of per capita spending on public services than England or Wales: this has allowed Scotland to maintain notably high standards in many public services, as compared to the rest of Great Britain. This will remain the position. The population adjustment will allow those high standards to be maintained, even if it means some lessening of the advantage that Scotland enjoys over the rest of the country.

THIS IS WHY THE SCOTTISH
OFFICE BELIEVE THE TREASURY'S

ANNEX D

NOTE OF SCOTTISH OFFICE RESERVATIONS ON ANNEX C PUBLIC PRESENTATION
TO BE FLAWED

The Treasury's draft will not minimise the adverse political reaction given the grounds on which that reaction will be based and the form it will take. The arguments based solely on population change could not be sustained in public debate and the highly technical presentation will not be convincing to the Government's own supporters let alone its opponents. Specific points are as follows:

"Population change is clearly an important factor"

Needs Assessment Survey
But on the evidence in the previous NAS, there are no grounds for claiming that marginal changes in total population are a significant determinant of need in most block services.

"Since 1979, Scotland's population has declined while England's has increased and both these things are relevant".

But there are other important changes in population relativities between parts of the UK. For example the South East of England has seen a significant growth in population. Is it Government policy to increase public expenditure there at the expense of (say) the North East of England to reflect that change? If not, the Government policy would appear to be to impose totally unjustified public expenditure cuts on one territory alone, Scotland.

"The Scottish block baselines have been adjusted by amounts that reflect the best available data about the change in population levels"

a. This will be seen to be totally misleading. It is the formula which is used to adjust the level of provision for the block in a Survey not the baseline, hence any adjustment should be and would be expected to be in terms of the formula. By reducing the baseline instead, the Government is introducing a totally new principle to justify arbitrary cuts. Would Scotland's share of the national cake have been reduced on account of England's increase in population even if there had been no change in Scotland's population? Under the "logic" of this proposal, yes.

b. Not only is a totally new principle being applied but it is being applied retrospectively. All at once Scotland is being penalised for accumulated population changes - including those in England - over a period of 8 years.

c. The cut is being applied to all programmes in the Scottish block when it is abundantly clear that expenditure on many of these programmes is not dependent on marginal changes in total population which make no difference at all to "the real situation on the ground". Expenditure on roads, for example, depends on the size of the country not on small changes in population density. Expenditure on health depends on the number of people requiring treatment and waiting lists in Scotland are longer than in England.

d. The principle that areas suffering a loss of population ought to be further penalised by a reduction in public expenditure is a total reversal of regional and inner cities policies. To offer such a justification for cuts in Scotland would be a banana skin for Ministers.

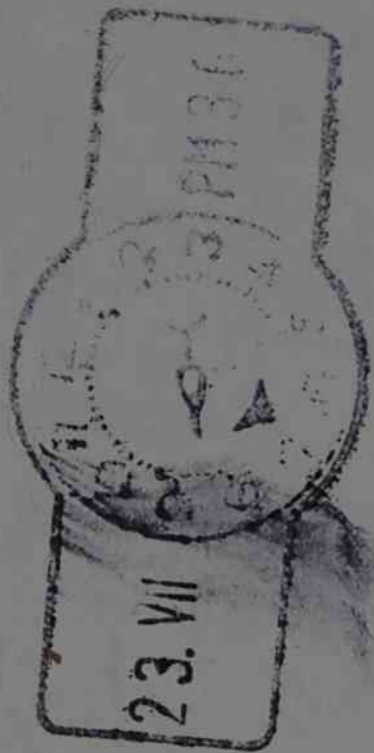
"It is a tiny adjustment in relation to a block budget of £7 billion but a fair one"

£140m would be 2% of the whole block, well beyond the effect of the cuts in cash limits in July 1983 which evoked a considerable outcry and were not confined to Scotland alone. In fact, since local authority current expenditure is dealt with separately, £140m means about 4% on the rest of the block.

"This [higher level of per capita spending] has allowed Scotland to maintain notably high standards in many public services as compared to the rest of Great Britain"

But the public perception is that standards have fallen in many block programmes (such as education because of falling rolls) and that they are already under-resourced. On two major basic services - health and education - Scotland suffers from longer hospital waiting lists and lower educational achievement. Comparisons with "the rest of the country" will invite examination of population changes outwith Scotland where, to be consistent, there would also have to be evidence of similar treatment ie cuts from the North of England where population has also declined and increases for Northern Ireland and the South East of England where it has gone up.

REGIONAL POLICY ; Review PE7





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c. Mr Wicks
No 10

G W Watson
Under Secretary

Mr Roberts

9.6

It is in the Treasury's interest to press the Scots to get on with it, if they want something out of this for this year PES.

J B Unwin Esq
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70 Whitehall
LONDON
SW1A 2AS

9 June 1986

JW
10/6/86

Dear Brian,

TERRITORIAL EXPENDITURE

Thank you very much for your letter of 2 June about the paper for the forthcoming Ministerial meeting.

Kenneth Mackenzie has undertaken to produce a first draft and he hopes to let us have it in the middle of this week. So it looks as if we are unlikely to let you have anything until at least the middle of the week beginning 16 June. I hope this is not too late.

If however Kenneth Mackenzie can advance his timetable at all I am sure he will. But inevitably it will take a day or two to agree the text.

I am copying this letter to Kenneth Mackenzie at the Scottish Office.

G W Watson

G W WATSON