PREM 19/168

PART 11 ends:-

Th to HMT 7.11.80

PART 12 begins:-

C/S EM to FST 11.11.80

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
C (80) 58	22.10.80
C (80) 59	22.10.80
C (80) 60	22.10.80
CC (80) 36th Meeting, Minute 6	23.10.80
MISC 47(80) 1st Meeting, Minutes	24.10.80
C (80) 61	24.10.80
C (80) 62	27.10.80
C (80) 65	28.10.80
C (80) 64	29.10.80
CC ((80) 37th Conclusions, Minute 5	30.10.80
Limited Circulation Annex to CC (80) 38th	
Conclusions	4.11.80
Limited Circulation Annex to CC (80) 39th	
Conclusions, Minutes 3 and 5	6.11.80
CC (80) 39th Conclusions, Minute 4	6.11.80

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed AWayland

Date 4 February 2010

PREM Records Team

CONFIDENTIAL

Econ Pol

Copied to:
Econ Pol: Budget: Pt 4

cc Mr Ingham
Mr Hoskyns.

10 DOWNING STREET

Econ Pol.

From the Private Secretary

7 November 1980

1981 Budget and Public Expenditure White Paper

The Chancellor minuted the Prime Minister yesterday on the above subject - too late for them to discuss it at their morning meeting.

The Prime Minister has now read the minute. She agrees that the Treasury should start planning for a Budget Day of Tuesday 10 March, and that the public expenditure White Paper should be published on Budget Day as it was this year. But she has suggested that it would be better if it could be issued on the morning of the Budget as the Economic Survey used to be, rather than at the end of the Budget speech.

The Prime Minister is not disposed to the idea of a delayed Budget debate unless the Opposition press for it.

T. P. LANKESTER

A.J. Wiggins, Esq.,
HM Treasury.

NPAW

Copied to:
Econ Pol: Budget: Pt 4

1. Mr Scholar
2. Prime Minister

2

This came in too late for your meeting this morning. You can discuss with the Chancellor next week along with the the time-table decisions.

cc Mr Lytton
Mr Hoskyns

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

Agree 10th March. Agree virtually simultaneous publication of White Paper with Budget. ~~[illegible]~~

Believe it should be on the ~~morning~~ of the Budget or the Economic Survey would take. Don't like the delayed debate – which opposition would want. MT.

PRIME MINISTER

1981 BUDGET AND PUBLIC EXPENDITURE WHITE PAPER

In my minute of 4 November I set out my thinking on the handling of policy announcements on public spending, monetary policy and so on over the next month or so. Before we meet on 6 November I thought you might like to know also of the timetable I have in mind for the 1981 Budget and publication of the public expenditure White Paper with details of our plans to 1983-84. Perhaps we can then have a word about this aspect at the same time as we discuss the handling of things over the next few weeks.

The White Paper

2. We need to present the spending figures for all programmes, not only for 1981-82 but for later years, in a medium term fiscal context, showing how they relate to our financial and monetary strategy. The best time to do this is with the 1981 Budget next spring - hence John Biffen's proposal in C(80)58, which I endorse, for publishing the public expenditure White Paper on Budget Day again next year. This year's simultaneous publication was of course welcomed by many outside commentators and by the Treasury Committee as helpful in giving a more

coherent presentation of economic strategy. It proved too to be very much in line with one recommendation of the Armstrong Report, published subsequently.

3. I take this opportunity of mentioning that I am having further work done on the possibility of including in the White Paper itself some information in terms of planned or forecast cash spending, rather than just volume figures. I cannot be definite at this stage about how much progress we shall be able to make on that for the coming year, but I will keep you informed.

4. For the moment I should be grateful to know whether you would be content with publication of the White Paper at Budget time. I would propose to make clear our intentions on this in any announcement on 1981-82 spending generally, of the kind foreshadowed in my minute of 4 November.

5. There is one aspect of simultaneous publication of the White Paper and the Budget to which we may need to give further consideration. Mr. Callaghan remarked this year about the case for the House having the White Paper (and by implication the traditional Budget documents) 10 days or so "before the Budget". I do not think this request can be met in the terms in which it was put. But one possibility for going some way to give the House more time to consider the Budget proposals before debating them would be to release the documents and announce our proposals on the Tuesday, as is traditional practice, but to resume the Budget Debate not the next day but on the Monday of the following week. There would be some disadvantages in this - e.g. more time for the Opposition to marshal their

I doubt that the Opposition would like this - they wouldn't be able to mount a sustained attack quickly enough!
MS

attack - but by the same token it would give us more time to influence the climate of opinion and on balance I think the idea worth considering further. But before I do - which would involve talking to Norman St. John Stevas and Michael Jopling - I should be grateful for any views you may have.

Date for 1981 Budget and White Paper

6. I have considered this in the light of last year's experience and I am asking my Departments to plan for the time being for a Budget Day of Tuesday 10 March. An early Budget has important revenue advantages - especially next year when we shall need all we can get. The earliest date we can manage is to be preferred if simultaneous publication of the White Paper is not to mean undue delay in telling the country (including suppliers to the public sector) of our detailed plans. (Departments will of course be able to do their own budgeting for 1981-82 as soon as programme figures are decided and without waiting for the White Paper.) 10 March will also enable us to get the Finance Bill second reading through before Easter.

7. Of course no final decision on the Budget date is needed until the New Year and it is best to hold options open until then in case unforeseen developments change the balance of advantages. But it would be helpful to know that you are content with a planning date of 10 March.

(G.H.)

6 November 1980

SECRET

File

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Econ Pol

10 DOWNING STREET

From the Private Secretary

6 November 1980

When the Chancellor and the Prime Minister met this morning, they discussed very briefly the proposal to increase an employee's national insurance contribution (Richard Tolkien's letter of 5 November refers). The Chancellor said that he was thinking in terms of an increase which would yield £1000 million in 1981-82 as one means of bridging the PSBR gap. The distributional effects of such an increase, if combined for example with an 11% increase in tax thresholds, would not be excessively regressive. If he were to go down this route, early primary legislation would be required. He would be considering the matter further in consultation with the Secretary of State for Social Services; but wanted to have the Prime Minister's initial reaction first.

The Prime Minister said that she was in principle in favour of the proposal.

T.P. LANKESTER

A.J. Wiggins, Esq.,
HM Treasury.

SECRET

~~Copied to~~
~~Public Sector Pay.~~

MR. INGHAM

MR. GAFFIN

PRESS OFFICE

MR. LANKESTER

RSG Announcement

Mr. Heseltine's office have confirmed to me that Mr. Heseltine does intend to use the 6 per cent figure when he sees the local authority employers at 6 p.m. this evening. This is notwithstanding the impression given by DoE Information Division that he will merely give a broad indication of the range.

As regards a public announcement, the DoE are hoping to insert into a reply to a Treasury PQ on Clegg the decision on the RSG pay assumption. That would be so timed as to enable them to say that Parliament was informed at the same time as the employers. It is therefore likely that around 6.30 this evening the story will break that the Government is operating a 6 per cent pay policy for its employees.

I checked what formula Mr. Heseltine would be using for referring to Central Government pay. Mr. Heseltine had recorded, in his own handwriting during Cabinet, the following:

> "The Central Government will be operating broadly within the same financial disciplines."

JV.

6 November, 1980

J. M. M. VEREKER

PRIME MINISTER

MEETING WITH THE CHANCELLOR: THURSDAY 6 NOVEMBER

You will want to take stock of the public expenditure position prior to Cabinet and discuss the tactics for handling. You will, in particular, want to take a view with the Chancellor on whether it is worth having a further public expenditure Cabinet if - as seems likely - we do not get near his target. (In effect, we are £150m further away from his target now in the light of the E decision this afternoon on nationalised industries' EFLs.)

The Chancellor also wants to discuss the timetable for announcements (see his note at Flag A); and also the issue of the employees' national insurance contribution (see papers at Flag B).

I have mentioned to the Treasury your concern about the fact that all nationalised industry borrowing is included in the PSBR, including borrowing for profitable investments by, for example, British Telecom. The Treasury have in fact been looking at this again, and they are still adamant that there would be no mileage in taking such borrowing out. But I think they would be prepared to put a paper round to E Committee: I think this might help since there are a number of Ministers, including Treasury supporters, who are sceptical of the Treasury's arguments.

TPL

pp T. P. LANKESTER

5 November 1980

16

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

5 November 1980

T. Lankester, Esq.,
Private Secretary,
10, Downing Street

Dear Tim,

The Chancellor proposes to raise with the Prime Minister tomorrow the possibility of increasing employees national insurance contributions (ENIC) as one step to close the "PSBR gap" in 1981-82.

There are, of course, a variety of inter-related issues involved here: I am therefore attaching some papers which the Chancellor hopes the Prime Minister will find useful as background to their talk.

Yours ever,

Richard Tolkien

R.I. TOLKIEN

1b

Top copy destroyed
as PM written on this one

SECRET

1. MR BAILEY [initials] 5/11

2. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Minister of State(C)
Minister of State(L)
Sir D Wass
Sir A Rawlinson
Mr Middleton
Mr Battishill
Mr Unwin
Mr C D Butler
Mr Ridley
Mr Cardona
Mr Cropper
Mr Green (IR)
Mr Gracey(IR)
PS/Inland Revenue

EMPLOYEES NATIONAL INSURANCE CONTRIBUTIONS (ENIC)

Following your meeting yesterday we have put together the attached note intended as aide memoire for any discussion you may have with the Prime Minister or other colleagues.

Decisions.

2. The question for decision is whether you want to go for more than £250 million for 1981-82 by this route. We assume that you will want to go at least for this, which can be secured without immediate primary legislation, either by way of a "normal" increase in employees contribition rates or (subject to further legal advice) as an addition to the "health stamp".

3. Whether or not you want to go for more depends on your assessment of:-

(a) your need for help with the 1981-82 PSBR in the light of other factors such as the outturn of the current public expenditure discussion;

(b) the relative disadvantages of ENIC compared with other taxation and quasi taxation measures (bearing in mind of course that in the light of (a) then there might not be too much choice);

(c) the desirability, notwithstanding (a) and (b), of playing safe and not giving up these additional 1981-82 funds now - if it turned out that you did not need them you could always, come Budget time, "give them back".

22/5

4. Our advice would be that if the fiscal stance is to be held, the risk of

giving up say £500 million or £750 million of 1981-82 revenue now is very great. It would seem wiser to go for the safer course, standing ready to make other concessions in your Budget if this proved possible when the time came. And there is the point, made at your meeting yesterday, that this measure would not, technically, count as a "Budget measure" which presentationally would ease the position next March anyway.

5. As for amount, you could go for £750 million,(or 0.75% on the employees rate);made up of £250 million "normal" increase, £250 million health, and £250 million Treasury supplement to the fund. Or, if you wanted, to go for £1000 million,(or 1.0% on the employees contribution), the Treasury supplement to the fund. could be made to raise £500 million.

6. The table attached to the the note below shows how these would effect people at different levels of income, and how the position would look after tax thresholds had been held back to 11% increase. This holding back of itself, of course, yields a further £700 million.

7. This route requires early primary legislation, ideally to be obtained before Christmas but at any rate by around the middle of January. We are told that technically it would be extremely simple to draft.

Consultation.

8. I attach a letter below for you to send to Mr Jenkin. This is on the basis that you will want to go for either £750 million or £1000 million. Mr Jenkin may not be happy, but he is not in a position to challenge your judgement as to what you need to carry through your fiscal strategy. The letter to Mr Jenkin also makes it clear that you are looking for an upper earnings limit of £200 per week; any lower figure loses money and arguably increases regressivity.

9. Because of legislation, it is also necessary at an early stage to consult with Mr St John Stevas and Mr Jopling. They are already on notice that you may want to do this, and it does not seem that any further approach to them is needed until a firm decision has been reached. We will continue to keep in touch with their officials. But it would be very desirable for sufficiently firm decisions to be taken now for Counsel to start drafting early next week.

SECRET

Down-rating of Social Security Benefit.

10. Of itself the down-rating proposal is not, strictly speaking, relevant to ENIC. It is for settlement in the public expenditure context, and will come up at Cabinet tomorrow. But assuming that the down-rating is agreed we need to get the PSBR savings as well as the public expenditure savings - Mr Jenkin has agreed to this - which means not letting this down-rating lead to lower contributions than would otherwise be the case. There are two approaches:-

(a) carry through the "normal" contributions on the basis of no down-rating, and let the PSBR benefit of the down-rating work through by way of a larger surplus than would otherwise happen;

(b) allow the down-rating to affect the "normal" re-rating, but pick up the "loss" through a bigger reduction in the Treasury supplement than would otherwise be the case.

11. The choice really depends on whether a decision and announcement about the down-rating has been taken/made before the Parliamentary process in respect of the ENIC ~~re-rating~~ (whether Order or legislation) comes before the House in December. If it has, then the second course appears preferable. Immediate decisions are not required.

Summary.

12. To summarise, the position is as follows:-

(a) if you want to raise no more than £250 million through ENIC no early primary legislation is needed and we can run the normal contributions review and/or the health stamp idea with little difficulty (~~no later~~ subject to legal advice);

(b) but if you want more, early primary legislation is needed;

(c) it seems likely, in the light of current difficult developments, that you will need at least £500 million or £750 million more. A decision on this is needed;

(d) the table attached below shows the effects on individuals of various levels of ENIC against an 11% threshold increase;

(e) if you decide to go for £750 million or £1000 million, you will need to discuss it with the Prime Minister (as you intend) and obtain her agreement;

(f) As a quasi-budgetary matter it does not appear that the agreement of other colleagues is necessary. But clearly you will want to carry Mr Jenkin with you and a draft letter is below, which might be despatched after your talk with the Prime Minster. You will also have to carry the Leader of the House and the Chief Whip in order to get the necessary legislative time and to secure the services of Counsel.

(g) The down-rating of social security benefits is a slightly different matter, but could affect the detail and presention of ENIC depending on what is decided.

(h) Final decisions whether to go for additional sums under ENIC, or whether to abandon obtaining a full year's income for 1981-82, must be taken by 14 November. However, it would be very desirable indeed for you and the Prime Minister to decide now that the likelihood of going ahead is sufficiently strong for Parliamentary Counsel to embark on drafting.

13. As a post-script, I should add that DHSS officials say their Solicitors have grave doubts whether Mr Jenkin, as he apparently suggested in Cabinet, can increase the health stamp without very early primary legislation. Their view is that while after the event it might be possible to turn part of the insurance contribution into a health contribution, this could only be justified if no previous decision to do so had been been taken. If there were such a decision, it would not be proper to use the existing legislative machinery. The attached note covers the doubt on this point by referring to the need for further legal advice in the matter. But since you are likely to go for more than £250 million anyway, the point is academic.

EPK

E P KEMP
5 November 1980

EMPLOYEES NATIONAL INSURANCE CONTRIBUTIONS

This note considers ways of raising further sum from employees via the national insurance machinery (ENIC) to benefit the PSBR for 1981-82.

2. There are three inter-linked considerations:-

(a) The normal national insurance contribution review. The Government Actuary estimates that without change in present rates (and assuming the upper earnings limit goes from £165 per week to £200 per week, and that there is full uprating of benefits - see paragraph 7 below) the Fund will run at a deficit of about £200 million in 1981-82. Given the current year's surplus and the accumulated surplus, this does not demand an increase in contribution rates, but it could justify an increase in employees rates (at present 6.35% and 3.85% for contracted in and contracted out employees respectively) of 0.25%, on the grounds that the balance in the Fund should be maintained in real terms. This would raise about £250 million, and would be permissible without further primary legislation.

(b) An increase in the so-called "health stamp". Ministers have decided that in lieu of cutting gross spending on the health service and in order to replace lost income from charges, the health stamp could be increased. An increase in the employees health contribution (at present 0.40%) of, again 0.25% would be required to raise £250 million to cover this. Primary legislation would certainly be needed in due course for this; whether or not very early legislation is required is for legal advice. (Note: it is certainly not possible to do 2(a) and 2(b) together without very early primary legislation).

(c) A reduction in the Treasury supplement to the Fund. A reduction of 1.7% or 3.3% would reduce the supplement paid into the Fund by respectively £250 million and £500 million, which would benefit the PSBR; the difference on the Fund would be made up by an increase in employees contributions, which would have to go up by 0.25% or 0.5%. Very early primary legislation would be required for this. (By very early it is meant by ideally Christmas and certainly not later than around the second or third week of January).

On the employee the effects of (a), (b) and (c) taken together would be to increase his overall contribution from the present 6.75% by 0.75% or 1.0%, depending on what is decided under (c), to 7.50% or 7.75%. These percentages apply to earnings between the lower earnings limit, likely to be around £27 per week, and the upper earnings limit (assumed to be £200 per week). The total raised would be £750m or £100m.

3. The attached table shows the effects on individuals of various combinations of 2(a) to 2(c), giving the immediate reduction in take home pay at various levels and inserting it alongside the increase in take home pay of tax thresholds were, for example, raised by 11% next year.

4. 11% would be the amount required on present forecasts to give the full increase in social security benefits at November 1981. A threshold increase on this level would roughly halve the "clear water" between the single pension and the single persons tax threshold but still leave something; if social security benefits are held back to 8%, as is proposed, then comfortable clear water is maintained.

5. Holding back most social security benefits by 3% gives savings on the public expenditure forecast of some £200 million in 1982-82 and over £500 million in later years. Decisions on this are to be taken separately as part of the public expenditure exercise. But it is relevant here to consider how the PSBR saving consequent on this holding back should be obtained. There are two ways:-

(a) as in 2(a) above, assuming full uprating of benefits and letting the PSBR advantage arise as a surplus on the fund.

(b) Reflect the down-rating at 2(a), but take a bigger reduction in supplement at 2(c).

The same PSBR advantage is obtained. The choice depends on whether and when decisions/announcements on the down-rating are taken/made.

Decisions.

6. The questions for decision are:-

(a) How much should be sought to be raised through this route;

(b) if £250 million or less. It appears that early primary legislation is not needed if the normal national insurance contribution route is followed (2(a) above). Legal advice is required as to whether this amount could be raised through the health element (2(b)) without very early primary legislation;

(c) if more than £250 million is required then legislation is needed before the second or third week in January 1981. The question for decision is how the amount sought to be raised should be split between the normal contribution (2(a) above), the health element (2(b)), and the Treasury supplement approach (2(c)).

Timing and Announcement.

7. Final decisions are needed by 14 November if they are to be reflected in the Government Actuary's report and the Industry Act forecast and the necessary legislation put on course. (Indeed it would be desirable to have a decision in principle earlier than then for legislative purposes in order that Counsel be put to drafting.) The announcement could be associated with the clutch of announcements to be made around 25/26/27 November.

SECRET

Notes

① Net + indicates an increase in take-home pay;
② " – " " decrease " " " ";
③ These changes are in money of the day, ie they say nothing about the real burden of NI contributions and income tax.

Cash effect on a single person at different income levels of:

(i) increasing tax thresholds by 11% and
(ii) raising ENIC by various percentages

ENIC increase	revenue raised by ENIC change	revenue raised (compared with full indexation) by holding down increase to 11%	£50 per week			£75 per week			£100 per week			£150 per week			£200 per week		
			NIC	Tax	Net	NIC	Tax (pence	Net	NIC per	Tax	Net week)	NIC	Tax	Net	NIC	Tax	Net
¼%	250	600	−12½	+86½	+74	−18¾	+86½	+67¾	−25	+86½	+61½	−37½	+86½	+49	−50	+86½	+36½
½%	500	600	−25	+86½	+61½	−37½	+86½	+49	−50	+86½	+36½	−75	+86½	+11½	−100	+86½	−13½
¾%	750	600	−37½	+86½	+49	−56¼	+86½	+30¼	−75	+86½	+11½	−112½	+86½	−26	−150	+86½	−63½
1%	1 000	600	−50	+86½	+36½	−75	+86½	+11½	−100	+86½	−13½	−150	+86½	−63½	−200	+86½	−113½

i. For married men, add 52p to net figure in all cases (because an 11% increase in the married allowance is worth more than in the single allowance).

ii. For higher incomes (above about £250 a week) the increase in personal allowance is worth more in cash terms because of higher rate tax, but NIC remains the same as for £200 a week. Eventually the net cash losses are eliminated and become net cash gains at the highest levels (though not, of course, in real terms).

Notes

1. An increase in ENIC is proportionate (ie neither progressive nor regressive) on earnings between £27 and £200 a week (the earnings ceiling). Above £200 the amount does not increase (ie it becomes regressive).

2. An increase in ENIC has no staff cost.

3. An increase in ENIC affects earners only - not pensioners or unemployed.

4. A tax threshold increase gives a flat rate amount to everyone in the basic rate band (taxable income up to £11,250). Within this band less than full indexation is regressive as compared with full indexation; and hits hardest those brought into tax for the first time.

5. To those above the higher rate threshold, a threshold increase gives more (in absolute terms) than to basic rate taxpayers, the amount depending on the individual's marginal rate.

6. Putting up thresholds by full 15% indexation saves 290 staff, and reduces taxpayer numbers by 400,000. 11% indexation cuts the staff saving to 50 and reduces taxpayers by 100,000.

7. Present "clear water" between single allowance and widow's pension is £90. To keep the gap at £90 needs 13½% on thresholds, if pensions go up by 11%. 11% on benefits and thresholds cuts the gap to £56. If benefits increase by 8%, the gap compared with 11% on thresholds becomes at least £75.

SECRET

DRAFT LETTER FOR CHANCELLOR TO SEND TO SECRETARY OF STATE FOR SOCIAL SERVICES

cc Prime Minister

NATIONAL INSURANCE CONTRIBUTIONS

We have spoken informally about the options for reducing the PSBR in 1981-82 through employees national insurance contributions. I am now writing with a formal proposition.

2 The proposal is that we should take legislation to reduce the Treasury Supplement to the National Insurance Fund so as to reduce the PSBR by a clear £500 million (over and above the £500 million that may be necessary for Fund and NHS purposes) and make up the difference in income to the Fund by raising the rate of employees' contributions payable from 1 April 1981.

3 There are two reasons for this:

(a) If we are to achieve the desired target for the PSBR next year we shall certainly have to reduce public expenditure. I may also have to contemplate increases in taxation. To the extent that Cabinet cannot agree to the full public expenditure reductions, the option of raising taxation through less than full revalorisation of personal tax thresholds becomes more likely. If I can achieve a contribution from the National Insurance Fund, my taxation options become easier.

(b) The Treasury Supplement to the NIF has stood at 18% of net contributions since 1975, despite a rapid growth in the volume of non-contributory (i.e. Exchequer-financed) benefit payments. There is a case for re-adjusting the Exchequer contribution to contributory benefits and placing the burden of readjustment on employees. Industry has carried a considerable share of the burden of economic adjustment so far. It is right that we should relieve employers of the additional contributions and ask those in employment to contribute more to the costs of payments to the unemployed.

4 You will be considering, in the light of information from the Government Actuary, what the levels of contribution should be for 1981-82 as part of your normal review. You will also be considering what the NHS contributions should be, following Cabinet's decisions on Tuesday 4 November. I should be grateful if you would also take my proposals into account. The level of contributions will of course be your responsibility. I hope however that you will aim to set the level of normal contribution so as to maintain the b alance in the Fund in real terms and to go to the maximum permissible under the legislation for the upper earnings limit (i.e. to £200 pw). I attach a note setting out the inter-relationship between these three issues in more detail (though not the table).

5 If we are to secure the increase in contributions from 1 April 1981 and give employers the usual notice for adjustment of payrolls etc, the legislation will have to be passed through its main stages by very early in the New Year. And we shall have to be ready to introduce it soon after the start of the new Session.

/The Prime Minister has agreed that Parliamentary Counsel should draft the necessary legislation. I suggest we aim to go to Legislation Committee on 18 November./

6 I am sending copies of this to the Prime Minister /and the Leader of the House and Chief Whip and Sir Robert Armstrong./

15

Ref: A03461

SECRET

PRIME MINISTER

Cash Limits, RSG and Public Expenditure

We have put cash limits as the first item on the agenda (after the stock items) because the Chancellor of the Exchequer is very anxious to have decisions which he can announce later in the day, ahead of the CBI Conference. There may be problems on two points:-

(a) If the Cabinet are willing to agree a percentage factor on pay for cash limits, they may be content that it should be announced very soon, before the CBI Conference. There may be greater reluctance to agree upon the prices factor, since the figure there interacts with the 2 per cent volume cut. There is deep suspicion of the Treasury, because, although the 11 per cent for prices is presented as a "low realistic" factor, spending Departments fear that the Treasury is looking for some volume squeeze out of that, on top of the 2 per cent volume reduction. It may be argued that the decision on the prices factor should not be taken until the public expenditure decisions have all been taken too. From the point of view of the CBI Conference it is presumably the pay factor that matters. Would the Chancellor be prepared to consider announcing the pay factor only at this stage? The prices factor will have to be disclosed when the RSG announcement is made; but that would at least see us through until the discussions on public expenditure reductions is complete.

(b) Some colleagues may ask the Chancellor to postpone his announcement until Friday morning, to give time for preparatory warnings to staff associations and other preparations of that kind. I expect that the Chancellor will be reluctant to postpone even until Friday morning; but if there is pressure on this he might buy some goodwill by bowing to it. He would not lose anything from the point of view of the CBI Conference.

SECRET

2. After you have taken cash limit factors, you will wish to take the Rate Support Grant paper. Decisions on that are also urgently required for operational reasons. It is crucially important for the RSG decision that the 1 per cent cut in local authority current expenditure (including education) should be agreed. You may wish to confirm that all the Ministers concerned are agreeable. You will remember that the Cabinet agreed the cut in education, ~~I understand~~ on the understanding that everybody else took their share.

3. If and when we come back to other public expenditure, I think that (for reasons I have explained in a separate minute) it would be premature to resume the discussion on defence. Both the Chancellor and the Secretary of State for Defence are content to leave over further Cabinet discussion until next week.

4. I understand that the Chancellor would like to take the other programmes in the following order:-

Scotland

Wales

Social Security

Education (the 2 per cent cut for cash limit programmes)

5. There is clearly going to be unfinished business which we ought to try to complete next week. There is other business to do on Thursday, 13th November, and I do not think that we can count on being able to complete the public expenditure business and the rest of the business in that meeting alone. I fear that you may have to call your colleagues for a meeting of Cabinet on the morning of Tuesday, 11th November.

RA

(Robert Armstrong)

5th November 1980

Copied to: Econ Pol Strategy: Pt 7 14

Ref A03459

PRIME MINISTER

I have seen a copy of the Chancellor of the Exchequer's note of 4 November about the timetable for announcing decisions on public expenditure and other matters.

2. The Chancellor will probably be reluctant to contemplate anything that could be described as an Autumn Budget. But the case for a comprehensive announcement of decisions, not just the cash limits and the Rate Support Grant (which have to be announced in November anyway) but also on public expenditure reductions and on tax proposals, seems to me to become increasingly strong.

3. It is widely believed outside that the Cabinet is looking for reductions in public expenditure of the order of £2,000 million. What is actually achieved is likely to become as widely known as the objective. The further achievement falls short of the objective, the greater the damage to the credibility of the Government's strategy, the greater the fear of a very high PSBR next year, the more damage will be done to prospects and hopes of a fall in interest rates and of the exchange rate. Indeed, expectations could force both interest rates and the exchange rate still further up.

4. These effects could be much reduced, credibility maintained, and the prospect of reduced interest rates held out, if the Chancellor could demonstrate that by a combination of agreed cuts in public expenditure and specific changes in taxation he would be able to keep the PSBR next year down to the sort of level he has in mind (which seems to be somewhere about £9 to £9½ billion). That would also provide a framework for whatever monetary decisions - either on rates or on techniques - he wanted to announce.

5. You will remember that in 1968 Roy Jenkins announced public expenditure cuts in January but postponed his tax announcements until Budget time. He came to regret the postponement, because the expenditure decisions were not credible without the tax decisions, and there was a very difficult three month period between the two.

6. There is in any case something to be said, in terms of impact upon industry and markets, for getting all the agony out and over in one fell swoop, rather than paying it out in instalments. People then stop expecting more agony, and begin to look forward to the possibility of better things; and industry may then be more disposed to hold on to markets and accept lack of profitability for a little longer, because they see the prospect of improvement more clearly.

RA

ROBERT ARMSTRONG

5 November 1980

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

CASH LIMIT FACTORS AND PAY

In my minute to you yesterday about the possible timetable for a number of announcements, I said that I thought it was important to announce the pay and price factors in the cash limits this week, so as to get the press coverage before the CBI conference.

2. The subsequent developments in the firemen's dispute mean that we ought to do everything possible to make the announcement tomorrow (Thursday), and to secure the maximum publicity for it, in order to influence the resumed negotiations on Friday. One of the questions tabled for Oral Answer tomorrow provides a natural opportunity to do this. I would therefore like to announce in the Answer the actual factors, and then to circulate in the Official Report the fuller statement which I originally had in mind for a Written Answer.

3. Such an announcement is, of course, dependent on reaching agreement on the factors at Cabinet tomorrow. I hope that you will agree that this is of sufficient importance for you to arrange the agenda so that we can resolve this item - I do not think that it needs to be held up for those decisions on public expenditure programmes which are still outstanding.

4. I attach a copy of the statement in the form in which it would be circulated in the Official Report. The fourth paragraph is there in order to ensure that we do not run into the same trouble as we had with the Select

/Committee

Committee this year. You will see that the problem of the carry-over from the staging this year is dealt with on the basis which I put to E: this too will need to be confirmed tomorrow.

5. I am sending copies of this minute to all members of Cabinet, the Minister of Transport, and Chief Whip and Sir Robert Armstrong.

A Wiggins

for (G.H.)

5 November 1980

(Approved by the Chancellor & signed in his absence)

PASSAGE FOR OFFICIAL REPORT

CASH LIMIT FACTORS FOR 1981-82

Cash limits and Votes for expenditure other than pay will provide for an average level of prices in 1981-82 11% higher than the corresponding level in 1980-81.

The cash limits and Votes for pay will include provision for increases in the level of earnings of [6]% in annual settlements which are due before 1 August 1981. For annual settlements due after that date a corresponding provision of [4]% will be made at this stage.

The cash limits set a framework for negotiations; with the outcome settlements in particular cases will depend on the way in which the cash is allocated.

In particular cash limits or Votes the actual percentage increase between 1981-82 in the provision for pay will differ from these factors because of changes in numbers employed, and because in some cases the settlement date is not 1 April, so each financial year will include a period at the rate before and a period at the rate after the due settlement date. In addition, the increase in the provision for pay between 1980-81 and 1981-82 will be affected in some cases by settlements having being staged in 1980-81 with increases paid later than the usual settlement dates, but such staging not being repeated in 1981-82: this will contribute some 1% to the increase in the total public service pay bill between the two years.

The staging of awards has in the past resulted in a higher rate of pay being carried forward into subsequent years than otherwise would have been consistent with the cash limit. This erodes the effectiveness of the cash limit system and confuses the comparisons of the growth of earnings. The Government therefore think it desirable for the future to avoid the staging of awards, and will avoid it where it is itself the employer. If, this general policy notwithstanding, an employer were to agree to staging an award, the Government would not allow for the element of that award which was financed by staging when it set the relevant cash limit for the subsequent years.

SECRET

Mr Wright (C.O.).
cc Mr. Ingham

Copied to Econ Pol: Strategy, Pt 7

Prime Minister

You can discuss this with the Chancellor on Thursday morning.

TL 4.11.80

13

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

BF 12/11 for mtg with Ch. TL.

PRIME MINISTER

I have been considering the timetable for announcing the decisions we shall be taking in the coming weeks and I thought that you might find it helpful to see the attached schedule which summarises what I have in mind. For convenience the schedule also notes the dates of announcement of important economic statistics and other major relevant developments.

2. As you will see, I envisage essentially a two-stage operation. The first stage is the announcement of the cash limits pay and price factors soon after we have decided them next week. I think it is very important to announce these before the CBI conference on 10 and 11 November, and I envisage a written Parliamentary Question, preferably on Thursday 6 November, but failing that on Friday 7 November so as to achieve maximum impact through the weekend press.

We need the RSG assumptions announced on Thursday to influence the firemen's pay negotiations which have been suspended until Friday. TL

3. The second stage is the announcement of our monetary decisions (which will include the roll-over and any decisions we may by then have taken on monetary base control) together with the Industry Act forecast, which we are required by law to publish by the end of the month, and our decisions on nationalised industries EFLs. There is also the question of any tax decisions that we may take now - principally the possibility of changes on PRT and employees' national insurance contributions. Since I should want to reflect these in the Industry Act forecast, publication of the latter could not precede their announcement. And in any case early announcement would be operationally necessary if any such changes were to take effect from next April.

SECRET

4. What I have in mind is announcement of the monetary decisions in the course of my speech on the economic day of the Debate on the Address. Choice of date will, of course, be a matter for the Opposition. But in the past they have generally chosen the final or penultimate day (i.e. 26 or 27 November) and, with the October unemployment figures being published on 25 November, I would expect them to choose the earlier of the two days. As indicated above, if we had also taken decisions on either of the two major tax possibilities, I would include an announcement in the same speech.

5. I envisage that we should also publish on the same day the Industry Act forecast and our decisions on the EFLs. The former will, of course, reflect the various other decisions announced and will contain among other things our latest estimate of the PSBR for the current year together with at least an indication of our forecast for 1981-82. I am giving further separate consideration to the problems of presentation here. So far as the EFLs are concerned (which we could announce by Written PQ) it will be a pity not to be able to publish them before the NUM delegates conference scheduled for 14 November. But I believe that publication before then of the public service cash limits pay and price factors will do as much, if not more, to set the general tone in the public sector.

6. One item for which no date is given in my schedule is the possible announcement about our intentions on public expenditure generally, with at least such information about particular decisions or programmes as is necessary to make the target credible. There is no doubt that we shall have to say something. Given the intense interest and speculation, we shall not be able to avoid this. And in any case we shall need to demonstrate how the EFLs, which will be manifestly larger than those in the last White Paper, are consistent with

continued adherence to our public expenditure strategy as a whole.

7. I have not yet decided how best this should be tackled. There are some arguments for an announcement before the end of the session (i.e. before 14 November) if we have reached the main decisions by then. If we delay, there will be continued press speculation and the risk of leaks. But on the other hand we may not be ready then to announce any possible decisions on social security. And there is also a case for postponing such an announcement until the statement during the economic debate referred to above, so that we can relate our public expenditure posture to our monetary and fiscal plans as a whole.

Probably best to keep public expenditure decisions for announcement at the same time as everything else.

M.

8. I should welcome an opportunity to have an early word with you about these possibilities.

(G.H.)

4 November 1980

Timetable for Announcement of Policy Decisions

Date	Publication of economic statistics or other relevant developments	Policy Announcement	Comment
November			
4	October banking figures, including provisional money supply		
5			
6	[Possible written PQ on stock relief]		[Trailer for consultative document on 14 November]
7		Written PQ on cash limits pay and price factors.	Assumes Cabinet decide on 4 Nov or 6 Nov at latest. Timed to catch weekend press in advance of CBI conference.
10) 11)	CBI Conference.		
		Local Authority Consultative Council informed provisionally of RSG settlement.	Would include cash limit factors but not necessarily decision on volume change. (Formal communication likely to be on 4 December, preceded by warning of any change in volume).
12			
13	October money supply figures		
14	October RPI Parliament Prorogued.		
17			
18			
19			
20	Queen's speech. PSBR figure for first half 1980-81.		
21			
24	CBI Industry Trends Survey (November).		

25	Unemployment figures (November)		
26	[Proofs of Winter Supplementary Estimates to Select Committees.]	Possible complex of announcements as follows: (a) In speech in economic debate: (i) £M3 roll-over (ii) any decisions on MBC (iii) any tax decisions for 1981-82 (b) Industry Act Forecast up to end 1981 (by press notice or Supplement to Treasury Economic Progress Report). (c) Nationalised Industries EFLs (by written PQ).	Assumes Opposition will choose this day for economic debate. For consideration whether speech should also be vehicle for public expenditure announcement.

56 12 24 1
26

Pub. Exp.
Pt 12.

12B

PAPER FOR CABINET

Copies 2-30 destroyed
except numbers 5, 6, 12, 24, 26.
? taken away from Cabinet.

PUBLIC EXPENDITURE: SOCIAL SECURITY

Memorandum by the Chancellor of the Exchequer

This paper outlines my proposals for savings on the Social Security programme and on public sector pensions.

Social Security

2. The attached Annex outlines 3 proposals. The Secretary of State for Social Services is prepared to accept proposals A and B (savings on shift to monthly payment of child benefit following the Rayner study, and 2 per cent cut in cash controlled expenditure affecting mainly administration). He points out, however, that the proposal to pay child benefit four weekly in arrears has yet to be agreed in its own right, and to that extent the savings must be regarded as provisional. I accept this.

3. Proposal C - a reduction in real value of all benefits in November 1981, including retirement pensions - is clearly very difficult. We shall be accused of "attacking the poor" and of breaking our pledges. Nevertheless in the present situation, given the size of the social security programme, the very difficult proposals we are putting in respect of other programmes, and the fact that we expect prices to be increasing slightly faster than earnings over the next year or so (ie the standards of living of people in work are likely to fall) we have no choice but to tackle this area. The Secretary of State accepts the proposals in principle. But there are, however, some outstanding points yet to be settled.

4. First, exceptions. The Annex also sets out certain exceptions which the Secretary of State would wish to make to the across the board reduction, together with their cost. I believe that in principle there should be no exceptions, but I am ready to concede the first two in the list - war pensioners, and mobility allowance and attendance allowances.

5. The Secretary of State also considers that invalidity benefit recipients, having already received a 5 per cent reduction in this year's uprating, should not suffer a further 3 per cent. In addition the Secretary of State feels that some exception for the poorest of all, namely those on the short term rate of supplementary benefit, is needed if the other reductions are to be carried. This could be done either by continuing to price protect the short term supplementary benefit rates (thus preserving the safety net for those on the lowest rates) or by allowing the long term unemployed, who at present have to make do with the short term rates however long they have been unemployed, to qualify for the long term rates after one or two years of unemployment. In my view to go further than I have indicated would cut excessively into the savings we are looking for and, because a good case can always be made out for a social security benefit, end up creating resentment and risking having to concede more.

6. Second, there is the question of presentation of our decision and the timing of the necessary legislation on pensions. The Secretary of State and I both feel there would be advantage particularly in the context of wage negotiation in announcing a decision soon in terms of "'x' per cent increase" (which on present forecasts would be 8 per cent), rather than "3 per cent reduction". A decision to announce an "8 per cent increase" now would however have to be provisional, in case my final forecast of inflation differs from 11 per cent. The legislation that will be necessary need not be introduced until after the Budget, and the exact form can be settled nearer the time.

7. Finally, I should report that in order to ensure that the PSBR as well as public expenditure benefits from the holding back of contributory benefits, I propose that the legislation include a power to reduce as appropriate the Treasury Supplement to the National Insurance Fund. However as an entirely separate matter I may wish to look to a reduction in the Supplement anyway as a means of helping the next year's PSBR.

Public Sector Pensions

8. As a parallel to the proposals on Social Security I propose that index-linked public sector pensions should be held back at the next uprating also by 3 per centage points. My reason for making this proposal is not solely financial. If state pensions are to be held back it is inconceivable that

we should not take similar action in the area of public sector pensions. We have set up the Scott Enquiry to look at the values of the deduction for index-linking for current employees, but we have not yet touched past employees. For these reasons I would wish the coverage to be as wide as possible. Since this concerns a number of colleagues I propose that the Chief Secretary should circulate a separate paper on the legislative and administrative details. Meanwhile I invite colleagues to endorse the principles of this proposal.

Conclusion

9. I ask my colleagues to :

i. agree the proposals A, B and C in the attached Annex.

ii. consider the possible exceptions discussed in paragraphs 4 and 5 above.

iii. agree the abatement of public sector pensions proposed in paragraph 8, in principle.

HM Treasury
4th November, 1980

ANNEX

£ million 1980 Survey prices

	1981-82	1982-83	1983-84	
Proposal A				
Savings on shift to monthly payment of child benefit, following Rayner study	- 61	- 1	- 13	
Proposal B				
2% cut in cash controlled programmes				
(i) effect in 1980-81 cash limits squeeze	- 11.1	- 11.1	- 11.1	
(ii) further proposed reduction	- 6.3	- 6.3	- 6.3	
Proposal C				
Uprating of all benefits in November 1981 by 3 percentage points less than needed to give full price protection	-175	-504	-504	
Agreed minor additional bids	+ 9	+ 12	+ 14	
Net saving	-168	-492	-490	
Exceptions to C, proposed by Secretary of State				Manpower effect
- Agreed (i) War pensions	+ 4	+ 10	+ 10	Nil
(ii) Mobility and attendance allowances	+ 3	+ 9	+ 9	Nil
Net saving on proposal C	-159	-473	-471	
- Not agreed				
(i) Invalidity benefit	+ 8	+ 24	+ 24	slight saving
(ii) Either short term supplementary benefit	+ 11	+ 31	+ 31	+220
or give long term rate of supplementary benefit to the unemployed either after 2 years	+ 15	+ 46	+ 51	+ 45
or after 1 years	+ 26	+ 74	+ 84	+190
Public sector pensions : proposed abatement - public expenditure savings	- 10	- 30	- 30 (estimated)	

PAPER FOR CABINET

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3. Proposal C - a reduction in real value of all benefits in November 1981, including retirement pensions - is clearly very difficult. We shall be accused of "attacking the poor" and of breaking our pledges. Nevertheless in the present situation, given the size of the social security programme, the very difficult proposals we are putting in respect of other programmes, and the fact that we expect prices to be increasing slightly faster than earnings over the next year or so (ie the standards of living of people in work are likely to fall) we have no choice but to tackle this area. The Secretary of State accepts the proposals in principle. But there are, however, some outstanding points yet to be settled.

4. First, exceptions. The Annex also sets out certain exceptions which the Secretary of State would wish to make to the across the board reduction, together with their cost. I believe that in principle there should be no exceptions, but I am ready to concede the first two in the list - war pensioners, and mobility allowance and attendance allowances.

5. The Secretary of State also considers that invalidity benefit recipients, having already received a 5 per cent reduction in this year's uprating, should not suffer a further 3 per cent. In addition the Secretary of State feels that some exception for the poorest of all, namely those on the short term rate of supplementary benefit, is needed if the other reductions are to be carried. This could be done either by continuing to price protect the short term supplementary benefit rates (thus preserving the safety net for those on the lowest rates) or by allowing the long term unemployed, who at present have to make do with the short term rates however long they have been unemployed, to qualify for the long term rates after one or two years of unemployment. In my view to go further than I have indicated would cut excessively into the savings we are looking for and, because a good case can always be made out for a social security benefit, end up creating resentment and risking having to concede more.

6. Second, there is the question of presentation of our decision and the timing of the necessary legislation on pensions. The Secretary of State and I both feel there would be advantage particularly in the context of wage negotiation in announcing a decision soon in terms of "'x' per cent increase" (which on present forecasts would be 8 per cent), rather than "3 per cent reduction". A decision to announce an "8 per cent increase" now would however have to be provisional, in case my final forecast of inflation differs from 11 per cent. The legislation that will be necessary need not be introduced until after the Budget, and the exact form can be settled nearer the time.

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we should not take similar action in the area of public sector pensions. We have set up the Scott Enquiry to look at the values of the deduction for index-linking for current employees, but we have not yet touched past employees. For these reasons I would wish the coverage to be as wide as possible. Since this concerns a number of colleagues I propose that the Chief Secretary should circulate a separate paper on the legislative and administrative details. Meanwhile I invite colleagues to endorse the principles of this proposal.

Conclusion

9. I ask my colleagues to :

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HM Treasury
4th November, 1980

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Copied to: Social Services
Pt 2: Benefits

Copies of Chancellor's minute to be left in Cabinet room.

12

SECRET

Ref. A03433

PRIME MINISTER

Public Expenditure: Social Security

The Chancellor of the Exchequer proposes to hand out at the Cabinet meeting tomorrow the paper attached to his minute of 31st October to you.

2. Proposal A is for savings which will follow the shift to monthly payments of child benefit following the Rayner study. This was endorsed by H Committee at their meeting on 29th October, but its implementation is subject to the reactions to the proposed White Paper on payment of social security benefits.

3. Proposal B is for relatively modest savings following the application of the general 2 per cent cut on cash controlled expenditure.

4. Proposal C is the main one of uprating all benefits in November 1981 by 3 percentage points less than needed to give full price protection. The Chancellor of the Exchequer has agreed with the Secretary of State for Social Services that war pensions and mobility and attendance allowances should be an exception to that. They have not reached agreement on whether an exception should be made for invalidity benefit or on the treatment of short-term supplementary benefit - the figures are summarised at the foot of the table annexed to the minute.

5. The Chancellor further proposes that the de-indexing should apply to public sector pensions, and that the Chief Secretary should circulate a note setting out the details of this. It is important to note here that 'public sector' embraces both the 'public services' and the nationalised industries and a number of other trading bodies. The public services include the Civil Service, armed forces, NHS, teachers, local government, police and firemen, MPs and Ministers. The pensions of these groups are statutorily linked with state retirement pensions and can fairly readily be dealt with as a whole. The pensions of the nationalised industries and other similar bodies, however, depend on a variety of arrangements whose complexities will not be fully known to the Cabinet until the Chief Secretary's note is available.

HANDLING

6. After the Chancellor of the Exchequer has introduced his paper you will wish to invite the Secretary of State for Social Services to comment. The main proposal is of major political importance and most other Ministers will no doubt wish to comment.

7. The discussion might be based on the proposals tabulated in the annex to the minute. It should not be necessary to spend any time on A - already discussed by H Committee - or B which is non-controversial.

8. The key question on C is whether it is politically on, given past pledges (including your own undertakings in your interview with Brian Walden on 6th January). Notwithstanding the very real political difficulties there are powerful arguments in favour of this measure:-

(i) The size of the contribution to the public expenditure savings - before exceptions, £175 million in 1981-82 and around £500 million in each year thereafter.

(ii) It does not directly affect industry or unemployment.

(iii) The difficulties in the present climate of offering full protection to these groups of people, when many wage and salary earners (including those in the public services) are being expected to settle for less than the expected rate of inflation.

9. If it is accepted that the proposal should not be ruled out, the Cabinet will wish to consider the exceptions. It is common ground that exceptions should be made for war pensions and mobility and attendance allowances. There are obvious dangers in moving on to a slippery slope by giving anything more. The Cabinet may nevertheless feel that in order to get the main measures through, concessions will be necessary on invalidity benefit and, in some way, on short-term supplementary benefit. On the latter, of the options listed, the best seems to be to give long-term rate of supplementary benefit to the unemployed after two years. It would be represented as a general change rather than a further exception to the 3 per cent arrangement. It is the cheapest in terms of demands on additional manpower.

10. The Cabinet may not be able to come to a final decision on public sector pensions - or at any rate on whether any abatement should apply solely to the public services only or to the nationalised industries as well - until they have seen the Chief Secretary's promised minute and have a better feel of the complexities in the nationalised industry area.

CONCLUSIONS

11. In the light of a discussion you should be able to:-

(i) Endorse Proposals A and B.

(ii) Either endorse Proposal C and record agreement on the exceptions to be made

<u>or</u>

agree to defer a decision (even if there were to be strong opposition to it, I suggest that it would be tactically better not to rule it out until the Cabinet is clearer on the overall package - in other words the more concessions the Cabinet decides to make on other programmes, the more it may be necessary to insist on this measure).

(iii) Subject to (ii), agree to an abatement on public sector pensions subject to examination of the details in the minute which the Chief Secretary will be circulating.

D J Wright

(Robert Armstrong)

(approved by Sir R. Armstrong and signed on his behalf)

3rd November, 1980

SECRET

Copied to: Social Services
Prime Minister Pt 2: Benefits.

The Chancellor proposes to hand this round at Cabinet. In view of its sensitivity, I suggest that you (or he) ask that the copies be left in the Cabinet Rm.

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

PRIME MINISTER

PUBLIC EXPENDITURE: SOCIAL SECURITY

We agreed that Cabinet should discuss the Social Security on Tuesday, 4 November.

..... 2. I enclose a copy of the paper I propose to circulate at this meeting, which is based largely on the minute, agreed with Patrick Jenkin, I sent you on 28 October. I have added a reference to the proposal on public sector pensions. I think it would be convenient for Cabinet to take a decision in principle on this as well, though the details can be discussed later with our colleagues who would be concerned.

3. I am sending a copy of this minute to the Secretary of State for Social Services.

P.S. Jenkins
for (G.H.)
31 October 1980
Approved by the Chancellor and signed in his absence.

SECRET

DRAFT PAPER FOR CABINET

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2% cut in cash controlled programmes				
(i) effect in 1980-81 cash limits squeeze	- 11.1	- 11.1	- 11.1	
(ii) further proposed reduction	- 6.3	- 6.3	- 6.3	
Proposal C				
Uprating of all benefits in November 1981 by 3 percentage points less than needed to give full price protection	-175	-504	-504	
Agreed minor additional bids	+ 9	+ 12	+ 14	
Net saving	-168	-492	-490	
Exceptions to C, proposed by Secretary of State				Manpower effect
- Agreed (i) War pensions	+ 4	+ 3	+ 10	Nil
(ii) Mobility and attendance allowances	+ 3	+ 9	+ 9	Nil
Net saving on proposal C	-159	-480	-471	
- Not agreed				
(i) Invalidity benefit	+ 8	+ 24	+ 24	slight saving
(ii) Either short term supplementary benefit	+ 11	+ 31	+ 31	+220
or give long term rate of supplementary benefit to the unemployed either after 2 years	+ 15	+ 46	+ 51	+ 45
or after 1 years	+ 26	+ 74	+ 84	+190
Public sector pensions : proposed abatement - public expenditure savings	- 10	- 30	- 30 (estimated)	

Copied to :- Public Sector Pay

CONFIDENTIAL

2. Prime Minister.

[illegible]

Civil Service Department
Whitehall London SW1A 2AZ
01-273 4400

We cannot return to Pay research as it is at present constituted. It must be more objective and positively reflect fair pay comparisons which although relevant may be unfavourable. M.

The Rt Hon Sir Geoffrey Howe, QC, MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON SW1P 3AG

31 October 1980

Dear Chancellor,

At yesterday's Cabinet we discussed briefly the point made in paragraph 6 of C(80)65 in which you proposed that for cash limits purposes we should decide now on a provisional pay factor for the pay round starting in August 1981; and that this should be two percentage points below the figure we adopt for the pay round which has now begun.

I can well understand the reason for making this proposal. We all hope that the general level of pay settlements will decline and will continue to do so. But I am concerned at the additional strain which this course would place on our efforts in this pay round. It will not be possible for us to disguise the assumption that has been made about the next pay round and it will appear that we are deciding now on what amounts to a two year pay policy for the public services. This is certainly how it will be presented by the unions even if the figure for the 1981/82 pay round is described as only being "provisional". It is far from clear yet how the present pay round as a whole will turn out and it is important for us not to appear at this stage to close off options on the longer term treatment of public service pay. For example it is important we should not give the impression that we are deciding now that pay research cannot return for the non-industrial Civil Service in April 1982. This would belie our recent assurances to the unions that we are prepared to review that possibility in the light of progress in our discussions with them on improvements to present procedures.

It seems to me that there are two courses we could follow which would save us from boxing ourselves in and avoid giving the impression that we are launching an incomes policy, at least for the public services, and at least for two rounds.

a) to use the pay factor fixed for the present round in making provision for any settlements in the 1981/82 pay round which fall within the period of the 1981/82 cash limits. It would be made clear that the provision made for these settlements would be adjusted up or down once we were in a position to make a firm judgement on their appropriate level. I recognise that this would involve being prepared to contemplate "claw back" which would not be easy;

b) to assume a nil increase for those settlements which will fall in the 1981/82 pay round and then to adjust the cash limits upwards nearer the time. This would involve accepting in advance the need for upwards adjustment but would make it clear we were not making any assumptions about the 1981/82 round at this stage.

I would myself prefer either of these courses to the one you propose; it may well be that (b) is the less difficult of the two.

As this is somewhat technical, I thought I would put the problem to you and colleagues on paper before our discussion in Cabinet.

I am copying this letter to the Prime Minister, other members of the Cabinet, including the Minister of Transport and Sir Robert Armstrong.

Yours sincerely,

Buckley
(Private Secretary)

for

SOAMES

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

Econ Pol.

From the Secretary of State

The Rt Hon John Biffen MP
Chief Secretary
HM Treasury
Treasury Chambers
Parliament Street
London, SW1P 3AG

29 October 1980

Dear John.

PUBLIC EXPENDITURE: IMPLICATIONS FOR PSA

In your letter to Michael Heseltine of 7 October, you drew attention to the implications for other departments of reductions in the PSA programme for 1981/82 and later years.

In my letter of 24 June to Christopher Soames on Civil Service manpower and efficiency I said that the staff cuts I was able to offer were conditional on an assumption that "the CSD and the Treasury will ensure that the PSA has the funds to cover accommodation changes needed to cope with contraction, or to enable staff to be employed more efficiently". I trust that the provisions you are making for the PSA in 1981/82 onwards will have taken account of this essential constituent of our staff cuts programme.

An example in my own area is the need to move staff engaged on export promotion work from the City to my Headquarters building in Victoria Street, so that they can be lodged together with other divisions engaged on export work, as the Rayner study recommended. Our ability to cut numbers and improve efficiency is dependant on PSA having the funds to finance such a move.

From the Secretary of State

I am copying this letter to Michael Heseltine, other Members of the Cabinet, Sir Derek Rayner and Sir Robert Armstrong.

Yours ever

John.

JOHN NOTT

1

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

29 October 1980

Prime Minister has seen
C Stevens 29/10 DC

T Lankester Esq
Private Secretary
Prime Minister's Office
10 Downing Street
LONDON SW1

Dear Tim,

PUBLIC EXPENDITURE - THE SOCIAL SECURITY PROGRAMME

Amended!

Annex C of the Chancellor of the Exchequer's minute to the Prime Minister of 29 October should be replaced by the slightly amended version attached.

I am copying this letter to David Wright and Jim Buckley.

Yours,
Peter.

P S JENKINS
Private Secretary

Econ Pol

Ref. A03392

PRIME MINISTER

Rate Support Grant Settlement 1981-82

(C(80) 61)

BACKGROUND

The annual Rate Support Grant (RSG) Settlement is always a difficult one to handle in Cabinet because of the interlocking complexities of the subject, and the impact the decisions have on the fortunes of individual local authorities. This year the problem is compounded by the changes being made in the grant support system itself. In an attempt to ease the decision-taking task of Cabinet you asked the Home Secretary to chair a group of the Ministers most closely concerned (the Secretaries of State for Industry, Social Services, Education, Scotland, Wales, Trade and the Chief Secretary, Treasury, and the Minister of Transport) to consider the problems and make recommendations to Cabinet. The paper now before colleagues (C(80) 61) is their report. The Group have gone as far as the subject allows, in simplifying the issues. Even so, those colleagues who have not previously been involved may well find the subject difficult, and it would, I think, be helpful to them if they could be led orally through the subject by an expert colleague. I understand that this proposal has already been put to you, and that you have agreed that, after a brief introduction by the Home Secretary, Mr. Heseltine should be asked to open discussion and take the Cabinet through the subject.

2. At bottom, colleagues have to decide on three key issues: the grant distribution formula; the cash limit numbers and the level of RSG payable. They also have to decide on the treatment to be afforded to Wales; the arrangements to govern the settlement for Scotland; and, almost as an incidental, the public presentation of any decisions on police pay.

3. On the grant distribution formula, MISC 21 was in agreement in recommending that described in paragraphs 3 to 6 of the paper. There is no reason why any colleague should object to this decision. Equally, it is unlikely

that anyone would object to the agreement reached in MISC 21 that the Welsh share of the England and Wales grant should be retained unchanged this time round.

4. The figures used for illustrative purposes in the paper have been based on an 8 per cent cash limit for pay and an overall cash limit (pay and prices) of $10\frac{1}{2}$ per cent. In the final settlement the cash limit figures here will need to be brought into line with those which the Cabinet will have agreed earlier in the discussion should be applied to the public services in general.

5. The setting of the cash limits is one part of the process of establishing a base against which grant decisions must be taken. The other important part is the decision on the volume of spending to be financed. This is the point at which the decisions on the RSG settlement will be closely dependent on the decisions which the Cabinet has to reach separately on the Chief Secretary's proposal to call for a reduction in the volume of local authority spending next year by 1 per cent. Decisions to call for reductions in local authority expenditure affect public spending totals (provided that they are effective); the RSG percentage decision is a decision, not on public spending but on the distribution of the burden of paying for that spending between tax and rate payers.

6. So the choice posed in the paper between a grant level of 61 per cent and one of 60 per cent is very much a political one, deriving as much from expectation of rating increases as from the level of expenditure to be financed. Although paragraph 10 is carefully worded to avoid saying so, the reality is that almost every Minister in MISC 21 thought that the grant percentage should be held this time to 61 per cent, and only the Treasury strongly backed 60 per cent - though Mr. Heseltine may now have changed his mind.

7. The paper raises in paragraph 17 the question whether the pay element in the cash limit should be separately identified. On the face of it there would seem to be every reason to do this, given that the figure will be the standard number adopted for the public services as a whole. The one snag is the presentational difficulty caused by the present arrangements to index police pay.

If indexing were to continue, the standard provision for pay would be different in local authorities from the rest of the public services: but, if the same figure is used throughout, it will be taken as evidence that the Government has dropped its commitment to index police pay. It may be that this issue too will be resolved in the course of the discussion on cash limits. If not, a separate decision on presentation will be needed, as pointed out in paragraph 19 iii.

8. It is normal for Scottish arrangements to be settled in the light of the decisions taken for England and Wales. Conclusion 19(iv) seeks authority for the Secretary of State for Scotland and the Chief Secretary, Treasury, to reach the normal consequential settlement without further reference to Cabinet. No-one is likely to object.

HANDLING

9. As already agreed, you might ask the Home Secretary briefly to introduce the subject and then ask the Secretary of State for the Environment to take the Cabinet through the conclusions in paragraph 19 of the paper.

CONCLUSIONS

9. These will follow the display in paragraph 19, and should emerge naturally from the discussion. In taking his colleagues through the conclusions, Mr. Heseltine may well urge the timetabling need to arrive at specific conclusions at the present meeting (his letter of 27th October to the Chancellor of the Exchequer points to the Parliamentary and timing problems which delayed decisions would cause). A lot will depend upon the outcome of the Cabinet's discussion on cash limits, the 1 per cent proposed cuts in local authority expenditure and the related decisions on education. But, even if it is not yet possible to reach final decisions, it would still be very helpful to reach provisional conclusions.

D J Wright

(Robert Armstrong)

(approved by Sir R. Armstrong and signed on his behalf).

29th October, 1980

Copied to :-
Loc Govt : Part 4
Relations between Central and Local Govt.

9

Ref. A03391

PRIME MINISTER

Public Expenditure Programmes

(C(80) 58, 62 and 64)

The Chief Secretary's proposals for increases and reductions in individual programmes were summarised in his memorandum C(80) 58. As agreed by Cabinet, ref in Item 5(a) last week the Chancellor of the Exchequer, the Home Secretary (available for only two meetings because of the prison crisis), the Lord President and the Chief Secretary, meeting as MISC 47, have discussed these proposals in separate meetings with eleven spending Ministers. The Chancellor of the Exchequer and the Chief Secretary have summarised the outcome of the Group's discussions in C(80) 64. I suggest that this latest paper, and its tables (which update those in C(80) 58), should form the basis for discussion.

2. You will also wish to have before you the Chancellor of the Exchequer's minute of 29th October to you about the social security programme (copied only to the Home Secretary, the Lord President and the Secretary of State for Social Services); and the Secretary of State for Scotland's memorandum (C(80) 62) on the proposed cuts on his programme.

3. If the Cabinet gets round to discussing the unresolved issues on departmental programmes, you might take them under the following seven headings:

I. The 1 per cent cut on local authority current expenditure
- and the education programme in particular.

II. Social Security and Health.

III. Employment.

IV. Defence.

V. Scotland.

VI. Wales.

VII. The 2 per cent cut on cash controlled programmes
- this in effect wraps up all the other Departments and issues.

It is important to take I. first in order to make headway on the Rate Support Grant discussions. The Cabinet generally do not know of the social security proposals and therefore these need to be explained early in the discussion. There are no overriding arguments for taking the other items in the order suggested, although it follows that in C(80) 64. It would however be prudent to leave VII. to the end, or each Minister will be tempted to spend time on exposing to colleagues the difficulties of recommendations which he has accepted.

4. I attach separate notes on each of the seven items, with cross-references to the Chancellor's paper C(80) 64. For ease of presentation I have for the most part focussed on 1981-82 although the decisions for the later years are of course extremely important. In commenting in some cases on the practicability of proposed cuts I have drawn on the impressions gained by the Secretariat of MISC 47 in listening to discussion in that group.

5. Although most Ministers have signed up on the 1 per cent local authority cuts and on the 2 per cent cuts on cash controlled expenditure, they have done so on the understanding that there is equality of misery all round. If they were to see exceptions being made, their provisional agreement could well crumble. This point has very much influenced the Chancellor in his handling of MISC 47. It is also our impression that, in accepting the 1 per cent local authority cut 'subject to the decisions of other colleagues' the "territorial" Ministers had in mind that the real battle here is on educational spending i.e. that to a significant extent they were giving away someone else's money.

6. Finally, a number of Ministers may be tempted to point to the additional provision earmarked for the nationalised industries, and to argue that if this could be reduced the burden on them would be so much less. This cannot be taken any further at this stage. E Committee will be considering on 5th November the latest recommendations on the External Financing Limits for 1981-82. You will recall that at the last discussion in E firm agreement was not reached on the measures necessary to get the total additional requirement down to £500 million, let alone the £300 million which the Chief Secretary notes in C(80) 58.

RtA

(Robert Armstrong)

29th October, 1980

I. LOCAL AUTHORITY CURRENT EXPENDITURE AND EDUCATION
(Section Bi of C(80) 64)

1. Proposed reduction: a further 1 per cent cut in local authority expenditure (in addition to the 2 per cent reduction already announced) saving £130 million in each year for England and Wales, of which £61 million on education services.

2. All local authority Ministers agree to this except the Secretary of State for Education who argues -

(i) Education has already been reduced by $3\frac{1}{2}$ per cent compared with the overall reduction of 2 per cent on local authority current expenditure so far imposed.

(ii) With the further cuts a total of at least £100 million would have to come from primary and secondary schools, and in practice from a moratorium on recruitment of teachers.

(iii) The education authorities are already stretched to the utmost in finding cuts, and anything more would be both politically unacceptable and, more to the point, impractible.

3. Subject to the views of the Secretary of State for the Environment the Rate Support Grant calculations are now so advanced, and the timetable so tight, that the 1 per cent cuts cannot be made selectively. It is all or nothing. So unless the Secretary of State for Education accepts this £61 million cut the full £130 million is lost, plus the consequentials for Scotland. If this were to happen it would strongly reinforce the case for an RSG of 60 per cent rather than 61 per cent - this issue will come up in discussion of C(80) 61.

4. It would be helpful to dispose of two further issues on education at the same time. First, the 2 per cent cut on cash controlled expenditure requires the Secretary of State for Education to save £30 million on his programmes for higher education. This will have to be done mainly by

reducing places available at universities and polytechnics. He offers only £7$\frac{1}{2}$ million on the grounds that he has already made a 1$\frac{1}{2}$ per cent reduction as part of the cuts agreed for his programme in July. If this is conceded other Ministers, who for the moment are signing up on their 2 per cent cuts, will also be tempted to renege.

5. Secondly, the Secretary of State for Education has yet to sign up on the proposal that the 1981-82 cuts should be carried forward into the two later years by reductions of £236 million and £241 million. It was suggested in MISC 47 that the two Ministers might discuss this further bilaterally before final decisions were sought, though this has not yet been done.

II SOCIAL SECURITY AND HEALTH
(Chancellor of the Exchequer's minute to you of 29 October on the social security programme; and Section E ii of C(80) 64).

Social Security

1. In C(80) 58 the Chief Secretary said that the question of provision for social security, and public service pensions, were being considered separately. For reasons of security his table did not show the figures under discussion. The main proposal is the uprating of all benefits in November 1981 by 3 per centage points less than is needed to give full price protection. The savings would be approximately £175 million in 1981-82 and £500 million in each of the later years. The Chancellor and the Secretary of State for Social Services agree that exceptions should be made for war pensions and mobility and attendance allowances. They have not yet reached agreement on exceptions for invalidity benefit and short-term supplementary benefit - see Annex C of the Chancellor's minute.

2. As the Chancellor points out, in his paragraphs 7 and 8, there are major questions over the tactics for presenting these decisions, if they are approved, and over the form of legislation. I suggest, however, that for the purposes of the discussion tomorrow it is sufficient for the Chancellor to make an oral report to Cabinet, as he proposes, on the basis of his minute. As he says, it may be necessary, in the light of the discussion, to circulate a paper setting out the proposals in more detail. The main purpose of tomorrow's discussion will be to measure the first reactions of Cabinet.

3. The Chief Secretary will circulate his separate letter on the holding back on index-linked public sector pensions in the same way after Cabinet's discussion - see paragraph 10 of the Chancellor's minute.

<u>Health</u>

4. Proposed reductions -

£126 million (2 per cent off cash controlled programmes) and £12 million (1 per cent local authority current spending); and no requirement to make good the £100 million loss of receipts from expected charges.

5. The Secretary of State for Social Services does not dispute his local authority contribution. He strongly argues, however, for finding the rest of the saving by a relatively small increase in the national insurance health contribution rather than by cuts on services or higher charges. He sees this as socially and politically more acceptable.

6. Treasury Ministers wish to insist on the expenditure cuts. The national insurance contribution is essentially a form of tax. It helps the PSBR but not the public expenditure totals.

7. The choice is between -

<u>either</u>
a PSBR saving through the national insurance health contribution
<u>or</u>
a 2 per cent expenditure cut as proposed by Treasury Ministers and in line with the cuts on other spending Departments (who do not have the tax alternative).

III. EMPLOYMENT

(Section B iii of C(80) 64).

1. Proposed additions: setting aside his contribution to the general percentage cuts, the Secretary of State for Employment is bidding for a net additional £269 million in 1981-82 for the special employment measures discussed by E. Treasury Ministers offer him £167 million. There are similar large gaps in the two later years.

2. The Secretary of State for Employment will argue -

(i) most of his additional bid is for maintaining existing schemes and arises in part because of rising unemployment and in part because two schemes were previously financed from the Contingency Reserve and are now being brought into his programme ie that in the latter case the Treasury are backing the reality of an ongoing programme on purely accounting grounds.

(ii) There are some modest improvement for Youth Opportunities Programme, in line with the views of E.

(iii) It is ridiculous to talk of cutting schemes at a time of sharply rising unemployment.

(iv) The net PSBR cost is about half the expenditure cost if allowance is made for payments avoided eg on unemployment benefit - the Treasury would say the offer is about one third.

3. Cabinet may judge that Treasury Ministers have made unrealisticly low provision for these measures. To the extent that provision is increased, however, the pressure on other programmes also goes up. The choice is -

either to stick to the Treasury figures, though Mr Prior will find these totally unacceptable

or to approve Mr Prior's proposals, and seek offsetting savings elsewhere.

IV. DEFENCE
(Section B iv. of C(80) 64).

1. Proposed reduction: £500 million in each year, of which £188 million for the 2 per cent general cut on cash controlled expenditure.

2. The Secretary of State for Defence is strongly opposed to any cut. His line will be -

i. Defence is already squeezed to the limit and any further reduction is tantamount to a significant change in defence policy.

ii. Need to finance Trident, and to honour the undertaking given to President Carter and NATO not to reduce conventional defence capability.

iii. Damage to the NATO alliance and the 3 per cent growth target.

iv. Effects on British industry (£1 billion already lost from cuts).

v. Effects on jobs - he estimates that £500 million cuts would cost 75,000 jobs in the United Kingdom.

Nevertheless, and without any commitment, he agreed in MISC 47 to consider the implications of accepting the £188 million equivalent to the standard 2 per cent cut in cash limited expenditure as an alternative to the full £500 million on the understanding that the commitment to 3 per cent real growth would be renewed thereafter.

3. Is it unlikely that the Cabinet will have other than a provisional discussion of this. You may, however wish, to probe the Defence Secretary on the possibilities of his contributing at least the £188 million a year. Provisional calculations suggest that, if the cut were limited to this amount, and subject to the effects of cash limit decisions, it would be possible to argue that defence spending would increase by 2½ per cent in 1981-82 over 1980-81 and that we would be on track with the 3 per cent target in the two later years.

V. SCOTLAND

(Section B v. of C(80) 64; and C(80) 62 by the Secretary of State for Scotland)

1. Proposed reduction: £150 million each year.

The Secretary of State accepts the formula cuts of £60 million provided the equivalent percentage reductions are made by other Departments (surprisingly perhaps he made no particular play in MISC 47 with the educational element in their decision - but perhaps he hopes to ride on the back of Mr Carlisle's separate fight to defend the educational programme). He is however strongly against the further £90 million cut which the Chief Secretary proposes on the grounds that the Scottish share of public expenditure on comparable services is larger than justified by relative need.

2. His case, which is set out in C(80) 62, is on two grounds -

i. political - a "levy on the Scottish people"; nothing similar being imposed on Wales and Northern Ireland; playing into the hands of the Scottish Nationalist Party.

ii. Practicability - could only be done, by a 16 month moratorium on capital expenditure, so ravaging the Scottish construction industry.

3. Counter arguments -

i. Even with the £90 million cut, expenditure per head in Scotland would be about 30 per cent higher than in England compared with the 17 per cent which the Needs Assessment Study would justify.

ii. Wrong to continue to cushion Scotland when the North of England, and other regions too, are being hard hit.

4. Cabinet may judge that it is impracticable to get anything near the full £90 million. But, unless they find Mr Younger's political argument to be overriding, they will wish to press for some contribution. The choice seems to be -

either insist on full £90 million

or let the Scots off the £90 million

or press Mr Younger to find some contribution towards the £90 million.

VI. WALES
(Section Bvi of C(80) 64)

1. The Secretary of State for Wales agrees to take his percentage cuts. However, he wants an additional £20 million in each of 1981-83 and 1983-84 for factory building in areas affected by steel closures.

2. The Secretary of State for Wales will argue -

i. Increased provision has been made to deal with the consequences of steel closures in 1980-81 and 1981-82 but not in the two later years, and this is unrealistic with the general industrial situation in South Wales getting much worse.

ii. He has already diverted resources to his industrial programme from elsewhere.

iii. With this additional provision he would stand a reasonable chance of riding the problems in front of him and of attracting some inward investment from the States.

3. The counter arguments are -

i. There are also pressures in England, Scotland and Northern Ireland, and a concession to Wales would mean concessions to them too.

ii. He should find the money by switching resources within his overall programme.

4. The choice is -
either
i. stick to the proposed cuts but leave Mr Edwardes free to switch his own resources into his industrial programme if he wishes
or
ii. modify the cuts by giving Mr Edwardes the £20 million more he wants for industrial support in 1982-83 and 1983-84.

VII. 2 PER CENT CUT ON CASH CONTROLLED PROGRAMMES
(Section A - Agreed programmes - of C(80) 64).

1. The problems of the Departments who are dissenting from cuts under this heading will have already been discussed - Education, Health and Defence.

2. Section A of C(80) 64 records that agreement has been reached with Environment, Transport, the Foreign Office and the Office of Arts and Libraries. The Secretary of State for the Environment will want to point out that, in order to avoid capital investment cuts, he will be requiring a rent guideline for next year indicating an average rent increase of £3.25 as against the £2.85 previously assumed - see Section A i.

3. The Treasury reached agreement on the remaining programmes - Industry, Trade, Energy and the Lord Chancellor's Department - without meetings.

4. Provided that any exemptions agreed for the currently dissenting departments do not provoke other Ministers into withdrawing their offers, it should be sufficient to record general agreement on these proposals and to avoid detailed discussion on the problems of each department.

Copied to :-
Econ Pol: Pt 2
Public Sector Pay

Ref. A03389

PRIME MINISTER

1981-82 Cash Limits and Votes: Pay and Price Factors
(C(80) 60 and 65)

BACKGROUND

In C(80) 60 the Chancellor is proposing a single cash limit uplift figure for new pay settlements in the public services in 1981-82 of 6 per cent and a single figure for prices of 11 per cent. In C(80) 65 he records certain technical recommendations on the staging and "over-hang" elements in cash limits - recommendations which were circulated to E Committee earlier this week (in E(80) 122) and which, though not discussed, appear generally to be acceptable. The one point on which his new paper goes beyond the proposals put to E this week (although it was put to them earlier and not resolved) is the suggestion in paragraph 6 of C(80) 65 that for settlements occurring towards the end of 1981-82 (in the pay round starting on 1st August 1981) the cash limit figure applicable to those settlements should provisionally be 2 percentage points below the figure agreed for the current pay round (ie. 4 per cent if Cabinet agrees to 6 per cent).

2. There are thus four issues to be resolved -

(a) The cash limit for 1981-82 for pay.

(b) The cash limit for 1981-82 for prices.

(c) The treatment of over-hang and staging in 1981-82.

(d) The "provisional" cash limit for pay in 1982-83.

3. E Committee has already had a general discussion of these matters (E(80) 37th Meeting, Item 1), and the 6 per cent figure was mentioned but not specifically endorsed in that discussion. The Chancellor has taken his cue from that figure, but (I am informed) might, if pushed, go to 7 per cent. In summing up the E meeting you recorded agreement to a single pay figure increase for the public services in 1981-82 and were able to conclude also that "provided that it was not unrealistically low, and was seen to apply fairly through the public services, ... there was a reasonable chance of securing satisfactory

settlements without industrial action in the coming winter". You will want to check with the Lord President that this judgment has not been adversely affected by the subsequent announcement of the suspension of the pay agreement for the Civil Service. Colleagues are unlikely to demur from agreement on a single figure limit. But it will be in everybody's interests that they should be quite clear about the implications of their decision. A single figure of 6 per cent for the public services will mean 6 per cent not only for the Civil Service, local government and the National Health Service but also for the

NP Armed Forces, the doctors and dentists, the nurses, the TSRB groups and, in due course, MPs and the police (indeed, if the Chancellor's proposals for a provisional limit for 1982-83 is accepted, the police increase next year could be only 4 per cent - a point also picked up specifically in C(80) 61 on the RSG to be considered later in the meeting). The Secretary of State for Defence will certainly seek an escape clause for the Servicemen. But, as you said at E, the policy will be at risk if it is not seen to be fair. It will be difficult to blur the consequences of the decision, because the interest groups concerned are bound to ask where they stand once the initial announcement has been made.

4. The proposed figure of 11 per cent for price increases reflects a slightly optimistic assumption by the Chancellor about the likely increase in the RPI over the coming year. Nevertheless, his stand with his colleagues has been that the price assumption is realistic and is not intended as an instrument for a further volume squeeze. Most are likely to accept this, though Mr. Pym will point to the differential increase in the price of defence equipment caused by growing sophistication of weaponry. He may not seek a special concession here, in order to reserve his fire for the discussion on defence expenditure as such; but it is possible that he will reserve his position on cash limits generally, pending resolution of the defence package as a whole.

5. As for the technical questions in C(80) 65, there is likely to be little argument about the Chancellor's proposals, other perhaps than on his suggestion for a provisional cash limit for 1982-83 to apply it to settlements reached late in the coming round (paragraph 6 of C(80) 65). Colleagues may accept this as being only a provisional stance which can be re-examined next year in the light of circumstances.

HANDLING

6. You will wish to ask the Chancellor of the Exchequer to introduce his two papers. It may then be possible to get quick agreement to the technical points in C(80) 65, especially those in paragraphs 2-5 of that paper (paragraph 6 being the "4 per cent point" discussed above). Thereafter you might move to the pay cash limit and ask each of the Ministers primarily concerned whether they accept 6 per cent and whether they are prepared to accept the consequences of this decision for the major groups of staff for which they are responsible, e.g. the overriding next year of the reports of the three review bodies - TSRB, DDRB and AFPRB. The Ministers primarily concerned are: the Lord President (for the Civil Service), the Secretary of State for Social Services (for the NHS, including the doctors and dentists), the Secretary of State for the Environment (for the local authorities), the Home Secretary (for the police), the Secretary of State for Defence (for the Armed Forces) and, possibly, the Chancellor of the Duchy (for MPs).

CONCLUSIONS

7. You will need to record conclusions on -

(i) The pay factor for 1981-82.

(ii) The price factor for 1981-82.

(iii) Whether any special provision has been agreed for particular groups.

(iv) Whether the technical recommendations in paragraphs 2, 3, 4 and 5 of C(80) 65 are accepted.

(v) Whether a provisional pay figure, below that for 1981-82, is acceptable for settlements reached after 1st August 1981, and if so what level for this should be set.

RtA

(Robert Armstrong)

29th October, 1980

8

Copied to :-
ECON POL : Pt 2
Public Sector Pay.

Ref. A03388

PRIME MINISTER

The Economic Situation and Public Expenditure

(C(80) 58-61, 64 and 65)

On these papers the Cabinet has to address itself to decisions on a number of crucial questions for economic policy and public expenditure in 1981-82:

(1) The volume total of public expenditure: in other words, the total amount to be sought by way of reductions.

(2) The distribution of that amount among Departmental programmes.

(3) The percentage figure and the inflation factors for the RSG settlement.

(4) The cash limit factors for pay and prices.

BACKGROUND

2. The Chancellor of the Exchequer's paper on the economic prospect and implications for policy (C(80) 59) sets out the reasoning which leads the Treasury to propose the reductions set out in the Chief Secretary's paper (C(80) 58). The presentation is (as the Treasury are themselves now saying) a little confusing, because some of the figures are in 1980 Survey price terms and others in 1981-82 cash terms; I gather that the Chancellor may circulate at the meeting a page of figures which straightens out the confusion (and incidentally updates some of the numbers). But the gist is clear enough. In order to get the Public Sector Borrowing Requirement (PSBR) next year back to the current forecast of about £11,000 million, we need the full amount of the cuts in public expenditure proposed by the Chief Secretary; that will still leave a need for fiscal measures to bring the PSBR down further, in order to leave room for reductions of interest rates (and thus, it is to be hoped, the exchange rate).

3. Some of your colleagues may nonetheless want to argue that, because of the depth of the recession and the depressed state of industry (confirmed by the CBI figures announced today), there should now be a modification of the strategy which would permit smaller reductions in public expenditure and a higher PSBR next year. This line of argument requires them to accept that on that proposal: either interest rates must go higher to enable the Government to finance the higher PSBR without an increase in money supply - which would intensify the present liquidity squeeze on industry, and thus reduce output

and increase unemployment in the short term;

or money supply is allowed to increase at a faster rate (printing more money), which could mean higher inflation, greater uncompetitiveness, lower output and higher unemployment two years out than can be expected if the present strategy is maintained.

There may be requests for more information about the possible effects on industry and employment of the Treasury's proposals. That would be for the Chancellor of the Exchequer to answer: I believe that the answer is in fact that the overall effects would not be very great, but that (depending on the distribution) there could be more serious consequences in particular industries or geographical areas.

4. If this sort of argument looks like emerging, I suggest that the right course is to have it out, and to re-establish the collective commitment of the Cabinet to the present strategy. That is the only way to provide a sound and secure basis for agreement on the total amount by which public expenditure in 1981-82 is to be reduced. Once that is established, then it becomes a question of distribution: the Chief Secretary's proposals provide a starting-point, from which discussion can proceed on the basis that, if one programme is to be cut by less than is proposed, that will have to be made good by larger reductions in other programmes.

5. The other line of argument which you might get - it surfaced in E last week from the Secretary of State for Social Services - is that it would in present circumstances be better to effect more of the required reduction in the PSBR by increasing taxation and less by reducing public expenditure. The Chancellor's argument in reply will presumably be that, even if the whole amount of the proposed reductions in public expenditure are agreed and put into effect, he will still be left with a substantial amount to recover by increased taxation. By tradition it is for the Chancellor - consulting only the Prime Minister - to decide what he can and should raise by way of taxation and by what means, and that has not usually been discussed in the Cabinet - for reasons of Budget security. But Ministers in charge of spending Departments are being asked to make very large and very painful cuts, and in order to convince them of the need to persist in them the Chancellor may need to expose rather more of his general thinking on the size and shape of his Budget.

6. Once you have established a collective commitment to the strategy, and to the size of the reductions required, the next question will be how to get them. In my judgment some discussion of that should precede the discussion of cash limit factors and the RSG, not least because there is a trade-off between the proposed 1 per cent volume cut in local authority current expenditure and the percentage figure for the RSG; if the 1 per cent volume cut can be made to stick, then it would be reasonable to accept a figure of 61 per cent for the RSG, whereas if the 1 per cent cut cannot go forward, that will strengthen the case for 60 per cent for the RSG.

7. The Chancellor will be reporting on the outcome of the enlarged bilaterals; but they have not produced very much by way of firm commitments, and there remain pockets of stout resistance. The Secretary of State for Defence has undertaken, without commitment, to look at a reduction of £188 million, on the understanding that there would be a commitment to return to 3 per cent a year real growth thereafter; he can probably be got that far, but in his present frame of mind no further. The Secretary of State for Education and Science considers that the 1 per cent cut in local authority current expenditure would mean not only abandoning the Manifesto commitment on standards of education but also at least a moratorium on teacher recruitment, if not making some teachers redundant. The Secretary of State for Scotland will go along with the Scottish share of whatever cuts are agreed on a Great Britain basis, but declines to go further. The Secretary of State for Employment will argue for much more than the Chief Secretary is prepared to allow on measures to tackle rising unemployment.

8. There is, I think, no possibility of agreement round the table tomorrow on reductions adding up to the total proposed by Treasury Ministers. Once the Cabinet agrees on the total, there will have to be a further process of "brokerage", which is bound to turn primarily on the large spenders: defence, education, health, and social security. At this meeting you might seek a second-reading sort of discussion, in which Ministers might comment in general terms on the shape and direction of the reductions, in the hope that it might be possible to extract from the discussion some generalisations to guide the process of identifying where cuts should fall.

9. You have yourself said that you would like to minimise cuts in capital programmes and equipment programmes which would bear especially hard on certain industries which are especially vulnerable. You may wish to see whether there is any disposition to accept this as a general proposition. If there is, the implication must be that greater reductions should fall on public service manpower and current expenditure, and on transfer payments. You will wish to see if there is general readiness to cut deeper into the area of social security benefits, which account for a sizeable proportion of total expenditure.

10. If the discussion does establish some degree of agreement about where the cuts should fall, the next step should presumably be for the Chancellor and the Chief Secretary, together with the Home Secretary and the Lord President, to have another go at the spending Ministers who are going to have to bear the main brunt of the reductions, supported by whatever general conclusions have emerged at this meeting.

11. The discussions on cash limit factors and on the RSG are separable from the main issues of strategy and public expenditure; but final decisions cannot be recorded until those issues have been resolved. If time permits, you could have some discussion of cash limit factors and the RSG settlement; but I am inclined to think that those could and should be held over for a later meeting.

Timing

12. Decisions on the whole range of issues need to be reached before the State Opening of Parliament on 20th November. Between then and now there are three further meetings of the Cabinet: on 6th, 13th and 19th November. I should think that the aim should be to complete the process not later than 13th November. We have provisionally allowed time for an extra meeting of Cabinet on Tuesday, 4th November; so you have this up your sleeve if you need it. We could use it to discuss cash limit factors and the RSG, so as to be able to revert to the public expenditure questions on 6th November; but that is very rushed, and I suspect that it may make better sense to take cash limit factors and the RSG on Thursday, 6th November, so as to leave a fortnight for the process of brokerage on public expenditure, and then hope to be able to confirm decisions on all the issues on Thursday, 13th November.

HANDLING AND CONCLUSIONS

13. It is more than usually difficult to make recommendations to you about how to handle this discussion, because of the uncertainties about how it may go. Clearly you should invite the Chancellor of the Exchequer to open the discussion with a "scene-setting" presentation of the economic background to and reasons for the Treasury's proposals on public expenditure and cash limits. You may like to ask the Secretary of State for Industry to come in behind the Chancellor, to support him on the case for freeing resources from the public sector for the private sector. Other Ministers who may want to enter the discussion at this stage are the Secretaries of State for Trade, Employment, the Environment, Social Services, and the Minister of Agriculture.

14. The objective in this phase of the discussion will be to rally the Cabinet round the strategy, and record a conclusion accordingly. That done, it should be possible to proceed to the public expenditure proposals. You could invite the Chancellor or the Chief Secretary to open this part of the discussion, reporting on the present state of the bilateral discussions. I have suggested that this might be a second-reading discussion, leading to general conclusions which could provide a framework and direction indications for a second round of bilaterals, with a view to reporting agreements and resolving outstanding differences on 13th November.

15. If there is time, you could then proceed to take the papers on cash limit factors, and a first go at the RSG; but that makes for a very large mouthful at this meeting, and you could let those two papers stand over either until Thursday, 6th November or, if you want to force the pace, until a special meeting of the Cabinet on Tuesday, 4th November.

RA

(Robert Armstrong)

29th October, 1980

Tim

Copied to:
Social Services
Pt 2: Benefits

7

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

PUBLIC EXPENDITURE - THE SOCIAL SECURITY PROGRAMME

For reasons of security the Chief Secretary's paper for Cabinet on Thursday which will report the upshot of discussions in MISC 47 will not refer to social security (or public sector pensions). The purpose of this minute is, however, to report to you the present position on discussions in this area, and to seek your agreement that I should make a brief oral statement on Thursday. This minute has been agreed with the Secretary of State for Social Services.

.... 2. Annex A attached shows the position on the social security programme, and the savings which the Chief Secretary proposes.

3. The Secretary of State is prepared to accept proposals B and C (savings on shift to monthly payment of child benefit following the Rayner study, and 2 per cent cut in cash controlled expenditure - in this case largely administration). He points out, however, that the move to pay child benefit four weekly in arrears to the better off recipients has yet to be agreed in its own right, and to that extent the savings must be regarded as provisional. I accept this.

4. Proposal A - a reduction in real value of all benefits in November 1981 - including retirement pensions - is clearly very difficult. We shall be accused of "attacking the poor" and of breaking our pledges; in this context I have to draw your attention to the transcript at Annex B of part

/of the

of the interview you gave Brian Walden on "Weekend World" on 6 January last. Nevertheless in the present situation, given the size of the social security programme, the very difficult proposals we are putting in respect of other programmes, and the fact that we expect prices to be increasing slightly faster than earnings over the next year or so (i.e. the standards of living of working people are likely to fall) we have no choice but to tackle this area. The Secretary of State is in principle in agreement. But there are, however, some outstanding points yet to be settled.

5. First, exceptions. Annex C sets out certain exceptions which the Secretary of State would wish to make to the across the board reduction, together with their cost. The Chief Secretary and I feel that in principle there should be no exceptions, but we are ready to concede the first two in the list, war pensioners, and mobility allowance and attendance allowances. To go further than this would, in my view, cut excessively into the savings we are looking for and, because a good case can always be made out for a social security benefit, end up creating resentment and risking having to concede more.

6. However, the Secretary of State considers that invalidity benefit recipients, having already received a 5 per cent reduction in this year's uprating, should not suffer a further 3 per cent cut (which may not get through the House of Lords anyway). In addition the Secretary of State feels that some exception for the poorest of all, namely those on the short term rate of supplementary benefit, is needed if the other reductions are to be carried. This could be done either by continuing to price protect the short term supplementary benefit rates (thus preserving the safety net for those on the lowest rates) or by allowing

/the long term

the long term unemployed, who at present have to make do with the short term rates however long they have been unemployed, to qualify for the long term rates after one or two years of unemployment. If something on these lines were to be done, I would prefer to give the long term supplementary benefit rate to the unemployed after two years, rather than create any further exceptions to the 3 per cent; but on balance I do not think we should go beyond the limited concessions in paragraph 5 above.

7. Second, there is the question of presentation of our decision. The Secretary of State and I both feel there would be advantage particularly in the context of wage negotiation in announcing a decision soon in terms of "'x' per cent increase", rather than "3 per cent reduction". On current forecasts 'x' would be 8 per cent. But I have to make another forecast of inflation before final decisions can be taken. A decision to announce an "8 per cent increase" now would therefore have to be provisional. Some flexibility would have to be left in case my final forecast of inflation differs from 11 per cent. I would want to be assured of my 3 per cent savings while the Secretary of State would not want pensions to fall more than 3 per cent below the RPI forecast.

8. A third outstanding point concerns the form of the legislation that will be necessary. The Secretary of State would prefer to make this "one-off" affecting the November 1981 uprating only, with our pledges to price protect, and indeed give pensioners and others more as our economic situation improves, merely suspended rather than abandoned. I myself would prefer something more akin to the so-called "Rooker-Wise" provisions in the tax statutes.

9. Finally, I should report that in order to ensure that the PSBR as well as public expenditure benefits from the

/holding back

holding back of contributory benefits, we propose that the Treasury Supplement to the National Insurance Fund be held back as appropriate. The legislation I have just referred to could cover this also. However as an entirely separate matter I may wish to look to a reduction in the Supplement anyway as a means of helping the next year's PSBR, and if so both points will be swept up together.

10. I should add here for convenience that the Chief Secretary will also be proposing that index-linked public sector pensions should be held back at the next uprating also by 3 per cent, to parallel what is proposed on the s tate retirement pension. The Chief Secretary will be circulating a separate letter on this. The presentational issue discussed in paragraph 7 also arises here.

11. If you are in agreement I will make an oral report to Cabinet on Thursday on the lines of the foregoing. In the light of the discussion we may need to circulate a paper later.

12. I am copying this to the other members of MISC 47 and to Sir Robert Armstrong.

GH

(G.H.)

29 October 1980

SECRET

ANNEX A

DHSS SOCIAL SECURITY

	£ million 1980 Survey prices				
	1979-80	1980-81	1981-82	1982-83	1983-84
Cmnd 7841 revalued	19,272	19,731	20,183	19,860	20,000
Estimating changes etc	-167	-313	+20	+147	+45
Other increases proposed					
(a) child benefit uprating proposed in C(80)40			+75	+250	+360
(b) small bids			+9	+12	+14
Cuts already proposed					
Not yet agreed					
<u>Proposal A</u>					
Uprating of <u>all</u> benefits in November 1981 by 3 percentage points less than needed to give full price protection			-175	-504	-504
<u>Proposal B</u>					
Savings on shift to monthly payment of child benefit, following Rayner study (provisional)			-61	-1	-13
<u>Proposal C</u>					
2% cut in cash controlled expenditure			-6.3	-6.3	-6.3
Resulting programme including latest estimate for 1979-80 and 1980-81)	19,105	19,418	20,044	19,758	19,896
Effect of revised economic assumptions*					
(a) unemployment benefit etc			+185	+330	+130
(b) administrative costs to both DHSS and DE of paying unemployment benefit		+10	+47	+60	+60
Resulting programme	19,105	19,428	20,276	20,148	20,086

*provisional figures, including extra computer costs in first year

ANNEX B

Extract from "Weekend World" 6 January 1980

MARGARET THATCHER: Now your questions, I'll try to answer those....

BRIAN WALDEN: .....and very shrewd. You're obviously looking at indexation in general, and when you say things like people can't expect in fact to have their earnings linked to an everlasting rise in inflation, it's pretty clear that something is going to happen in this sphere. However, I do take it do I not that you're not looking at and that you won't be looking at, the indexation of old age pensions.....

MARGARET THATCHER: No...I'm pledged on that.

BRIAN WALDEN: ...to prices.

MARGARET THATCHER: No, I'm absolutely pledged on that.

BRIAN WALDEN: For the life time of the parliament?

MARGARET THATCHER: For the national, of the life time of the parliament that was the pledge which I made at the election. What, we've taken the index linking away from earnings sometimes as a matter of fact earnings were below prices, as you know during the life-time of the Labour Government, for three years on the trot the standard of living of the British people fell, actually fell, it only started to get back again in 1978, the year before the election. But I, I pledged at the election to our old people that their state National Insurance pensions would keep pace with rising prices, and we honoured that this last time, so that when that went up they did get the increase, I'm pledged on that, and a pledge must last.

BRIAN WALDEN: Can I ask you about employers. There have been a lot of suggestions that employers will be asked to pay the first eight days of sickness benefit , are you looking at this?

ANNEX C

Exceptions proposed by the Secretary of State £ million

	1981-82	1982-83	1983-84	Manpower (full year)
A. War pensions	4	10	10	None
B. Mobility allowance and attendance allowances	3	9	9	None

These are accepted by the Chief Secretary

	1981-82	1982-83	1983-84	Manpower (full year)
C. Invalidity Benefit	8	24	24	slight saving

The Chief Secretary is not convinced that this is justifiable

	1981-82	1982-83	1983-84	Manpower (full year)
D.1 Short term Supplementary Benefit	11	31	31	220
or				
D.2 Give long term rate of Supplementary Benefit to the Unemployed				
(a) after two years	15	46	51	45
(b) after one year	26	74	84	190

The Chief Secretary is not convinced that D.1 is justifiable when eg retirement pensions are being restricted. D.2 though more costly, is less unattractive as not causing so much erosion of the 3 per cent cuts; and also as more justifiable in its own right given unemployment trends. But the Chief Secretary is opposed to both.

6A

SECRET CF. pa.

CHANCELLOR OF THE EXCHEQUER

cc: Chief Secretary
Financial Secretary
Sir D Wass
PEX
GECS

PUBLIC EXPENDITURE: CABINET TOMORROW

You asked for a table which you might hand round, showing the profile of public expenditure over the period since 1974-75.

2. I attach a number of copies of a table for that purpose.

3. The figures for the years up to 1980-81, excluding the forecast outturn for that year, are those in the tables sent to the Prime Minister on 24 October (with a little rearrangement of the lines). The forecast outturn for 1980-81 is that in the recent NIF.

4. The second column for 1981-82 shows the rough outcome if none of the reductions still at issue were agreed; the final column assumes that those reductions are all agreed in full.

MEP

MISS M E PEIRSON
29 October 1980

[illegible] A

SECRET

PUBLIC EXPENDITURE 1974-75 to 1981-82

[illegible] 102
[illegible] 73

100 105 110 104.5

	1974-75	75-76	76-77	77-78	78-79	79-80 Provisional outturn	1980-81 White Paper revalued, adjusted for transfers from reserve to programmes	1980-81 Forecast outturn	1981-82 White Paper revalued	1981-82 Including likely increases and agreed cuts	1981-82 Including remaining proposed cuts
1. Central Government (1)	53,735	54,479	54,011	52,546	55,144	55,468	57,305		57,080	57,900	57,150
2. Local authorities	24,358	24,262	22,910	21,533	21,415	21,714	20,360		19,426	19,250	19,150
3. Nationalised industries' borrowing	3,040	2,624	2,266	908	1,335	1,527	1,124		-146	625	625
4. Reserve	-	-	-	-	-	-	575		1,400	2,000	2,000
5. Special sales of assets	-	-	-	-697	-	-998	-500		-50	-150	-150
6. Shortfall	-	-	-	-	-	-	-1,120		-840	-640	-640
7. EC refunds	-	-	-	-	-	-	-	-545	-	-670	-670
8. Planning total after shortfall	81,133	81,365	79,187	74,290	77,894	77,711	77,744	78,100	76,870	78,300	77,450
9. % change on previous year	+8.5	+0.3	-2.7	-6.2	+4.9	-0.2	-	+0.5	-1.1 (2)	+0.3 (3)	-0.8 (3)
10. Debt interest	1,400	1,693	2,179	2,472	2,847	3,845	3,500	3,900	3,500	4,000	4,000

£5b

(1) Including public corporations other than nationalised industries, and grants to nationalised industries, but excluding Government lending to nationalised industries (included in line 3).

(2) Change on White Paper revalued for 1980-81.

(3) Change on forecast outturn for 1980-81.

given to PM

cc: Chief Secretary
Sir Douglas Wass
Sir Anthony Rawlinson
Mr. Bridgeman
Mr. Evans
Mr. Folger
Mr. Ridley

CHANCELLOR

PSBR AND PUBLIC EXPENDITURE ARITHMETIC

... I enclose, as per the instructions relayed to me by Mr. Lankester, two tables - the shorter one for handing round to your colleagues, the longer one for use by you and the Prime Minister.

2. The shorter one shows sequentially the effects on the starting point (forecast) PSBR of the reductions proposed by the Chief Secretary that have so far been agreed, and the further effects of your additional (not yet agreed) proposals, including the possible social security savings. The longer table also includes the effects of the two main tax starters (North Sea and employees' NIC), together with a 'ready reckoner' on indexation of the income tax structure and the specific duties. I have not included VAT on imports, which you have not so far mentioned to colleagues. But the proposals you have seen would reduce the PSBR by around a further £0.6 bn in 1981-82.

3. The expenditure figures are shown in 1980 Survey prices and should therefore be recognisable to your colleagues (except, of course, that the social security item has not previously been revealed to them). But in the right hand column they are translated into the cash effect on the PSBR in 1981-82.

4. I have rounded the PSBR figures in the right hand column so as to avoid the presentational problem about the adjustment in the forecast that we discussed with you earlier this evening. The figures should now be consistent with your earlier paper, and with the Chief Secretary's papers, but you should stress that the PSBT estimates are necessarily very broad orders of magnitude.

5. The message that emerges clearly is that to have any prospect of producing a credible PSBR, all the expenditure reductions must be accepted as a minimum. And even after taking account of the effect of the recession (your earlier paper made it clear that you are not seeking to get right back to the MTFS figure) there is a serious risk that you will have to raise the real burden of personal taxation in addition to the discrete tax measures identified in the longer table.

JW

for (J.B. UNWIN)
29 October 1980

B

£bn

PSBR POSITION 1981-82

			Changes in Public Expenditure plans 1980 Survey Prices	PSBR, cash (rounded)
1.	PSBR in Forecast			11
2.	Public Expenditure proposals in C(80)58 & 64		£2.0 b. N.I.	
	(a) Increases		2.8)	
	(b) Agreed reductions		-0.6)	2½
				13½
3.	PSBR taking account of agreed reductions			£13½ b
4.	Public Expenditure Reductions in C(80)58 &64 not yet agreed	Defence	-0.6)	
		Other	-0.4)	-1
5.	PSBR if all Chief Secretary's proposals accepted			12½
6.	Effect of holding all new public service pay increases to 6%			-½
7.	PSBR after all above adjustments			£12 b.
8.	Effect of social security savings, including public service pensions consequential		-0.2*	-¼*
9.	PSBR after all spending adjustments			£11¾ b.

[compare with 7½ implied by MTFS]

* Effects much larger in later years

7½-7¾

2b.

		£bn
		PSBR, cash (rounded)
10. Possible discrete tax measures		
(a) North Sea		- 1
(b) ½% point increase in employee NIC		- ½
		-1½
11. PSBR after discrete tax measures		10¼

Memo items

... each 1% under-indexation of income tax allowances and thresholds	-0.15	
... each 1% over indexation of specific duties and VED	-0.08	

28 October 1980

Policy Unit

PRIME MINISTER

BRIEFING FOR CABINET

Following our discussion last Friday morning, this minute suggests the approach you and Geoffrey might take to the Cabinet discussion on public expenditure cuts.

1. THE PROBLEM

1.1 The problem you face is at two levels. Superficially, we have the natural and familiar problem: spending Ministers resisting the call for further cuts; more fundamentally, this problem itself provides, for colleagues who are opposed to Government strategy, the opportunity to frustrate that strategy, discredit it and thus weaken your authority.

1.2 It follows, therefore, that the role you play and the tone of voice you use is very important.

2. YOUR OWN ROLE IN THE DISCUSSION

2.1 We suggest that you put special emphasis on chairing, rather than participating in, what will be a difficult, maybe acrimonious, discussion between Geoffrey and his Treasury team on one side and some, though not all, of the spending Ministers on the other.

2.2 Your opening statement should therefore defuse the situation and create an atmosphere in which it is much more difficult for the hostile colleagues to escalate the discussion into a row. For example, show some sympathy for the spending Ministers, recognising the difficulties they face when the Treasury come back at them again for more cuts. Remind them that that is the Treasury's job.

- "We have a duty to get the answers as right as we can. It is easy enough for us - well-paid, owning property and land - to look at both recession and inflation with equanimity. But we have a duty to the small man with savings in cash, and to the private wealth-creating sector."

- "That duty requires us to bring inflation down, <u>and</u> then bring interest rates down, as far as possible <u>without</u> putting taxes up. That duty is a Manifesto duty and a national duty."

- "What we decide in the present round of cuts may well not be enough. All experience suggests that the situation will have deteriorated even further by the Spring and that we will then be having to make bigger tax increases than we had hoped would be necessary. (Each penny on the standard rate of tax is worth over £700m)."

- "We cannot put the problem off in the hope that it will get easier. We can't win the next Election with a phoney give-away Budget. We would simply be recreating a re-run of the 1979/80 problem for 1984/5 and neither the public nor the media would in any case be fooled."

3. <u>GEOFFREY RECAPITULATES THE TREASURY PAPERS</u>

3.1 "We now face an all-too-familiar problem. We did <u>not</u>, as a Government, achieve what we had hoped to achieve in our first year as regards public spending. We are therefore caught in the familiar box:

- We <u>must</u> ease the pressure on the private sector; but we can't do that by simply losing control of the PSBR because then whatever we do for the private sector will be cancelled out by higher interest rates.

- If we close the PSBR gap by higher taxes, then we reduce the very incentives we were pledged to restore.

- If we try to close the gap by relaxing control of money supply, then we guarantee a resurgence of inflation in the run-up to the next Election."

3.2 "<u>We have to solve the problem now</u>: that is, in the 1980 Budget and public expenditure plans. We have <u>first</u> to agree what level of PSBR we can tolerate for interest rate purposes; <u>second</u>, what cuts we can make <u>without</u> damaging the private sector; <u>third</u>, what tax increases will be needed to make good the difference."

3.3 "The better we can do on public service pay, then the smaller those tax increases will have to be. But for the present, we should not count our chickens on pay and we therefore have to make the biggest cuts possible. Each percent on public services pay is £220m."

3.4 I know that you feel very strongly about the inequity of monopoly unions in the public sector (especially nationalised industries) putting their fellow workers in the private sector out of jobs. I don't think that you need to labour this point as you have made it at previous meetings, and I think that all colleagues fully understand it.

4. GENERAL POINTS WHICH NEED TO BE MADE DURING DISCUSSION

4.1 It is important that colleagues understand the need to decelerate payments. Public services pay rose very substantially last year and the 6% for public services and the 8% for nationalised industries is essential if the public sector pay as a whole is to decelerate in line with the economy as a whole, as per the MTFS. Similarly with social security. It might be best for Patrick Jenkin to make this point himself:

> "There is no question of 'cuts in social security' in the way that pressure groups suggest. Next month, as we announce cash limits and EFLs which imply a 6-8% range for pay, and private sector pay is beginning to come down into single figures, social security will be uprated by no less than 16.5%. A year hence, in November 1981, we will no doubt be pressing for cash limits and EFLs which reflect pay increases in the 3-4% range. But, on present policies, social security will be uprated by about 11%. All we are proposing is that that should be reduced to 8% which means that social security will be increasing relative to pay.

(Our view is that it should be de-indexed by one-third of the backward-looking inflation rate, which would have meant an 11% uprating this November.)

4.2 You suggested in our discussion that if alcohol and tobacco were taken out of the index for the purposes of indexing social security, this would give the same effect as a 3% de-indexation. We think that this would be psychologically the wrong way to do it. The principle of de-indexing is fair once it is understood. It is not a selective cut, but ensures that social security decelerates like everything else. To fiddle about with the index would look mean or dishonest (as TPI did in our view) which is bad for the Government; and the opportunity to teach the meaning and importance of deceleration in all payments, to conquer inflation, would be missed - which is bad for everyone.

4.3 The impact of the monopoly nationalised industries on prices or taxes causes natural indignation, but at present the "rules of the game" do not allow us to do anything about it. But it is worth making the point that, if it was not for the nationalised industries' total overspending of £2.9bn, income tax could now be at 26p standard rate. It will be difficult to get realistic settlements until and unless trade union power, especially in those monopoly industries, is substantially reduced. In the meantime, we have to decide whether excessive pay awards should lead to reduced investment or higher prices. Each hits the different parts of the private sector in different ways. (One has only to read Geoffrey's recent minute to you on trade union resistance in the Post Office to see how futile it is to talk of solving the nationalised industry problem without further steps to reduce the bargaining imbalance. See, for example, how the mere threat of disruptive action does the unions' work for them!)

4.4 Increased expenditure on youth employment schemes etc can only be cosmetic. We may agree to doing a bit, but we must be clear that the more we spend soothing the symptoms, the longer it will take to cure the disease. Better to spend time removing trade union obstructions to youth employment.

5. HANDLING COLLEAGUES' OBJECTIONS

5.1 When hostile colleagues object to the cuts, or criticise the strategy, don't get directly involved in argument with them, don't let them cross-examine you or Geoffrey. We suggest that you cross-examine them.

5.2 If, for example, they urge that nationalised industry investment programmes should not be touched, ask where the money is going to come from: from higher prices with the consequent effect that has on the private sector? From higher borrowing and thus interest rates (it's going to be difficult enough to bring them down as it is, and a high PSBR itself is inflationary)? From higher taxes - which amounts to subsidising nationalised industry prices? Or from printing more money, and thus creating higher inflation eighteen months to two years downstream? Each answer they give, press them further. Get them to display the inadequacy of their position in front of their colleagues. Put them in the hot seat. (To further defuse the situation, it may help to address them by their Christian names when cross-examining in this way. It makes it harder for them to be deliberately obstructive.)

5.3 After such questioning, you could probably sum up by saying:

> "If there really is a something-for-nothing solution to this problem, then of course we must look at it. But it seems to me that there is not; that whichever way we turn, we cannot get out of the box. The money has to come from somewhere. If the reality is inescapable and if it's going to hurt someone, whatever we do, let's at least make sure that the process is visible to the public, so that they can learn the economic realities and so that public opinion can be mobilised against public sector union monopoly and management incompetence. A big pay award leading to a large price increase leading to fresh bankruptcies does teach that lesson. A big pay award leading to reduced investment teaches that lesson slightly less directly. A big pay award leading to relaxed EFLs simply sustains the illusion that 'Government money' can solve every problem; the very illusion we have to shatter. And ends up with the dreamworld intact, and an electorate angry at higher taxes or else more inflation."

5.4 If the discussion threatens to end in disarray, you will obviously want to regain control by proposing a further meeting as soon as possible, or separate meetings with dissenting colleagues. What matters is that there is a clear "next step". What that step consists of is less important.

I have not copied this note to Geoffrey, but I am of course available for your meeting with him tomorrow evening if needed.

JOHN HOSKYNS

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Cabinet Bundle 5

1.

Qa 05164

TO: PRIME MINISTER
FROM: J R IBBS

PUBLIC EXPENDITURE

1. You agreed that the CPRS should prepare a note to bring together the main points that need to be considered by the Cabinet when the reductions in public expenditure are discussed in the context of economic prospects and policy.

2. I attach the paper which, given your approval, I propose to circulate. The purpose is not to guide the Cabinet to particular decisions but to set out for Thursday's meeting of the Cabinet the main arguments and suggest where some additional information might be helpful.

JRI

28 October 1980

Attachment

Prime Minister.

Tim and I saw an earlier draft of this paper this afternoon, and we told the Cabinet Office that we thought that it was so written that it would encourage those members of Cabinet who are inclined to argue for a relaxation of the money supply and PSBR targets. The Cabinet Office have sought to strike a better balance in this latest draft which, I think, does help to focus on the issues. But you should bear in mind that if Cabinet takes up the suggestion of assessments of the economic and employment consequences of both adopting and of not fully accepting the Treasury's proposals which are made in paragraphs 9 and 10 of the paper, this will delay decisions on public expenditure. Are you content for this paper to be circulated to Cabinet?

[initials]
28x.

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5

DRAFT CABINET PAPER

THE ECONOMIC PROSPECT AND ITS IMPLICATIONS FOR POLICY

Note by the Central Policy Review Staff

1. The Cabinet has for consideration three Treasury papers: C(80) 59, 58 and 60. A brief summary of the key facts in these papers and of the main decisions required is given in the Annex to this paper, the purpose of which is not to guide the Cabinet to particular decisions, whether those proposed by the Treasury or otherwise, but to draw the Cabinet's attention to the magnitude and implications of the issues involved. Before addressing themselves to these specific questions Ministers may find it helpful to consider the underlying questions given in paragraph 14 of this paper.

2. The Chancellor of the Exchequer in his paper (C(80) 59) on economic prospects states that -

i. The proposals in the Chief Secretary, Treasury paper (C(80) 58) are required to bring public expenditure volumes back as nearly as possible within published planning totals (the White Paper of last March) for 1981-82.

ii. These reductions in public expenditure would do little more than "validate the assumptions in the forecast" and little to reduce the Public Sector Borrowing Requirement (PSBR) below the present forecast of over £11,000 million for 1981-82.

iii. To get back to a PSBR equal to about 3 per cent of Gross Domestic Product (GDP), as implied by the medium-term financial strategy (MTFS), would require the PSBR to be reduced by about £4,000 million; to create conditions in which interest rates can fall requires a reduction of at least £2,500 million from the current forecast figure.

3. It is apparent that the Chancellor of the Exchequer envisages the need for fiscal measures (although the magnitudes of these are not yet defined) as well as all the reductions in public expenditure proposed by the Chief Secretary, Treasury, in order to create monetary conditions in which interest rates can fall and the upward pressure of interest rates on the exchange rate be eased.

BACKGROUND

4. The Government's strategy gives priority to the reduction of inflation through control of the money supply. This policy is having considerable success. If recent good performance on prices is sustained, the rate of inflation year on year is expected to be down to 11 per cent by late 1981.

5. There is in particular evidence of changed pay expectations in the private manufacturing sector. A major contributor to this change has been the liquidity squeeze caused by a combination of world recession, high interest rates and the strength of sterling. The effects have been particularly severe for those United Kingdom companies whose prices, whether in the home market or in export markets, are set by international competition. It

is important to maintain the pressure leading to improved attitudes and greater efficiency but not, the Central Policy Review Staff (CPRS) suggests, at an intensity which would put at risk fundamentally viable companies which are an integral part of the economic structure and whose survival is likely to be indispensable to economic recovery.

6. The liquidity squeeze on the corporate sector contrasts with continuing high liquidity in the personal sector. The substantial wage increases that prevailed until recently have increased personal earnings at the expense of company profits. It is desirable to reverse and not to exacerbate the disparity between the financial position of the personal and corporate sectors.

THE MAIN ISSUES

7. In considering the Treasury papers the Cabinet will want to consider not only what effects the proposals will have on the monetary strategy, but also their effects on the level of economic activity, industry and employment.

8. Within the overall strategy of reducing inflation by controlling money supply, one objective is to release to the private sector resources which on present forecasts are likely to be pre-empted by the public sector. To what extent and in what timescale will the Treasury's proposals meet this objective?

9. All reductions in public expenditure in the first instance reduce demand on private industry, either directly through reduced purchases or indirectly through reduced personal incomes.

In conditions of full or near-full employment the private and overseas sectors take up the slack. But we are now in a recession both at home and abroad. Even if interest rates and the exchange rate fell, it might be longer than usual before demand from the private and overseas sectors increased sufficiently to fill the gap resulting from the reductions of public expenditure. In that event the cuts might result in a temporary additional drop in output and a temporary further rise in unemployment. The Cabinet may wish to consider whether an assessment should be made of the economic, industrial and employment consequences of the Treasury's proposals, including the possible effect on particular sectors on geographic areas.

10. On the other hand, if public expenditure in 1981-82 is not reduced by the amounts proposed, and the shortfall is not offset by additional tax increases beyond those which the Chancellor of the Exchequer may already be contemplating, then the PSBR is likely to be well outside the ranges envisaged in the MTFS. For any given desired level of money supply interest rates (and therefore probably the exchange rate) will have to stay higher than they would otherwise need to be, and will perhaps even go higher than at present. If in order to avoid that consequence a higher rate of growth of money supply than that envisaged in the MTFS were accepted in 1981-82, that would presumably be reflected in the levels of inflation and output in 1983 and 1984. The Cabinet may wish to consider whether an assessment should be made of the consequences for industry and employment of making only part of the reductions now proposed.

11. Thus the dilemma which faces the Cabinet is that reductions of public expenditure on the scale proposed by the Treasury, together with whatever fiscal measures may be envisaged, may exacerbate the recession and make unemployment higher in the shorter term than it would otherwise be. However, not to make reductions on that scale could entail either higher interest rates and a higher exchange rate - making the liquidity squeeze on the corporate sector still tighter - or a relaxation of the MTFS, which in the medium term could reduce the rate at which inflation is brought down and postpone economic recovery.

12. Whatever total amount of reductions in public expenditure the Cabinet agrees upon, it will wish to consider whether the distribution of the cuts should be adjusted to take account of the potential impact on particular industries. For example, cuts on capital programmes fall with special severity on the construction and capital goods industries; cuts on defence equipment fall on the shipbuilding, vehicle and aerospace industries; while at the other extreme the impact of cuts in transfer payments which reduce the spending power of beneficiaries of social security is distributed over a wide range of consumer goods industries.

13. There is of course scope for further improvements in efficiency in the public sector. It is extremely important to obtain these if better attitudes and a sense of economic reality are to prevail. But the savings required go far beyond what can be achieved by improved efficiency.

14. The Cabinet will wish to consider the impact of reductions in public expenditure on its political commitments: including the commitments on defence (the North Atlantic Treaty Organisation target of 3 per cent annual growth and the commitment to implement the recommendations of the Review Body on Armed Forces Pay); the commitments on maintenance of standards of education and health care; the commitments to maintain the value of social security benefits; and, on the other side of the account, the commitment on taxation.

QUESTIONS FOR MINISTERS

15. The CPRS suggests that Ministers will want to address the following basic questions -

1. Taking account of the present state of the economy and of the Government's economic objectives, are the reductions proposed by the Chancellor of the Exchequer in the PSBR and in public expenditure for 1981-82 appropriate, or should some higher or lower figures be considered?

2. What monetary target for 1981-82 is implied by the reductions proposed? The outturn for 1980-81 will at best be at the top of the 7-11 per cent range proposed in the MTFS, perhaps a little outside it. Do the Treasury proposals imply an objective of returning to the centre of the range implied in the MTFS for 1981-82 (ie 8 per cent)? If so, is that practicable? What would be the consequences of a more gradual return to

the path (eg to 9 or 10 per cent as the central figure for 1981-82)? What would be the political consequences of modifying the government's strategy at this stage? Very roughly, each percentage point on the money supply is about £$\frac{3}{4}$ billion. A higher monetary target would accommodate a higher PSBR for any given level of interest rates - though the size of the increase would depend on its distribution.

3. Is the Cabinet content with the broad balance between reductions in public expenditure and fiscal measures in the Treasury proposals?

4. What are the likely consequences for industry, for employment and for inflation of the Treasury's proposals, both in the short and longer term?

5. Within the general framework of the MTFS, and the objective of making possible a fall in interest rates and the exchange rate, is there sufficient scope in the Treasury's proposals (or some redistribution of them) for mitigating immediate damage to industry and employment, without jeopardising longer-term objectives?

Cabinet Office

28 October 1980

ANNEX

For their discussion of the economic prospect and public expenditure on 30 October Ministers may find it helpful to have a brief summary of the main figures and points for decision arising from papers C(80)59, C(80)58 and C(80)60.

I - The Economic Prospect: C(80)59

GDP: likely to fall by 2½% in 1980 (as in Budget forecast); and by about the same amount in 1981. The Medium-Term Financial Strategy (MTFS) assumed an average GDP growth rate after 1980 of 1% a year.

Inflation: the year on year increase is currently around 16%. If recent good performance on prices is sustained, the increase is expected to fall to about 11% by late 1981.

Earnings and Profits: the year on year increase in earnings is currently well over 20%. Thus real earnings have still been rising at the expense of profits.

PSBR: latest forecast for 1980-81 is over £10 bn (£8½ bn in Budget forecast).

forecast for 1981-82 over £11 bn (on assumptions in paragraph 11 including full July cuts, full indexation of personal tax allowances and public service pay rises of 9%). This would be equivalent of 4½% of GDP (compared with illustrative figure of 3% in MTFS). To get back to MTFS would need cut of £4 bn. Chancellor proposes £2½ bn.

Points for Decision

(1) Do Ministers accept that target reduction in PSBR should be £2½ bn?

(2) Do Ministers accept the need for public expenditure cuts on the scale now proposed by the Chancellor and the Chief Secretary, given

(a) that increased tax revenue will still be required;

(b) that a substantial reduction in external financing requirements for nationalised industries is assumed, involving large price increases and cuts in capital expenditure;

(c) that the PSBR gap would be even larger if the July cuts were not already assumed.

II - Public Expenditure Programmes: C(80)58

Prospective excess over White Paper for 1981-82	£2.7 bn
of which:	
nationalised industries	£1,070m (£600m on top of £470m proposed in July)
changed economic assumptions	£ 700m
industry and employment measures	£ 150m
reserve/shortfall	£ 550m
miscellaneous	£ 250m

Points for Decision

(1) Do Ministers accept the specific cuts proposed in Table 2 first column?

(2) Do they accept an additional 2% volume cut on cash limited programmes (excluding local authority current expenditure) for 1981-82; and provisionally to carry these forward to subsequent years?

(3) Do they accept a 1% cut in local authority current expenditure for 1981-82 and subsequent years on top of the 2% cut shown in the White Paper and confirmed in August? Can this be achieved?

III - Cash Limits for 1981-82: C(80)60

Points for Decision

(1) Pay

Do Ministers accept the suggested 6% increase for public services (including Armed Forces, NHS etc)? Can it be effectively imposed?

(2) Prices

Do Ministers accept a price factor of 11% between 1980-81 and 1981-82?

IV - Announcements

Points for Decision

(1) Do Ministers with to make a general announcement in the near future of their overall position?

(2) <u>What specific announcements should be made, and when, on</u>

- public service pay and cash limits
- additional local authority cuts
- changes in other programmes
- the Industry Act forecast?

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4

PUBLIC EXPENDITURE 1974-75 to 1981-82

	1974-75	75-76	76-77	77-78	78-79	79-80 Provisional outturn	1980-81 White Paper revalued, adjusted for transfers from reserve to programmes	1980-81 Forecast outturn	1981-82 White Paper revalued	1981-82 Including likely increases and agreed cuts	1981-82 Includin remainin proposed cuts
1. Central Government (1)	53,735	54,479	54,011	52,546	55,144	55,468	57,305		57,080	57,900	57,150
2. Local authorities	24,358	24,262	22,910	21,533	21,415	21,714	20,360		19,426	19,250	19,150
3. Nationalised industries' borrowing	3,040	2,624	2,266	908	1,335	1,527	1,124		-146	625	625
4. Reserve	-	-	-	-	-	-	575		1,400	2,000	2,000
5. Special sales of assets	-	-	-	-697	-	-998	-500		-50	-150	-150
6. Shortfall	-	-	-	-	-	-	-1,120		-840	-640	-640
7. EC refunds	-	-	-	-	-	-	-	-545	-	-670	-670
8. Planning total after shortfall	81,133	81,365	79,187	74,290	77,894	77,711	77,744	78,100	76,870	78,300	77,450
9. % change on previous year	+8.5	+0.3	-2.7	-6.2	+4.9	-0.2	-	+0.5	-1.1 (2)	+0.3 (3)	-0.8 (
10. Debt interest	1,400	1,693	2,179	2,472	2,847	3,845	3,500	3,900	3,500	4,000	4,000

(1) Including public corporations other than nationalised industries, and grants to nationalised industries, but excluding Government lending to nationalised industries (included in line 3).

(2) Change on White Paper revalued for 1980-81.

(3) Change on forecast outturn for 1980-81.

Y SWYDDFA GYMREIG
GWYDYR HOUSE
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Oddi wrth Ysgrifennydd Gwladol Cymru

The Rt Hon Nicholas Edwards MP

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SWIA 2ER
Tel. 01-233 3000 (Switchboard)
01-233 6106 (Direct Line)
From The Secretary of State for Wales

Noted MS

27 October 1980

Dear Secretary of State,

R 29/10

You wrote to Geoffrey Howe earlier this month about the timetable for decisions leading up to this year's RSG Settlement and also to Norman St John-Stevas about the need for the Report on the 81/82 Settlement and Reports and Increase Orders to update the 79/80 and 80/81 Settlements to be tabled and debated before the House rises for the Christmas adjournment.

This is the first year for a separate Welsh RSG Settlement and we too of course, need to debate our Settlement in the House at the earliest possible date. For the same reasons that you set out I very much hope that this can be before the Christmas recess. It makes sense for the debate on the Welsh Report to be taken at the same time as that for England, and George Younger has commented on the need for the Scottish Order to be effected before the Christmas recess. Clearly there is a lot to be said for getting these debates over at the same time.

As regards announcements of the change in the Settlement date, Norman has suggested it would be helpful to defer announcements on this until after the Bill has completed all its stages in both Houses. There are arguments for giving the local authority associations as much warning as possible, but I am content to fall in with whatever you decide on this matter.

/ I am copying this letter to the Prime Minister, other members of MISC 21, Norman St John-Stevas, the Chief Whip and Sir Robert Armstrong

Leighton Davies.

Approved by the Secretary of State
and signed in his absence

The Rt Hon Michael Heseltine MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
LONDON
SW1P 3EB

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COPY No 9 52
PM

cc Mr Duguid

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

3

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1

27 October 1980

Dear Geoffrey,

PUBLIC EXPENDITURE

I have considered urgently the Chief Secretary's proposals in C(80)58 for reductions in my programmes. These are £10m cut in local authority current expenditure on transport next year, (which would be additional to the £15m cut which I have already offered in my bilateral with John Biffen) and a £21m cut on cash-controlled programmes.

I have no objection to my programmes taking their share of a general cut on local authority current expenditure. I am more concerned about the proposed 2% cut on my cash-controlled programmes, the bulk of which would have to fall on capital expenditure, either by my own Department on trunk roads and motorways or by local authorities on their roads. The private sector construction industry would bear the brunt, and our supporters would need to be convinced, against the background of

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what we said in Opposition and have said since about the importance of maintaining worthwhile capital programmes, that such cuts are justified in present circumstances, where an early reduction in the cost of providing public services seems to be the main objective.

My own position is that I accept that our general financial policy requires cuts in public expenditure on the scale proposed. I am willing to accept the proposals for my Department (subject to looking further at the detailed allocation) if they are necessary to achieve the overall reduction necessary next year. I would, however, reserve the right to reconsider this if, in the event, the reductions secured elsewhere fell short of what is required. I have doubts in particular about carrying forward cuts in capital programmes to later years. I would hope that, when Cabinet considers the public expenditure situation on Thursday you and John Biffen will provide the full explanation of the significance of these reductions for the objectives of our overall strategy.

Copies of this letter go to Willie Whitelaw, Christopher Soames and John Biffen, and to Sir Robert Armstrong.

Yours ever
Norman

NORMAN FOWLER

MR SAUNDERS, NO 10

cc PPS
PS/Chief Secretary
Mr Bridgeman
Miss Brown
Mr Kerr
Miss Peirson
Mr Robson
Mr R Ward
Mr Farman

PUBLIC EXPENDITURE 1974-75 TO 1980-81
(£ million at 1980 Survey prices)

The tables which we sent you on Friday 24 October are basically Cmnd 7841 (revalued) but updated for some more recent information on the years up to 1979-80, and with certain changes in 1980-81, as explained below.

2. For 1980-81, there have been some decisions to increase programmes at the expense of the Reserve, and these decisions are taken into account. The main items are:

	£ million (1980 survey prices)
Increase in British Steel's and British Rail's External Finance Limits	368
Rolls-Royce financing	51
Northern Ireland Finance (general purposes and De Lorean cars)	48
Assistance with fuel costs (including N Ireland)	19
Aid to the fishing industry	13
Civil Service early retirement scheme	13

3. The figures for 1980-81 do not, however, take account of any volume squeeze which may arise from the operating of cash limits (in particular in the case of Defence, whose cash limit has been increased, the volume figure in the attached table remains as in the White Paper, the likely volume outturn being very uncertain at present). Nor do they take account of the probability of overspend by the local authorities, the size of which is also very uncertain. Estimates of outturn will be collected later in the year, in connection with the Estimates for 1981-82 and the preparation of the next public expenditure White Paper, but such estimates will remain very uncertain until after the end of the current year (well after, in the case of the local authorities).

L.R. Robbins

L R ROBBINS
27 October 1980

NBPM Econ MS P01

2 MARSHAM STREET
LONDON SW1P 3EB

My ref: H/PSO/17857/80
Your ref:
27 October 1980

Dear Geoffrey

DEBATE ON RATE SUPPORT GRANT ORDERS

Thank you for your letter of 13 October. I have also seen your Private Secretary's further letter of 15 October which suggested that Cabinet might be unable to reach decisions on all the public expenditure issues which bear on RSG until 6 November.

This causes me concern. If we do not have final Cabinet decisions until 6 November the announcement of the settlement itself cannot be before 4 December because we must have at least 4 weeks computation and cross checking. If we were able to table the reports and orders on 4 December the House procedural requirements would mean that we could not debate them until about the middle of the week beginning 15 December. As I understand the House is likely to rise towards the end of that week it seems to me - despite Norman St John Stevas' helpful letter to me of 16 October - that our chances of securing a debate before Christmas would be very slim.

We touched upon this problem at MISC 21. I pointed out then that we need to maximise our influence on local authority budgeting. With the charges we are planning it is essential to give local government the maximum planning period. And they cannot plan fully until the Order is through the House. I very much hope therefore that we can reach final decisions on all the settlement issues at Cabinet on 30 October.

Norman also asked in his letter whether I could defer my announcement of the change in the settlement date until the Local Government Bill had completed all its stages in Parliament. On present plans we do not aim to complete the Commons' stages until about 11 or 12 November and it will be rather late in the day then to announce postponement of the settlement date from 21 to 28 November. But I will consider this further.

I am copying this to the Prime Minister, other members of MISC 21, the Chancellor of the Duchy of Lancaster, the Chief Whip and Sir Robert Armstrong.

Yours ever

MICHAEL HESELTINE

10 DOWNING STREET

From the Private Secretary

27 October, 1980.

Contributions to the Community Budget and the Public Expenditure White Paper

The Prime Minister has seen the Chancellor of the Exchequer's minute to her of 22 October on this subject. She is content that the revised estimates should be used for the forthcoming discussions on public expenditure. She would, however, wish to see the latest forecasts before they are finally included in the White Paper. The Prime Minister also agrees to the presentational changes summarised in the Chancellor of the Exchequer's minute, and that the Public Accounts Committee should be informed through the Treasury reply to the Public Accounts Committee Report.

I am sending copies of this letter to George Walden (Foreign and Commonwealth Office) and David Wright (Cabinet Office).

M. O'D. B. ALEXANDER

A.J. Wiggins, Esq.,
HM Treasury.

TABLE 1

PUBLIC EXPENDITURE 1974-75 TO 1980-81 (position as at 24 October 1980)

£ million at 1980 survey prices

	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80 Provisional outturn	1980-81 Estimated
1. Central Government	53,458	54,444	52,837	50,984	54,744	56,203	57,399
2. Local authorities	24,358	24,262	22,910	21,533	21,415	21,714	20,360
3. Certain public corporations	1,677	1,749	1,589	1,281	1,212	1,123	1,130
4. Expenditure on programmes	79,493	80,455	77,336	73,798	77,371	79,040	78,889
5. Reserve	-	-	-	-	-	-	575
6. Debt interest	1,400	1,693	2,179	2,472	2,847	3,845	3,700
7. Total public expenditure before shortfall and special sales of assets	80,893	82,148	79,515	76,270	80,218	82,885	83,164
8. Expenditure on programmes and reserve (4 and 5)	79,493	80,455	77,336	73,798	77,371	79,040	79,464
9. Net overseas and market borrowing of nationalised industries	1,640	910	1,851	1,189	523	-331	-100
10. Special sales of assets	-	-	-	-697	-	-998	-500
11. Planning total	81,133	81,365	79,187	74,290	77,894	77,711	78,864
12. General allowance for shortfall	-	-	-	-	-	-	-1,120
13. Outturn (actual or projected)	81,133	81,365	79,187	74,290	77,894	77,711	77,744
14. Percentage change on previous year		+0.3	-2.7	-6.2	+4.9	-0.2	-

TABLE 2

PUBLIC EXPENDITURE BY PROGRAMME: 1974-75 TO 1980-81

£m at 1980 survey prices

	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80 Provisional outturn	1980-81 Estimated
1. Defence	8,972	9,434	9,285	9,080	9,024	9,239	9,613
2. Overseas aid	634	707	680	720	805	779	803
EEC contributions	-13	16	281	632	774	947	1,024
Other overseas services	768	453	445	552	442	462	465
3. Agriculture, fisheries, food and forestry	2,657	2,397	1,475	1,128	932	971	960
4. Industry, energy, trade and employment	5,750	4,753	4,310	2,847	3,612	3,053	3,493
5. Government lending to NIs	1,400	1,714	415	-281	812	1,858	1,224
6. Roads and transport	4,515	4,634	4,165	3,594	3,521	3,614	3,454
7. Housing							
Capital	6,198	5,010	4,621	3,812	3,259	3,183	2,414
Current	2,147	2,231	2,377	2,260	2,433	2,593	2,542
8. Other environmental services	4,290	4,496	4,102	3,950	4,039	3,896	3,911
9. Law, order and protective services	2,638	2,812	2,868	2,797	2,827	2,963	3,106
10. Education and science, arts and libraries	10,783	10,999	10,948	10,524	10,693	10,815	10,365
11. Health and personal social services	9,963	10,352	10,462	10,531	10,827	10,816	10,959
12. Social security	14,489	15,737	16,247	17,093	18,644	19,105	19,750
13. Other public services	1,159	1,319	1,241	1,199	1,190	1,205	1,244
14. Common services	988	1,088	1,108	1,079	1,068	1,087	1,112
15. Northern Ireland	2,155	2,303	2,305	2,281	2,469	2,454	2,450

Copied to :-
EURO POL: Budget : Pt 10

Prime Minister.

Agree para 4 below?

Yes MT

Ref. A03339

MR. ALEXANDER

EC Contributions and the Public Expenditure White Paper

You will recall that the Prime Minister was struck by the apparent disparity between the figures which were presented to her and to the House following the 30th May Community budget settlement, and the figures which the Treasury had in mind to include in the next Public Expenditure White Paper, as shown in Mr. Wiggins' letter to Mr. Lankester of 2nd July 1980 and his subsequent letter to you of 9th July. The Prime Minister went through these figures with the Chancellor on 11th July. It clearly emerged that the main explanation lay in the delay in the payment of our refunds and the necessity, for PESC purposes, to show the figures in constant survey prices. The Prime Minister invited the Chancellor to consider how the presentation could be improved.

2. The Chancellor's minute of 22nd October contains both substance and presentation. On substance, he is saying that the earlier Treasury estimates probably took too gloomy a view about what our unadjusted net contribution might be. They now think that we should not have to hand over so much VAT and that our receipts will be higher because more of the money will be spent on other things and less on agriculture. Discussions on the 1981 Community budget suggests that both the Commission and the European Parliament will be useful allies in achieving the latter. Since our refund is basically a fixed amount (it does not seem likely that the 'risk sharing' formula will apply in respect of 1980), our adjusted net contribution will be correspondingly lower (by £25 million for 1980-81 and by £255 million for 1981-82). The figures may of course be subject to further revision before they need to be published in the White Paper.

3. As regards presentation, the Chancellor suggests that, while calendar year figures could not be dropped without provoking suspicion, they could be changed from a yearly cash flow basis so that they show receipts and payments

relating to each Community budget year. The change can be represented as a response to the PAC report published on 23rd October which criticised the confusing way in which the figures were presented. On this basis the negotiated refunds appear as 68 per cent, 62 per cent and 62 per cent of the unadjusted net contributions in 1980, 1981 and 1982 respectively. This is certainly an improvement.

4. If the Prime Minister agrees, you might wish to tell the Treasury:

(a) that the Prime Minister is agreeable to the revised estimates being used for the forthcoming discussions on public expenditure but that she would like to see the latest forecasts before they are finally included in the White Paper;

(b) that the Prime Minister agrees to the proposed presentational change and that the PAC should be informed through the Treasury's reply to the PAC Report.

D J Wright

(Robert Armstrong)

(approved by Sir R. Armstrong and signed on his behalf)

24th October, 1980

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Public Expend

Pt 4.

10 DOWNING STREET

From the Private Secretary

23 October, 1980

Local Government Borrowing

The Prime Minister has seen the Financial Secretary's letter of 16 October on the above subject, and she very much agrees that urgent consideration should be given to finding more effective means of controlling the Local Authority Borrowing Requirement.

I am sending copies of this letter to Stephen Locke (Financial Secretary's Office), Godfrey Robson (Scottish Office) and John Craig (Welsh Office).

T. P. LANKESTER

D A Edmonds, Esq
Department of the Environment

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Treasury Chambers, Parliament Street, SW1P 3AG
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PRIME MINISTER

EC CONTRIBUTIONS AND THE PUBLIC EXPENDITURE WHITE PAPER

At your meeting on 11 July, I undertook to consider how we could improve the presentation of the figures for our Community budget contributions in the Government's next Public Expenditure White Paper. Since then, there have been two relevant developments: agreement has been reached in Brussels on the timing of our refunds, and the Public Accounts Committee have decided to publish a report commenting on the presentation of EC Budget figures. In the light of these developments and our earlier discussion, I have taken a close look both at the figures themselves and at the method of presentation in the White Paper. This minute outlines the resulting proposals. The picture now envisaged represents a considerable improvement on that given in John Wiggins' letter of 9 July to Michael Alexander.

Revisions to figures

2. The figures which we considered in July have been updated in the light of later information including the agreement on the timing of our refunds. In addition, I believe that the Government would be justified in basing the White Paper figures on rather more favourable assumptions about the development of the Community budget than those which underlay the figures in John Wiggins' letter of 9 July. The figures could reasonably assume that -

/i. the UK share

i. the UK share of the Community VAT Own Resources base will remain unchanged (previous estimates assumed that it would rise by about 6% as a result of negotiations with the Commission over the coverage of the base); and,

ii. the economies needed to keep Community spending within a 1% VAT ceiling will bear as heavily on CAP expenditure as on other categories, thus producing a more favourable outcome for the UK.

3. On the basis of these assumptions and of the most recent information, (but ignoring receipts from the EIB and the ECSC, and that part of Community aid which is attributed to the UK aid programme) the latest figures we have calculated for our net contributions in this financial year and next are:-

	£ million at 1980 White Paper prices	
	1980-81	1981-82
1. Unadjusted net contribution	945	1120
2. Net refunds	545 -	670 -
3. Adjusted net contribution	410	450
4. 2 as a percentage of 1	58%	60%
5. Improvement in 3 since Cmnd 7841	660	750

These new figures compare favourably, especially in 1981-82 with those foreseen in July, which were:

1. Unadjusted net contribution	970	1432
2. Net refunds	535	727
3. Adjusted net contribution	435	705
4. 2 as a percentage of 1	55%	51%
5. Improvement in 3 since Cmnd 7841	636	495

/4. I propose that

4. I propose that the figures in the first table in paragraph 3 should be the ones we use in the public expenditure exercise this month. If further work in the near future shows that, on the assumptions we have used, some further contribution from this source to the public expenditure exercise could be justified, we could take credit for that at a later stage. On the other hand, although the figures in paragraph 3 are well within the range of possible outcomes, the assumptions on which they are based err if anything on the side of optimism. This optimism could produce an excess of public expenditure of up to £50m.

White Paper Presentation

5. The presumption must be that having used the paragraph 3 figures in the public expenditure exercise, we would use them in the Public Expenditure White Paper in March also. But we do not need to decide that now. The figures could well change again in the light of events and we can make a final decision nearer the time of publication.

6. The percentages of net refunds to unadjusted net contributions remain obstinately lower than one would wish, especially in 1980-81. But the comparison with the figures published in the last White Paper is impressive.

7. The revised estimates in paragraph 3 will improve the appearance of the financial year figures in the White Paper. They do not, however, solve the problem of presenting calendar year estimates of the UK's net contribution. On a calendar year cash flow basis, the reduction in the UK's unadjusted net contribution would still amount to no more than 13% in 1980 and 54% in 1981.

/8. I doubt whether

8. I doubt whether we can simply drop calendar year figures. This would maximise suspicion. MP's and commentators would be bound to ask why they had been dropped, and what the calendar year figures corresponding to the financial year figures were. We could decline to answer; but it would not be easy in practice to hold this line; especially as commentators could have a good shot at constructing the figures for themselves.

9. A better solution, which I recommend, would be to change the basis of presentation of the calendar year figures in the White Paper so as to show receipts and payments in respect of the Community budget for a particular year, not cash flow during the year. The net refunds due in respect of (say) the 1980 budget would be shown against the 1980 budget, even though the bulk of the payments will occur in 1981 and be financed from the Community's 1981 budget. As it happens, a PAC report which is to be published on 23 October (and of which we have seen a draft) provides a helpful peg for making this change.

10. If we adopt this solution, the calendar year table in the White Paper would be on the following lines:

£ million at 1980 survey prices

	1980	1981	1982
1. Gross contributions*	1780	2040	2040
2. Receipts			
a. Negotiated refunds	630	700	700
b. Other	860	910	910
3. Adjusted net contribution	290	430	430
4. Negotiated refunds 630 (2a) as percentage of unadjusted net contribution (1-2b)	68	62	62

*excluding contribution towards our own refunds

/11. This presentation

11. This presentation shows the figures in a more favourable light than the cash flow basis presentation which it would replace. But the new presentation would be consistent with the basis of the settlement and does, I believe, provide a true picture of the financial obligations that the UK incurs when agreeing to the adoption of a particular Community budget.

PAC Report

12. The PAC report of 23 October provides us with a convenient opportunity to tell Parliament what we propose several months in advance of the publication of the White Paper. As you will see from the attached extract - Annex A - the PAC criticise the "confusing variety of forms" in which information on the Community budget is presented to Parliament. The Treasury minute in reply to the report would say that, following a review of the information supplied to Parliament on the Community budget, we had decided that the White Paper should henceforth concentrate attention on two main types of presentation:

i. the financial year cash flow figures needed for public expenditure and budgetary purposes, and

ii. the figures "in respect of" a particular Community budget described above.

I attach the draft Treasury minute - Annex B - which would, on this basis, be our reply.

13. The proposed change in presentation would not necessarily divert all attention from the calendar year cash flow basis figures. We may well receive PQs asking for such figures. It would then be for consideration whether or not we should supply them. We could argue that to supply such figures regularly would create again the confusion criticised by the PAC.

/Conclusions

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Conclusions

14. My conclusions are:

i. we should use the revised estimates in the first table in paragraph 3 above as the basis for our forthcoming decisions on public expenditure and possibly in the next White Paper, but we should bear in mind that they may err on the optimistic side;

ii. we should plan to replace the calendar year cash flow basis table in previous White Papers by the table of figures "in respect of" a particular budget described in paragraph 10 above; and

iii. we should foreshadow this change of presentation in our reply to the forthcoming PAC Report, as in paragraph 7 of the attached draft Treasury minute.

May we proceed accordingly?

15. I am copying this minute to the Foreign Secretary and Sir Robert Armstrong.

(G.H.)
22 October 1980

(iv) Imbalance in the UK's net contributions

15. From information on net budget transfers within the Community provided by the European Commission and reported to the House of Commons on 25 February 1980 we see that the UK's contributions (after allowing for the adjustments under Article 131) exceeded its budgetary receipts by £626 million in 1978 and £845 million, provisionally, in 1979. The initial budget estimate for 1980 suggested that the excess would increase further to £1,310 million. In each of the three years the UK was the largest single net contributor, with Italy the second largest in 1978 and Germany in 1979 and 1980. The Treasury attributed this obvious imbalance in the UK's net contribution mainly to lower than average receipts in the Community but partly to higher than average contributions. They also told us about the Government's negotiations to secure rectification of the position. Appendix to the Report Qs 4523, 4558–60

16. Since we took evidence Parliament was informed on 2 June 1980 of the agreement reached in the Council of Ministers on 30 May 1980. Under this agreement the UK's net contribution for 1980, currently estimated by the Commission at 1,784 million EUA (about £1,080 million), would be reduced by 1,175 million EUA to 609 million EUA (£370 million). The net contribution for 1981, provisionally estimated by the Commission at 2,140 million EUA (£1,300 million), would be reduced by a similar proportion to 730 million EUA (£440 million). If the actual net contributions, before adjustment, for either of the two years exceeded the Commission's estimate the excess would be shared between the UK and the other Member States in agreed proportions. The proposed adjustments for 1980 and 1981 would be effected partly by removing the restrictions in the existing financial mechanism so as to enable the UK to qualify for a refund of contributions, and partly by the adoption of a new programme of financial support specifically for projects within the UK so as to increase its receipts. The Council also undertook to resolve the problem thereafter by means of structural changes. The agreement on the adjustment of the UK's net contributions was accompanied by an agreement on increases in Community farm prices for 1980. These were expected to result in increases in prices to consumers in the UK totalling about £200 million.

17. We do not think it would be appropriate for us to comment on the merits of the settlements negotiated by the Government, but there are some aspects to which we would draw attention. Firstly, the ad hoc settlements for 1980 and 1981 clearly do not provide an appropriate basis for any long term solution to the problem; we therefore trust that the consideration of the structural changes will bring about a more equitable sharing of the financing of the Communities' budget. Secondly, since the budgetary transactions do not by themselves provide an adequate measure of the costs and benefits of Community policies to the UK, we trust that full weight will also be given to these wider considerations in the future review of the budgetary arrangements. Thirdly, we do not know if the proposed new programme of financial assistance for projects within the UK will require some matching public expenditure from UK funds; we hope not, but in any event we trust that such projects will be

selected on their economic or social merits and not simply as a device to increase the UK's receipts from Community funds.

(v) *Accountability to Parliament*

18. Although the Consolidated Fund Accounts record the sums issued in respect of contributions towards the Communities' budgets we do not think this provides a sufficient measure of accountability for the expenditure of such large sums in accordance with the European Communities Act but without further periodic and specific Parliamentary authorisation. The extent of the UK's commitments is effectively determined when the Communities' budget for each calendar year is finally approved. We consider the Parliament has a right to be informed at that stage of the UK's estimated contributions towards the budget and of its expected receipts both from the refunds for collection expenses and from each of the Community programmes. We acknowledge that Parliament has in the past been given a substantial amount of information about the Communities' budgets, but this has been on an ad hoc basis and in a confusing variety of forms.

19. We therefore recommend that the Government should in future present to Parliament, as soon as the Communities' budget for any year is finally approved or subsequently revised, a statement giving the details of that budget, the UK's estimated contributions towards it and the expected receipts from it, expressed both in EUAs and in sterling; and that they should also present, after the close of the Communities' budgetary year, a corresponding outturn statement which can be reconciled with the charges to the Consolidated Fund Accounts. We also consider that such statements should, as far as possible, be set in the context of the contributions and receipts of the other Member States. As stated in paragraph 15 above, Parliament was provided with such information for 1978, 1979 and the initial budget estimate for 1980, but the Treasury told us that this had been obtained from European Commission sources and was derived from an ad hoc exercise. They were uncertain whether the Commission would continue to produce such information regularly. Since such information must clearly be available to the Commission and is of legitimate concern to the individual Member States, we trust that the Government will press for its continuing availability and will incorporate it in the statement which we recommend should be presented to Parliament.

Qs 4558–60, 4586–7

ANNEX B

DRAFT TREASURY MINUTE IN REPLY TO PAC REPORT (See paragraph 12 of covering minute)

The Government note the comments and recommendations of the Committee.

2. The Government will certainly seek to ensure that the review of the Community's policies and budgetary arrangements provided for in the 30 May 1980 agreement brings about a more equitable sharing of the financing of the Community budget and takes due account of the non-budgetary effects of Community policies.

3. The Government notes the Committee's comments on the proposed new scheme of Community support for public investment programmes in the UK. The Community will be contributing a proportion of the cost of these programmes, which will in all cases be part of existing public expenditure plans and chosen on their economic and financial merits.

4. The Government have noted the Committee's view that, while a substantial amount of information about the Communities' budgets is already provided to Parliament, it has been on an ad hoc basis and in a confusing variety of forms. They have concluded that the most helpful course in future would be to provide Parliament with the following statements.

5. First, as recommended by the Committee, the Government would present to Parliament, as soon as possible after the Community's budget for any year is finally approved, a statement giving details of that budget and the UK's expected contributions towards and receipts from it, expressed both in EUAs and in sterling. Second, again as recommended by the Committee, an outturn statement on the same basis would be presented to Parliament in the autumn of each year, as soon as the necessary figures for the preceding year's budget are available from the Commission.

6. The Government hope that it will be possible to include with these statements information from the Commission about the contributions and receipts of other member states. They will ask the Commission for this information.

7. Finally, the Government would improve the presentation of the UK's contributions to the Community budget in the annual Public Expenditure White Paper by concentrating on two forms of statement. The first would, as in previous White Papers, show gross and net contributions to the Community budget on a cash flow basis by financial years. This statement could be reconciled with the charges to the Consolidated Fund and National Loans Fund accounts, and corresponds to UK methods of public expenditure and budgetary control. The second statement would show the gross and net contributions and the refunds arising out of each annual Community budget, irrespective of when the payments and receipts occurred. This statement would reflect the Community's budgetary basis and the Community decisions which determine our gross and net contributions and commit UK public expenditure accordingly.

8. The statements in the supplementary statements to the Consolidated Fund and National Loans Fund accounts would continue. These statements would also identify in future the refunds arising from the 30 May agreement.

PART 10 ends:-

Unwin to ChEx 22.10.80

PART 11 begins:-

C(80)58 22.10.80