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Prime Minister 2

The Treasury forecast for 1987-88 seems to be based on more optimistic figures than are in fact emerging.

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From: J B UNWIN
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MR NORCROVE - NO 10

cc PS/Lord President

STAR CHAMBER: CURRENT POSITION

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17/10.

The Lord President has asked me to let you have for the Prime Minister a short report on the work of the Star Chamber, which he will wish to discuss when he sees her next Tuesday.

General Position

2. Apart from Overseas Aid (due to Sir Geoffrey Howe's absence) the Group have held initial discussions covering 7 of the 8 disputed programmes. Although this is fewer than last year, the Lord President has asked me to say that in his opinion the resistance, apart from the Defence Secretary, has been the stiffest he has ever known.

3. Although the Star Chamber have made some exploratory proposals without commitment, they have not reached any firm conclusions. They are meeting to discuss tactics on Monday and will start negotiations in earnest during the coming week. The Lord President will particularly wish to discuss with the Prime Minister which issues it would be right to continue to contest very strongly, and on which it would be sensible for the Star Chamber to strike the best deal they can.

4. In view of the provisional nature of the discussions it is far too soon to reach any precise overall judgement. But it is clear that to reach or even come near the targets set for the Group will entail very much greater cooperation from the Ministers concerned than has been forthcoming so far. As the Prime Minister will know, the aim set by Treasury Ministers was to settle within the Reserve in 1987-88, and to leave £3/4 billion and £1 billion of

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the Reserve unallocated in the two later years. This implied settlement of the outstanding "gap" some 70:30 in the Chief Secretary's favour in the first year, and 50:50 and 60:40 in the two later years. The implied outcome of the discussions so far on the first year (on which the Group have concentrated) falls well short of this; on a very rough calculation, it would produce a total some £1/2 billion over the planning total, including the Reserve (and excluding anything extra for teachers' pay). But there is a long way to go, and it would be wrong to reach conclusions yet.

Individual Programmes

5. Since the Group started its work the Chief Secretary has reached bilateral agreement on agriculture and Scottish electricity. He also hopes to reach agreement on coal and on the Chancellor's own Departments, which have submitted large additional bids. These agreements will add some £370, £530 and £330 million respectively in the three PES years. For the rest, I summarise below the position on the main outstanding programmes before the Star Chamber.

Defence

6. Although Mr Younger had made bids substantially above baseline, he seems ready to accept baseline in the first two years and baseline plus an agreed amount for the Falklands (some £127 million) in the last year. There is still an issue over how the baseline in the last year is constituted, whether by a 2 1/2 per cent or 3 per cent uplift. I think Mr Younger may well agree to accept the former, or some acceptable variant, in which case the Group would be inclined to settle with him.

Scotland and Wales

7. The Group have found the problems here exceptionally difficult. Although there are particular differences between the

two sets of bids, the crux of the problem is the unyielding insistence of both Secretaries of State on receiving the full territorial block and formula consequentials of the local authority settlement in England. This would give them both substantial uncovenanted sums which they would propose to use for other (ie non local authority) spending purposes. The preliminary view of the Group is that, although they would like to do so, such a radical step as dismantling the block arrangements entirely is not feasible now. They are, however, exploring the possibility of taking local authority current expenditure out of the Scottish and Welsh blocks and so denying the relevant "consequentials". Another possibility is to make the relative population change adjustment recommended in my report earlier this year. But Mr Rifkind will not accept this; it would reduce his block by £133 million in 1987-88, but by only some £10 million in Wales. The Group are in any case inclined to turn down the other bids outside the block (eg for the Scottish and Welsh Development Agencies) that the two Secretaries of State have submitted. The Group are due to see both Mr Rifkind and Mr Edwards again next Wednesday, and the Lord President would particularly wish to confer with the Prime Minister on this before they do so. If it proved possible to make any of the major changes described above, very careful thought would need to be given to the presentation.

Health

8. Mr Fowler has submitted very large bids (some £460, £410 and £770 million in the three years). The Group have asked him without commitment to show what further savings could be made, and their implications, in order to halve the gap between him and the Chief Secretary. If this were achieved, it would still leave a real growth rate of well over 2 per cent in the health programme in the first year, and roughly 1/2 per cent and 1 1/2 per cent in the later years. The Group will be pursuing this and other possibilities further with Mr Fowler on Tuesday.

Social Security

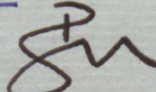
9. With the decision on the uprating, the first year is virtually settled. The Group have asked Mr Fowler to produce for further discussion a list, in ranking order, of possible savings for the later years, but their preliminary judgement is that the scope for making any substantial inroads into the very large (and mostly demand-determined) excesses is likely to be very limited.

Electricity (England and Wales)

10. This ranks so far with Scotland and Wales as the most difficult issue facing the Group. Mr Walker has submitted additional bids on behalf of the Electricity Supply Industry (ESI) totalling nearly £1 billion over the three years. Among other things these predicate real reductions in tariffs over that period of -3.5% -0.5% and -2% respectively. The Chief Secretary is seeking the elimination of most of these bids by assuming that prices would simply keep pace with inflation (ie no real increases). This would in turn imply negotiating tougher financial targets with the ESI, whose projected rate of return is low. Apart from the possibility of a small reduction (£40 million) in the first year, Mr Walker has argued strongly that no further savings are possible, or could be delivered even if he agreed to them. The Lord President has, however, asked him to consider the possibilities further, and he would like to discuss the handling of this matter with the Prime Minister.

Overseas Aid

11. As noted above, the Group have not yet been able to discuss this. They will see Sir Geoffrey Howe next Thursday. The bid is a substantial one (£36, £73 and £117 million) and is related to maintaining the programme at the same proportion (0.31%) of GNP as in 1986. This seems to be an opportunistic switch from the successful bid last year to maintain the programme level in real terms. The Lord President is particularly concerned about the possibility of a strong aid programme lobby (as last year) being mounted.


J B UNWIN