PREM 19/169

SECRET

PART 12

Confidential Filing

MT

Public expenditure and cash limits.
Rate support grant.
Pay factors in cash limits.

ECONOMIC POLICY

Part 1 : May 1979
Part 12 : November 1980

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~12.11.80~~							
~~20.11.80~~							
~~24~~. 11.80							
—ends—							

PART 12 ends:-

CST to S/S Env 24.11.80

PART 13 begins:-

C(80)73 25.11.80

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
C (80) 70	11.11.80
CC (80) 40th Conclusions, Minutes 1 and 6	13.11.80
Limited Circulation Annex to CC (80) 40th	
Conclusions, Minute 7	13.11.80
C (80) 72	17.11.80
Limited Circulation Annex to CC (80) 41st	
Conclusions, Minute 5	19.11.80

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 *CWayland* Date *4 February 2010*

PREM Records Team

Top papers with the
Prime Minister

Date 30.12.51

Try NSI on
Economic Prospects
to End 1981 24.11.80

2nd Copy.

Treasury Chambers, Parliament Street, SW1P 3AG

2

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

24 November 1980

Dear Michael,

COUNCIL HOUSE SUBSIDIES AND RENTS: RATE SUPPORT GRANT

Your letter of 20 November made suggestions for the Chancellor's statement today and set out the ground you purpose to cover in your opening statement in Tuesday's housing debate. This letter deals with the latter. The RSG aspects will be dealt with separately.

We are content with your proposals and your draft speech except in one important respect. I am afraid that we cannot agree to your saying, in relation to the effects of the housing moratorium, as you propose on page 3 of your letter and at the end of the draft you enclosed entitled "Housing Overspend", "Conversely if as a result of those steps the cash limit this year is underspent then the amount of the underspend will be added to next year's cash limit."

– See XCY of Heseltine letter below

It has always been our position that any "tolerance" of this kind must be accommodated within the cash limit derived from your PES allocation. That is why the Treasury paragraph in your paper E(80)130 said that increasing allocations to individual authorities in 1981-82 who underspend in 1980-81 must be subject to the total allocation and expenditure in 1981-82 being kept within the cash limit for that year. This can be achieved by allocating less than the full PES provision at the outset of the year and holding the back balance until it is clear that the additional expenditure carried forward will be sufficiently offset by shortfall to allow further allocations.

E Committee did not in my view resolve that the overall cash limit should be increased by the amount of any aggregate underspend (which would effectively increase the DOE PES allocation).

The Prime Minister's summing up of the discussion on 18 November refers only to the allocations to authorities including additions for underspending in 1980-81, which is consistent with the Treasury position. I must therefore ask you to omit this statement from your announcement.

I am copying this letter to the recipients of yours.

Yours

John Biffen

JOHN BIFFEN

Econ Policy

END NOVEMBER STATEMENT

With permission Mr. Speaker I wish to make a statement affecting both revenue and expenditure in the coming financial year.

Monetary Policy

I am today publishing the economic forecast that is required by the 1975 Industry Act. I said in my Budget Speech that I would consider this autumn the roll-over of the monetary target of 7 to 11 per cent growth at an annual rate set for the period from February 1980 to next April. I have done so in the light of monetary developments and developments in the economy generally.

Inflation is now falling rapidly. But monetary growth is likely to exceed the target. Recent statistics have, of course, been bedevilled by distortions apparent since the abolition of the corset imposed by the previous administration. The excess will certainly be less than the figures so

/far suggest.

far suggest. There are signs that bank lending is now starting to slow down. And as the public sector moves into surplus in the New Year I expect monetary growth to slow down in the rest of the target period.

The existing monetary target continues until April 1981. I do not propose today to extend the target period beyond that date, but I shall announce a new target in the Budget. The Budget will be designed to ensure that the thrust of the medium-term financial strategy is maintained.

The Treasury and Bank of England have completed the consultations arising from the Green Paper on methods of monetary control published last March. As a result between now and the Budget a number of improvements will be set in hand.

First, detailed consideration of new prudential arrangements for the banks will be brought to a conclusion so that the reserve asset ratio, which has complicated monetary control, can be phased out.

/Second, the

Second, the Bank of England will develop changes in its open market operations and last resort lending - in ways that will allow the market a greater role in the determination of the structure of short-term interest rates. Third, we are considering the future of the clearing banks' cash ratio and also collecting and publishing an additional series for banking retail deposits. These steps are desirable in their own right. They would be consistent with a gradual evolution towards a monetary base system, and will help us to judge how far such a system would contribute towards our medium-term monetary objectives.

I shall take further steps to mobilise directly a larger share of personal savings. I shall, in particular, extend the eligibility for index linked certificates so as to attract a total of not less than £3 billion of new money into national savings next year.

/Public Expenditure

<u>Public Expenditure</u>

As the House already knows, the unadjusted figure for the PSBR in the first half of this financial year was about £8½ billion. I expect a much lower figure for the second half of the year. But it could be around £11½ billion for the year as a whole. Over half the increase is attributable to the recession being deeper than expected. I now expect the volume of expenditure this year to be some 1½ per cent higher than expected at the time of the last White Paper, once again very largely because of the effects of the recession. If any excesses were to emerge over this year's cash limits, such overspending will be fully offset by reductions in the corresponding cash limits for 1981-82.

Spending on unemployment and other benefits will be higher next year than allowed for in the White Paper of last March. The effect of the recession on trading conditions is similarly reflected in the external financing limits for the nationalised industries

/for 1981-82

for 1981-82 which, excluding steel, are being announced separately today. These provide £620 million more than in the March White Paper. Even so, these industries are being required to secure substantial economies totalling more than £¾ billion. These amounts, and the other public expenditure changes I shall mention, are in the 1980 survey prices at which the decisions have been taken - that is broadly the prices of a year ago.

My rt. hon. Friend the Secretary of State for Employment announced last week extensions of the special employment measures. The Government have also decided to increase the provision for selective assistance for investment and support for industrial research and development. Next year the additional costs of these two measures will be £245 million and £50 million respectively.

Part of these increases will be balanced by the substantial reduction in our net contribution to the

/European Community

European Community Budget as a result of the agreement negotiated on 30 May. We now expect our refunds next year to be some £650 million.

In order further to offset upward pressures on expenditure, we are making cuts in the volume provision for the majority of spending programmes. Our aim is to keep the planning total for the volume of public expenditure in 1981-82 about 1 per cent below the outturn now expected for the current year.

I should mention some of the main changes. The scale of defence expenditure is such that we must make some adjustment. Planned expenditure in 1981-82 will be £200 million less than allowed for in the March White Paper. Defence expenditure grew by 3 per cent in 1979-80. It is now expected to grow by some 2½ per cent both this year and next.

For local authority current spending next year we shall be seeking a reduction of about 3 per cent in volume compared with the level we planned for this

/year.

year. We also propose to calculate the Rate Support Grant on the basis of providing a lower percentage of the reduced volume than the 61 per cent (for England and Wales) in recent RSG settlements. My rt. hon. Friends the Secretaries of State for the Environment, Scotland and Wales will be consulting their local authority associations on these proposals before the RSG settlements next month.

During 1980 prices have increased less than we allowed for when we decided on the uprating of social security benefits for this November. This will mean some increase in the real value of benefits. Subject to the necessary legislation, this over-provision, at present estimated at one percentage point, will be deducted from the 1981 uprating. This will maintain the real value of the retirement pension. Public service pensions will be treated in the same way. Any further action on index linked public sector pensions will follow the report of the Scott Enquiry which is expected next month. We have also decided

/that the

that the earnings limit for retirement pensioners will remain unchanged. A decision on child benefit uprating will be taken at the time of the Budget.

In addition to a number of other specific reductions, cash limited central government spending programmes except health are being cut by 2 per cent. The total savings from all these reductions are over £1 billion next year.

I shall be publishing in the Official Report and making available in the Vote Office now a summary of the effect on expenditure programmes in 1981-82 of these decisions. Further details of the changes for the years to 1983-84 will be set out in the public expenditure White Paper to be published at the time of the Budget.

We must also restrict the cost, and so the cash requirements, of the public sector. The cost of public expenditure programmes is as important as volume. It is essential to our fiscal policy, and also entirely fair, to look in the coming year for a much lower growth in public service earnings than in the recent past. It has already been announced that the Rate Support Grant limit will allow for a 6 per cent annual increase in earnings from due settlement dates in the current pay round. It will provide for an increase in prices other than pay of 11 per cent between the average levels for 1980-81 and 1981-82. Expenditure in other parts of the public services will be subject to broadly the same financial disciplines.

/Revenue

Revenue

I have also been giving consideration to the revenue requirements for financing next year's expenditure. I am determined that

the PSBR in 1981-82 should be consistent with the Government's medium-term economic strategy, and the need to ease the burden of adjustment at present falling on industry. The main fiscal decisions must await my Budget. But I have already announced proposals for a new scheme of stock relief. This largely removes from continuing businesses the threat of tax clawback and holds out the prospect of significant relief for companies and the self-employed.

If we are to secure a full financial year's revenue, then given the lead times involved, some other decisions are necessary now. That is why this is regularly the time of year for reviewing and announcing changes in National Insurance

/Contributions.

Contributions. We have concluded that an increase in employees' contributions would be appropriate. Full details of the changes, and their effects on the National Insurance Fund, are set out in the Government Actuary's Report to be published tomorrow.

In the first place, we propose that employees' contributions should be increased next year by ¼ per cent, which the Government Actuary's calculations show would be needed to keep the Fund in balance, while meeting larger demands for benefits.

Second, in order to maintain the planned level of health services, we propose that the health element of the national insurance contribution should be increased, again for employees, by a further quarter per cent.

Third, the Fund at present receives a substantial contribution from the general taxpayer through the Treasury Supplement. In addition the whole cost of non-contributory

/benefits

benefits also falls on the general taxpayer. In these circumstances, it is right that those in work should shoulder directly a larger share of the cost of contributory benefits. We propose therefore to reduce the Treasury Supplement to the Fund from 18 per cent to 14½ per cent. This will be offset by a further increase in the employees' rate of half a per cent.

The combined effect of these changes will increase the employees' rate of national insurance contributions from 1 April 1981, on earnings between £27 per week and £200 per week, from 6¾ per cent to 7¾ per cent. The additional contribution income will be about £1 billion in 1981-82. Other rates and levels, including those for the self-employed, will also change. Having regard, however, to the financial pressures on industry and the way the employer's share has grown in recent years, employers' contribution rates (including the surcharge) will remain unchanged. My rt. hon. Friend the Secretary of State for Social Services will introduce

/the necessary

the necessary legislation.

Since March there has been time to assess more fully the implications of the steep rise in the price of oil since 1978. This has been on as large a scale as that in 1973-74. The Government have concluded that there is scope for a further increase in oil taxation.

Petroleum Revenue Tax - because of the way reliefs are structured - does not provide an adequate means of obtaining further revenue. I shall therefore introduce in the next Finance Bill a supplementary tax to be paid in addition to PRT, to take effect from the beginning of next year. Present indications for the new tax point towards a rate of 20 per cent on gross revenue less an allowance. It will apply to fields which are in production whether or not they are yet liable to PRT. It will be deductible in calculating petroleum revenue tax and corporation tax. The Inland Revenue are setting out further

/details in a

details in a press notice and will be inviting the industry to hold immediate consultations with them.

We are also examining the scheme of PRT reliefs and any changes, which will take effect from the same date, will be included in the next Finance Bill.

I am confident that none of these changes will deprive companies of a fair return on their North Sea projects and exploration. They will together yield around £1 billion in 1981-82, mostly from the new tax.

Interest Rates

The changes which I have announced should leave no room for doubt about my determination to control the PSBR so as to lighten the burden on the private sector.

/The growth in £M3

The growth in £M3 and the wider monetary aggregates is expected to decline in the New Year and the narrower aggregates have been growing slowly. Inflation has come down appreciably, and is well below the current level of short-term interest rates. In agreement with the Governor of the Bank of England I have therefore concluded that some reduction in these rates is possible. Accordingly the Bank of England, with my approval, is this afternoon announcing a reduction in Minimum Lending Rate of 2 percentage points.

copied to
Nat Ind, Policy

H. M. TREASURY

Parliament Street, London SW1P 3AG, Press Office: 01-233-3415
Telex 262405

24 November 1980

NATIONALISED INDUSTRIES: EXTERNAL FINANCIAL LIMITS

As indicated in the Chancellor's statement today, the Chief Secretary to the Treasury, the rt. hon. W J Biffen, MP, today announced the External Financing Limits for the nationalised industries for the financial year 1981-82.

In a written Answer to a Parliamentary Question by the rt. hon. Sir R Graham Page, (Crosby) the Chief Secretary announced the figures for individual industries exluding British Steel, whose limit will be announced later.

The text of the Parliamentary Question and Answer is attached.

PRESS OFFICE
HM TREASURY
PARLIAMENT STREET
LONDON SW1P 3AG
01-233-3415

181/80

The rt hon Sir R Graham Page:

To ask the Chief Secretary to the Treasury what limits have been set on the external financing of the nationalised industries for the financial year 1981-82.

The limits are as follows:

Nationalised Industries' External Financing Limits 1981-82*

		£ million
National Coal Board		882
Electricity Council & Boards		-210
North of Scotland Hydro-Electric Board		32
South of Scotland Electricity Board		77
British Gas Corporation		-390
British National Oil Corporation		-360
Post Office	(Post & Giro	16
	(Telecommunications	180
British Airways Board		101
British Airports Authority		14
British Railways Board		920
British Transport Docks Board		-5
British Waterways Board		32
National Freight Company		7
National Bus Company		75
Scottish Transport Group		17
British Shipbuilders		150

These limits have been set, following consultations with the industries concerned, on the lines set out in my Rt. Hon. Friend's answer on 4 August 1980. (Hansard W.A. col. 41-42).

Notes

*No figure is included for British Aerospace on the assumption of a sale of shares in a successor company in 1980-81, or for the British Steel Corporation where a limit will be announced in the light of their Corporate Plan expected shortly. As in the past the forecast for BNOC does not represent a limit. The limit for the British Gas Corporation is before the imposition of the proposed Gas levy.

Notes for Editors

External financing limits (EFLs) are "a form of cash limit" for individual industries. They control the amount of finance (grants and borrowing) which an industry can raise in any financial year from external sources. They are thus the difference between very much larger flows of revenue and expenditure, both current and capital. As last year, the limits are being set in the autumn so that the industries can take them into account in wage-bargaining.

2. The White Paper on the Government's Expenditure Plans (Cmnd 7841) emphasised (page 55) the particular uncertainties attaching to the figures for the nationalised industries for the later years because their revenue and expenditure, like those of private sector companies, depend on trading conditions. As the Chancellor explained in his statement, the limits represent an increase of £620m on the White Paper figures reflecting the impact of the recession at home and abroad. To keep to these figures the industries have been asked to make substantial economies of more than £800m. (Both figures are at "1980 survey prices" - roughly £800m and over £1,000m in cash respectively.)

3. The Chancellor of the Exchequer set out on 4 August 1980 (Hansard WA col 41-42)the Government's approach to setting and administering EFLs. This will apply to the figures announced today. The statement made clear the role which EFLs play in the control of public sector borrowing. It also said (as did the April 1976 cash limits White Paper) that since the nationalised industries are trading organisations with large flows of expenditure and revenue, the EFLs cannot be immutable; but that equally there can be no presumption that a financing deficit would be met, as happened before 1976, by a further injection of external finance and went on to define in broad terms the circumstances in which the Government would be prepared to consider adjusting EFLs.

H. M. TREASURY

Parliament Street, London SW1P 3AG, Press Office: 01-233-3415
Telex 262405

24 November 1980

PUBLIC EXPENDITURE 1981-82

The Chancellor of the Exchequer, the Rt Hon Sir Geoffrey Howe MP, announced in Parliament today a number of Government decisions about public spending programmes for 1981-82. He said that some increases must be expected and planned for in expenditure arising from the recession. In view of this, cuts must be made in the plans for the majority of spending programmes.

Changes now announced from the plans for 1981-82 in the public expenditure White Paper of March 1980 (Cmnd 7841) include (figures at 1980 survey prices):

(i) An increase of £620 million in the external financing limits of the nationalised industries (excluding British Steel), including revised provision for shortfall. The increase reflects the deterioriation in trading conditions. The industries are being required to secure substantial economies exceeding £¾ billion. (See separate Press Notice covering the written answer by the Chief Secretary, Mr W J Biffen, to Sir Graham Page MP.)

(ii) An increase of £245 million in provision for special employment measures, as announced by the Secretary of State for Employment on Friday 21 November.

(iii) A reduction of £200 million in planned defence expenditure, which grew by 3%

in 1979-80 and is now expected to grow by some 2½% both this year and (after this change) next.

(iv) A reduction of about 3% rather than 2% in local authority current expenditure compared with the plans for 1980-81. This means a further reduction of £165 million in England, and corresponding reductions in Scotland and Wales.

(v) Changes in pensions and other benefits. Prices have increased less than the Government allowed for when deciding on the uprating of social security benefits for November 1980. There will accordingly be some increase in the real value of benefits. Subject to the necessary legislation, this over-provision, at present estimated at one percentage point, will be deducted from the 1981 uprating. This will maintain the real value of the retirement pension. Public service pensions will be treated in the same way. The earnings limit for retirement pensioners will remain unchanged.

The summary of expenditure policy decisions so far taken, included in the Official Report (Hansard), is attached.

PRESS OFFICE
HM TREASURY
PARLIAMENT STREET
LONDON SW1P 3AG
01-233-3415

NOTES FOR EDITORS

1. Today's announcements relate to policy decisions taken since Cmnd 7841. The next White Paper, to be published with the Budget next spring, will also include details of further changes resulting from revised economic assumptions and from decisions not yet taken, including decisions on the external financing limit of British Steel and the uprating of child benefit next year. It will also include figures for later years of the survey period.

2. 1980 survey prices are explained in the text attached (para 4). Revalued to those prices, the planning totals in the last two full White Papers were:

	£ million		
	1979-80	1980-81	1981-82
Planning total after shortfall:			
Cmnd 7439 (January 1979)(table 1, line 12)	80,340	82,090	83,470
Cmnd 7841 (March 1980)(table 1.1 line 13)	78,340	77,810	76,870

3. Some further background to the main changes is as follows.

Special employment measures: As announced by the Secretary of State for Employment on 21 November, the increase of £245 million will permit the continuation of existing schemes and the expansion of others, in particular the Youth Opportunities Programme which should provide places for 440,000 young people next year, 180,000 more than was planned for this year.

Industrial support: The increase of £52 million covers additional selective assistance for industrial investment, and support for industrial research and development. Upgradings of assisted areas affected by the rundown of the steel industry account (with other minor changes) for a further £10 million.

Local authorities' current expenditure: The Government is now seeking a total reduction in 1981-82 of about 3% compared with the planned level for 1980-81. The White Paper plans, and the provisional announcement in August, envisaged a reduction of about 2%. The local authority associations will be consulted about these proposals before the Rate Support Grant settlements for England, Scotland and Wales are announced next month.

Local authorities' capital expenditure: The reductions in Departments' programmes will include reductions in this expenditure. Details will be announced separately in due course.

Department of Environment (including Property Services Agency): The reduction of £158 million is in addition to the reduction in local authority current expenditure. The breakdown of the reduction between housing, other environmental services and the Property Services Agency will be given in due course.

Department of Education and Science: Education forms a major part of local authority activity and will be affected by the reduction in local authority current expenditure. In addition a reduction of £52 million compared with Cmnd 7841 revalued will be made on the remainder of the programme. The composition of this figure will be announced by the Secretary of State for Education and Science in due course.

Department of Health and Social Security (health): The planned level of health services is to be maintained. The savings of £25 million shown will be found through better use of resources. Gross current spending by Health Authorities will be about 1¼ per cent higher in real terms in 1981-82 than this year, allowing both for demographic changes and improvements in services. The table also shows an addition of £100 million to net expenditure (plus £21 million in Scotland, Wales and Northern Ireland) resulting from decisions not to proceed with some proposals for charges (see Cmnd 7841 page 105, paragraph 9).

Export Credits Guarantee Department: The Trustee Savings Banks have agreed to take over a further £200 million (cash) of outstanding fixed rate export credit refinance in 1981-82 (£166 million in 1980 survey prices).

Department of Health and Social Security (social security): The reduction of £66 million reflects the proposals mentioned above concerning retirement pensions and other benefits, and certain other changes. A decision on child benefit uprating will be taken at the time of the Budget.

Public service pensions will be treated in the same way as retirement pensions. Any further action on index-linked public sector pensions will follow the report of the Scott Enquiry expected next month.

European Community budget contribution: The UK's net contribution to the EC budget has been reduced substantially as a result of the agreement negotiated on 30 May 1980. The refunds are expected to total about £550 million in 1980-81 and about £650 million in 1981-82.

[NOT] FOR CIRCULATION IN THE OFFICIAL REPORT

SUMMARY OF PUBLIC EXPENDITURE POLICY DECISIONS

A. Volume

1. The changes in expenditure programmes for 1981-82 due to policy decisions since the March Public Expenditure White Paper (Cmnd 7841) are:

	1981-82 £m at 1980 Survey Prices (b)	
Nationalised Industries		
Increases in EFLs (other than for British Steel) including revised provision for shortfall		+620
Other policy increases (a)		
Special employment measures	+245	
Industrial support	+ 52	
Industry (other)	+ 10	
Health (withdrawal of some proposals for new charges)	+121	
Civil superannuation (accelerated retirement of civil servants)	+ 64	
Trade	+ 21	
		+510
Other significant policy changes: (a)		
(i) Local Authority Current Expenditure (England) - reduction by about 3% instead of 2% from planned level for 1980-81	-165	
(ii) Further changes in Departmental programmes (excluding elements of local authority current expenditure included in (i))		
Agriculture Departments	- 36	
Department of Employment	- 25	
Department of Transport	- 21	
Department of Environment (including PSA)	-158	
Home Office	- 17	
Department of Education and Science	- 52	
Office of Arts & Libraries	- 10	
Department of Health & Social Security (health)	- 25	
(iii) Other Departments		
Defence	-200	
Foreign & Commonwealth Office	- 16	
Export Credits Guarantee Department	-166	
Department of Health & Social Security (social security)	- 66	
Scotland, Wales and N. Ireland (including changes to local authority current expenditure in Scotland and Wales)(c) (about)	- 90	
Other (about)	- 15	
		-1,060
EC refunds agreed on 30 May 1980		- 650

/ Footnotes - see next page

2. The changes take account of the salary savings expected in 1981-82 from the progressive reductions in Civil Service numbers to 630,000 by 1984.

3. The list does not include changes where the exact amount will be decided later eg British Steel and Child Benefit. Nor does it include the estimating adjustments, eg for demographic and economic factors, which will be made in the public expenditure White Paper to be published at the time of the Budget. The White Paper will include further details of the policy changes for 1981-82 and will set out the plans for 1982-83 and 1983-84.

4. The figures are in the prices used for the 1980 Public Expenditure Survey. "1980 Survey Prices" means for most expenditure broadly the prices of late 1979, which were some 18 per cent higher than the 1979 survey prices used in Cmnd 7841. For transfer payments (including overseas aid), 1980 survey prices are generally estimated average prices for 1979-80, ie about the same as those in Cmnd 7841, as a result of a change of definition since that White Paper.

B. Cash limits

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

6. The cash limits for the Rate Support Grant and for the Universities' Grant will include allowance for increases in earnings of 6% in annual settlements due before 1 August 1981, and also provisionally of the same amount for annual settlements due after that date. The allowance for pay in other cash limits, and Votes, will be so set that the pay of the relevant groups is dealt with broadly within the same financial disciplines. The outcome of settlements in particular cases will depend on the way in which the cash is allocated.

(a) The increases and reductions shown include the net effect of various minor policy changes.

(b) Total changes are rounded to the nearest £5 million.

(c) The exact changes to Scotland, Wales and Northern Ireland programmes, in parallel with those to English programmes, will be given in due course.

H. M. TREASURY

Parliament Street, London SW1P 3AG, Press Office: 01-233-3415
Telex 262405

24.11.1980

1981-82 CASH LIMITS

The Chancellor of the Exchequer, the Rt Hon Sir Geoffrey Howe, QC MP, has written today to the Rt Hon Edward Du Cann, MP, Chairman of the Treasury and Civil Service Committee. The text of the letter is as follows:

'My statement today covers certain general aspects of the 1981-82 cash limits relating to pay in the public services. To avoid any misunderstanding I am writing now to inform you and the Treasury and Civil Service Committee of two further specific points; and I am releasing this letter to the press.

First, the prospective increase in the paybill between financial years. In particular cash limits or Votes the actual percentage increase between 1980-81 and 1981-82 in the provision for pay will differ from the announced provision for the increase in earnings from due settlement dates. The number employed may change. 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 been staged in 1980-81 with increases paid later than the usual settlement dates, but such staging not being repeated in 1981-82. This last will contribute some 1% to the increase in the total public service paybill between the two years.

Second,staging. 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 thinks it desirable for the future to avoid the delay or staging of awards, and will avoid it where it is itself the employer. If, this general policy notwithstanding, a public services employer were to delay or stage an award, the Government, when setting the relevant cash limits for the subsequent year, would not allow for the element of the award which had only been made compatible with the cash limit by such delay or staging.'

PRESS OFFICE
HM TREASURY
PARLIAMENT STREET
LONDON SW1P 3AG
01-233-3415

183/80

NOTE FOR EDITORS

The Chancellor confirmed in his statement today that the Rate Support Grant cash limit will allow for a 6% annual increase in earnings from due settlement dates in the current pay round, and for an increase in prices other than pay of 11% between the average levels for 1980-81 and 1981-82. Expenditure in other parts of the public services will be subject through cash limits to broadly the same financial disciplines.

This letter deals with certain aspects of the application of cash limits to pay, to which the Treasury and Civil Service Committee had drawn attention in their Second and Fifth Reports for the Session 1979-80. (HC584 and 730). The letter:-

(i) points out that the percentage increase in the pay bill between two financial years, and for the percentage increase in the cash limit, will not necessarily be the same as the percentage increase in the level of earnings, particularly where the settlement date is in the middle of the financial year;

(ii) explains the way in which cash limits will be calculated where awards have been staged in the past; and

(iii) states that the Government consider that for the future it is desirable to avoid the delay or staging of awards.

INLAND REVENUE
Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01-438 6692 OR 6706

[1x] 24 November 1980

OIL TAXATION

The Chancellor of the Exchequer announced today in the House of Commons his intention to introduce a supplementary tax on income from UK oil and gas production. He referred also to possible changes in the Petroleum Revenue Tax (PRT) reliefs.

It is proposed that these measures will be introduced in the 1981 Finance Bill and will take effect from 1 January 1981.

PROPOSED NEW TAX

1. It is envisaged that the new tax will be charged at a single rate on the total value of oil and gas produced ("gross revenues") under a UK licence, after deduction of an allowance. It will be computed on a field-by-field basis and will be deductible for PRT and Corporation Tax.

2. An allowance will be deductible from gross revenues: in this respect the new tax will differ from PRT, for which there is a deduction for actual field expenditures incurred and also an "oil allowance". It follows that companies whose field revenues are greater than the allowance may expect to pay the new tax even though they may not yet be liable to pay PRT. The precise form of the allowance will be decided by Ministers in the light of the Inland Revenue's discussions with industry representatives. For illustrative purposes, an allowance equal in value to a fixed amount of oil - or the value of actual production, if less - for each period might be taken as an indication of the type of allowance Ministers have in mind.

Yield and Rate

3. A further £1,000 million revenue in 1981/82 is expected from the oil taxation measures announced today, mostly from the new tax. For illustrative purposes, the new tax charged at a rate of 20 per cent, with an allowance of 1 million tonnes of oil per year might be expected to raise revenues of this order.

REVIEW OF PRT RELIEFS

4. The Chancellor has asked the Inland Revenue to review the

existing PRT reliefs in the light of the changed circumstances since PRT was introduced in 1975. These include changes both in North Sea economics and in the North Sea tax regime itself.

Scope and Progress of the Review

5. The review is concerned with the operation of, and interactions between, the following reliefs: the "uplift" on certain expenditure, the oil allowance and the "safeguard". (Brief details of these reliefs are given in the Annex.) A main purpose of the review is to ensure that the original objectives of the PRT reliefs - including protection of the post-tax returns to fields of lower profitability - are achieved efficiently and economically.

Discussions

6. The Inland Revenue will be in touch with the industry's representative bodies with a view to arranging discussions of the technical aspects of these matters as soon as possible.

ENQUIRIES

7. Enquiries about this press notice should be addressed to The Secretary, Inland Revenue Policy Division 7, (Oil), Room 55a West Wing, Somerset House, London WC2R 1LB - telephone 01 438 6670 or 438 7437 or the Inland Revenue Press Office 01 438 6692 or 01 438 6706.

PETROLEUM REVENUE TAX

PRT is a tax specifically charged on the profits of winning oil and gas under licence in the United Kingdom (or the United Kingdom continental shelf). The charge is on the landed value of oil and gas less the expenses (licence royalties and field costs - including capital expenditure but not interest) incurred in finding, extracting and landing it. The tax is charged on each field separately, currently at a rate of 70 per cent. Apart from the relief for expenditure already mentioned, the following reliefs are given:

UPLIFT

A supplement of 35 per cent is given on certain expenditure (notably expenditure on bringing the field into production).

OIL ALLOWANCE

An oil allowance equal in value to ½ million tonnes of oil (or to PRT profits for the period where less) is given to each field for each six-month chargeable period, subject to a cumulative maximum allowance of 5 million tonnes for each field.

SAFEGUARD

Where PRT profits for any calendar year (before deducting any "upliftable" expenditure - see above) are less than 30 per cent of total "upliftable" expenditure allowed to date, no PRT is charged. Above this level, there is an overriding limit to PRT payable equal to 80 per cent of the excess over 30 per cent of total "upliftable" expenditure.

CONFIDENTIAL

N R

14

DEPARTMENT OF EDUCATION AND SCIENCE

ELIZABETH HOUSE, YORK ROAD, LONDON SE1 7PH

TELEPHONE 01-928 9222

FROM THE SECRETARY OF STATE

R.

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

24 November 1980

R/PM's box?

Dear Michael.

Thank you for sending me a copy of your letter of 20 November to Geoffrey Howe.

I am content with all your revised proposals for the handling of RSG and am grateful to you for meeting the points that Janet Young and I made in our letters of 17 and 18 November and in particular for proposing 16 December for the statutory meeting of the Consultative Council.

You will wish to know that my officials will be consulting the local authority associations in the Expenditure Steering Group - Education, at a meeting already arranged for 8 December, on the implications of the education total which will be quoted in the "Government proposals" paper for discussion by the Consultative Council on 4 December.

May I raise one other matter about RSG? Our officials have been in touch about the presentation of information on grant related expenditure in the report on the RSG Order which you will be laying before Parliament. I am anxious, as I think you are, that the report should be as helpful as possible to MPs and the public and I hope you will be able to accept the sort of approach which my officials have suggested. If necessary, perhaps we could have a talk about this with other colleagues concerned.

I am sending copies of this letter to the Prime Minister, the other members of the Cabinet, Norman Fowler and Sir Robert Armstrong.

Yours ever

Mark

~~MARK CARLISLE~~

CONFIDENTIAL

24 NOV. 1980

SECRET until Chancellor's Statement
[redacted] on 24.11.80 then
Covering CONFIDENTIAL

12a

BRIEFING FOR 24 NOVEMBER ANNOUNCEMENTS

I attach briefing on the Chancellor's Statement to be made on Monday 24 November at 3.30 pm. The brief is classified secret except for those passages marked 'Confidential' or 'Not for use'.

A. Bottrill.

A BOTTRILL

EB

23 NOVEMBER 1980

This is an excellent brief

Mr Ehrig : pl cc for
Mr Ingham (at airport)
Mr Gaffin
Press Office
Mr Wolfson
Mr Hoskyns
Mr Lankester

& return to me.

T.
24/11

CONFIDENTIAL
till after Statement 24.11.80

CONTENTS LIST

A1. THE ANNOUNCEMENTS AND GENERAL ECONOMIC STRATEGY

Factual

(i) Announcements fully consistent with Government's medium-term financial strategy of securing sustained reduction in inflation through reduction of monetary growth with complementary fiscal policy.

(ii) No "mini-Budget". Fiscal items cover not this year but 1981-82. Reflect outcomes of usual review exercises ready for announcement at this time of year - broad conclusions of Cabinet discussions of public spending plans and normal autumn review of National Insurance contributions for coming year. New oil tax announced now to allow for consultations with industry and full year's revenue in 1981-82.

(iii) 1981-82 PSBR 1981 Budget time for firm view. As MTFS provides must take account inter alia of impact of recession. There is no PSBR 'target'.

(iv) Monetary target decision to reaffirm present £M3 7-11 per cent (at annual rate) target range to April 1981, follows 1980 Budget commitment to review target this autumn. Aim in 1981 Budget will be to set a new target together with any further measures needed to maintain thrust of MTFS.

(v) Monetary control . Announced conclusions of consultations, based on March Green Paper, about methods of monetary control - form of Bank's controls over money markets and banks. Some significant technical changes to be made which improve control over longer-term, but overriding requirement will remain fiscal policy which complements monetary restraint.

(vi) Public Expenditure. Recession has sharply affected expenditure 1980-81 expenditure expected to be some 1½ per cent higher than at time of Cmnd 7841. Recent decisions minimise departure from earlier plans. Aim for 1981-82 is to keep planned volume of expenditure about 1 per cent below expected 1980-81 outturn. Firm restraint of 1981-82 cash spending essential to keeping cost of programmes under control: thus, for example, 6 per cent factor for pay and 11 per cent for other items in Rate Support Grant cash limit. Total spending and borrowing must be consistent with medium term strategy.

/ A1 continued

A1 THE ANNOUNCEMENTS AND GENERAL ECONOMIC STRATEGY

Positive

(i) Government determined to take sensible and timely action . Increase in employee NIC and oil tax proposal together raise extra revenue of some £2 billion in 1981-82. Essential steps in restraining PSBR for next year so that monetary restraint can be secured without excessive interest rates.

(ii) Inflation: New Industry Act forecast confirms that inflation will continue to fall - essential prerequisite for recovery in output and sustainable economic growth. Annual rate of inflation recorded by 4th quarter of 1981 is expected to be about 11 per cent compared with 15½ per cent forecast to the 4th quarter of this year.

Defensive

(i) Output in course of 1981 expected to remain fairly flat - as in many other countries. Unemployment will inevitably rise further. Reflects worldwide developments, high exchange rate and past failure to restrain pay settlements. Timing of recovery in output and employment depends very much on rate at which UK costs - particularly pay costs - come into line with overseas competitors.

(ii) Restraint of PSBR remains important. Recession can mean that higher level of PSBR than otherwise is tolerable. But remains essential to avoid excessive borrowing that would put unacceptable pressure on interest rates. Hence measures at this stage - oil tax and NIC increase - to help restrain 1981-82 PSBR.

PSBR

(iii) 1980-81 PSBR now forecast at £11½ billion, reflects impact of recession eg on public spending as a result of higher unemployment. On cash-limited programmes and nationalised industry EFLs government has acted to contain pressures as far as possible. Expenditure not out of control.

(iv) Any excess monetary growth in current target period expected to be less than recent statistics might imply: public sector expected to move into surplus in New Year and signs that bank lending may be starting to slow down. Initiatives (eg National Savings) to reduce dependence on gilts and encourage revival of long-term debenture market. Effect on future inflation hard to predict - no mechanistic relationship between money and inflation, wrong to focus on monetary growth over an arbitrary short period when overriding need is to restrain monetary expansion over medium-term.

CONTACT POINT: M FOLGER 233-8737

SECRET until after Statement 24.11.80
then unclassified

A2. CHECK LIST OF MEASURES (Briefs in brackets)

Monetary policy

(i) 7-11 per cent target growth rate retained for period Feb. 1980 to April 1981 (D1)

(ii) Reserve asset ratio for banks to be phased out after consultation on new arrangement for prudential liquidity. (D2)

(iii) Bank of England to change money market operations and last resort lending to allow market greater role in determining short-term interest rates (D2).

(iv) Eligibility to buy index-linked National Savings certificates to be extended in future. (D3)

Public expenditure (details in H1)

Changes to expenditure programmes for 1981-82 due to policy decisions since March 1980 public expenditure White Paper Cmnd 7481):

	1981-82 £m 1980 survey prices
Nationalised industries increase in EFLs (other than British Steel)	+ 620
Other policy increases (including special employment measures, industrial support, withdrawal of proposed new health charges and others)	+ 510
EC refunds (agreed 30 May 1980)	- 650
Reduction in programmes (including local authorities current spending, defence, ECGD, social security, DOE and others)	-1070

Revenue

(i) Employees Class 1 national insurance contributions increased from $6\frac{3}{4}$ per cent point to $7\frac{3}{4}$ per cent on 1 April 1981. Payable on earnings of £27-£200 pw. (raised from £23-£165 pw). Estimated to raise around £1 billion in 1981-82. Employers' contribution unchanged. (See G1)

/A2 continued

(ii) New petroleum production tax to take effect from 1 January 1981. PRT reliefs to be examined. Expected total yield around £1bn in 1981-82 (See F1).

Pensions

(i) Uprating of retirement pensions and other social security benefits to be adjusted in 1981. Uprating to allow for over provision this year estimated at 1 per cent. (See H7).

CONTACT POINT: C H K WILLIAMS 233-7064

B1. UK ECONOMY - PRESENT SITUATION

(i) Output and demand: Output measure of GDP in Q3 1980 provisionally estimated almost 4½ per cent below average 1979. Decline in demand uneven. General Government consumption has held up, and so have exports until recently. Consumers' expenditure in Q3 estimated to be less than ½ per cent below average 1979. Fixed investment in Q2 was 1 per cent below average 1979, but capital spending by manufacturing, distributive and service industries fell further in Q3. Major reduction in final demand reflects fall in stocks. Industrial output in Q3 9 per cent below average 1979 and manufacturing 11½ per cent down.

(ii) Employment and Unemployment: Employment fell by 400,000 in year to June - just under 2 per cent. Fall heavily concentrated in manufacturing where employment fell by further 150,000 in July and August taken together. UK unemployment (excluding school leavers) was 1.9 million (7.8 per cent) at the October count, a rise of almost 600,000 since December.

(iii) Company finances: In H1 1980 gross trading profits net of stock appreciation and interest payments fell slightly for industrial and commercial companies excluding North Sea activities. Net borrowing rose substantially to £4½bn mainly financed by bank borrowing.

(iv) Earnings and Prices: Over last pay round earnings grew by 21½ per cent, well above the rise in UK prices and increase in earnings of major competitors. Comparatively few settlements so far in current round, but indications of a substantial decline with some settlements in manufacturing in single figures. Prices of materials and fuels purchased by manufacturers has been virtually flat in six months to October reflecting the appreciation of sterling and weak commodity prices. Wholesale output prices rising at an annual rate of 8½ per cent in six months to October. October RPI 15½ per above a year ago.

Balance of payments (See C1)
Exchange rate and Competitiveness (See C2)
Money supply (See D1)
PSBR (See E1)

/B1 continued

Positive

(i) Substantial progress on reducing inflation. Better than forecast and lower wholesale prices still to work through fully.

(ii) Encouraging signs of realism in wage negotiations. Substantial drop from level of last round. Manufacturing settlements in single figures. Industrial stoppages lowest for 30 years.

(iii) Balance of payments strong in contrast to other countries.

Defensive

(i) Last year's rise in consumer expenditure unsustainable as it was not matched by higher output.

(ii) Investment and stocks decline reflect usual cyclical downturn, but also squeeze on profits.

(iii) Recent decline of exports reflects at least partly lost competitiveness and emphasises need for wage moderation.

(iv) Inflation trends better than that inherited. In last six months of previous administration annual rate was 14 per cent and rising. Six monthly rate now lower and trend falling.

(v) Latest 26 per cent year-on-year earnings rise for September distorted by back pay (now) and engineers' dispute (a year ago). Current settlements much lower than in last wage round.

(vi) Unemployment similar in United States, Canada and France. UK however suffering from self-inflicted damage of past wage excesses over productivity and failure to adjust.

Contact point: C Williams 233-7064

B2 Industry Act Forecasts

Factual

1. Industry Act Forecast published on 24 November by Press Notice meets the requirement of 1975 Industry Act for Government to publish two forecasts a year.

2. Coverage of forecast much the same as usual: text includes references to manufacturing and North Sea output and to world trade.

3. Main points of forecast (see Table 1):-

(i) Inflation continuing to fall: perhaps to 11 per cent by end 1981.

(ii) Output fall in 1980 of 3 per cent, in 1981 of 1½ per cent, but with no further fall from current levels.

(iii) Current account of balance of payments forecast to remain in substantial surplus.

(iv) PSBR in 1980-81 now estimated at £11½ billion, 5% of GDP; some fall in percentage of GDP expected in 1981-82.

(v) All forecasts, especially in current circumstances, subject to large margins of error: figures in table 1 of error margins are average errors derived from past forecasts, and not outer limits.

Positive

1. Major reduction in inflation already achieved this year; further substantial fall envisaged next year. Single figure inflation next year a real possibility.

2. Worst of output fall may now be over: forecast shows no further decline either in total output or in manufacturing output in the course of 1981.

3. Average standard of living not likely to decline much, despite much lower rate of pay settlements.

4. Prospect of some fall in PSBR (as percentage of GDP) in 1981-82 consistent with downward trend envisaged by MTFS.

Defensive

1. UK economy facing difficult period of adjustment because of: adaptation to falling inflation; high exchange rate; world recession.

2. Fall in output, especially in manufacturing, greater than expected at this time last year or at Budget time; nevertheless, government forecasts not very far out.

3. Fall in volume of exports in 1981 foreshadowed by: past losses in competitiveness; export orders; tailing off in last few months.

4. PSBR this year higher because of extra government spending, partly because of recession, and because local authorities and public corporations have borrowed more than expected.

5. Can't be more precise about PSBR in 1981-82 because of the difficulties of forecasting the balance between very large (£125 billion or more) revenues and expenditure, and because many fiscal policy decisions on the year naturally await Budget.

6. Unemployment is bound to go on rising for some time, but rate of increase should slow down. /no figures given in Industry Act forecast: the figure of 2.3 million wholly unemployed. GB, appearing in the Government Actuary's Report /to be published on Monday 24 November/ is an assumption - not a forecast - given to the Government Actuary for the purpose of his calculations on the National Insurance Fund./

7. No figure for earnings growth given in Industry Act forecast, but reference to "less than half the rate in previous pay round". Government Actuary's report uses figure - again as assumption, not forecast - of 10½% earnings growth for financial year 1981-82 on 1980-81.

8. Government is merely following all past precedent in not giving forecasts of unemployment, or precise forecasts for earnings.

Contact Point: Mr H P Evans 233 4297

TABLE 1: ECONOMIC PROSPECTS TO END 1981

	Percentage changes 1979 to 1980	Percentage changes 1980 to 1981	Margins of error// for 1981 forecast
			per cent
A. OUTPUT AND EXPENDITURE AT CONSTANT 1975 PRICES			
Gross domestic product (at factor cost)	- 3	- 1½	1½
Consumers' expenditure	0	- ½	1½
General Government expenditure on consumption and investment	- 1	- 2	1½ /
Other fixed investment	½	- 4	4 *
Exports of goods and services	1	- 3	3½
Change in stockbuilding as a percentage of GDP	- 4	1	1
Imports of goods and services	- 3	0	2½
B. BALANCE OF PAYMENTS ON CURRENT ACCOUNT	1980	1981	
	£ billion		£ billion
	2	2	2
C. RETAIL PRICE INDEX	Percentage changes		Per cent
	4th Quarter 1979 to 4th Quarter 1980	4th Quarter 1980 to 4th Quarter 1981	
	15½	11	3

// The errors relate to the average differences (on either side of the central figure) between forecast and outturn. The method of calculating these errors has been explained in earlier publications on government forecasts, notably in November 1978 (see Economic Progress Report Supplement or Economic Trends No. 301, November 1978). The calculations for the constant price variables are now derived from internal Treasury forecasts made during the period June 1965 to October 1978. For the current balance and the retail price index forecasts made between June 1970 and October 1978 are used. The errors are after adjustment for the effects of major changes in fiscal policy where excluded from the forecasts.

/ This margin applies to general government consumption only.

* This margin applies to private sector investment only.

CONFIDENTIAL
Until Statement 24.11.80
Then UNCLASSIFIED

B3. OUTSIDE FORECASTS

(New NIESR forecast is expected in the week beginning 24 November and a new CBI forecast in the first week of December.)

FACTUAL (See also B2 - Industry Act forecast)

(i) GDP forecasts for 1980 and 1981 progressively more pessimistic. Fall of 2½ to 3½ per cent in 1980 is broad consensus (although CEPG in April forecast a fall of 6 per cent). For 1981 there is less agreement. Most forecasts predict falls of ½ to 2 per cent, although ITEM expect 4 per cent drop.

(ii) Inflation forecasts have become progressively more optimistic. Only LBS, however, expect single figure inflation (in consumer prices) by end 1981. Most others forecast 11½-12½ per cent. ITEM, however, predicts increase in the RPI of over 14 per cent in 1981 as a whole.

(iii) Unemployment forecasts are increasingly pessimistic. Almost all forecasters agree on 1.9 million adult unemployment (seasonally adjusted) for 1980 Q4. For 1981 Q4 there is a reasonably narrow range of 2.2 million (LBS) to 2.6 million (CEPG, Charterhouse).

(iv) PSBR Most recent forecasts range from £10 billion (LBS) to £13½ billion (ITEM). For 1981-82, forecasts range between £9½ billion (LBS) to £14 billion (ITEM).

(v) Sterling M3 For 1980-81 growth forecasts mainly fall in the range of 13½ per cent (St James Group) to about 16 per cent (Phillips and Drew). In 1981-82 only LBS expect a growth within the MTFS target of 6-10 per cent. Only Phillips and Drew expect a significant fall in MLR this financial year, although most predict a fall to 11-12 per cent for 1981-82 as a whole.

(vi) Current balance of payments forecasts have become more optimistic, but 1981 forecasts range from a £1½ billion deficit (LBS) to £1¼ billion surplus (Phillips and Drew.)

(vii) Medium-term forecasts There is disagreement on timing of GDP trough and extent of recovery. LBS and Phillips and Drew expect activity to recover from low point in H1 1981.

/B3continued

For 1982 and beyond LBS forecast a strong recovery with GDP growth of about 2 per cent per annum. Other forecasters are less optimistic. All forecasters expect further reductions in inflation rate. There is general pessimism over unemployment. Camb. Econ. and CEPG forecast over 3 million by 1983 and further increases by 1985. LBS see 2¼ million by 1982 but no fall over next four years.

(viii) Policy comments Only LBS has consistently advocated MTFS. Increased PSBR during recession is seen as consistent with stated £M3 targets. Other forecasters range from sceptical (Camb. Econ. and Phillips and Drew) to opposed (NIESR and CEPG.) NIESR favour more direct action on wage bargaining, whilst CEPG champion import controls. Both recommend expansionary fiscal policies.

Positive

(i) All forecasters have become more optimistic on inflation outlook.

(ii) All forecasters now forecast a more favourable current account balance for 1980 and 1981.

(iii) At least some forecasters expect activity to recover in the course of 1981.

Defensive

(i) All forecasts are subject to margins of error. Forecasters have for example, markedly underestimated the fall in inflation and the continuing favourable balance of payments, and there is a wide-range of projections for the PSBR.

(ii) Unemployment forecasts are particularly subject to wide margins of error and uncertainty; and have often been wrong in the past.

(iii) Groups advocating reflation overlook longer-term inflationary consequences of such policies.

(iv) Import controls would risk breaking UK's international agreements, risk retaliation and not guarantee extra output/employment.

CONTACT POINT: A SMITH (EB) 233-4524

C1. BALANCE OF PAYMENTS CURRENT AND CAPITAL ACCOUNTS

Factual

(i) Current account surplus £1.2 billion in first 10 months of 1980, made up of £200 million visible trade surplus and estimated £1 billion invisible surplus.

(ii) Capital account shows inflow of £1.4 billion in first half of 1980. Private non-residents' sterling deposits increased £1¼ billion in first half 1980.

Positive

(i) Current account surplus likely to persist though not on scale of last few months. (see B2 Industry Act Forecast).

(ii) Recent large surplus reflects better than expected performance on invisibles and continuing movement in our favour of terms of trade (excluding oil up 7 per cent in the first three quarters of this year). But main reason is a sharp fall in imports which were £1.3 billion lower in third quarter than in the first largely reflecting destocking.

(iii) Oil account now likely to be in regular surplus.

(iv) Capital outflows following abolition of exchange controls still building up and should offset some upward pressure on exchange rate.

Defensive

(i) It is true that our volume share has probably declined during 1980. This emphasises the need to regain the competitiveness we have lost.

(ii) Good export performance depends on controlling UK costs not exchange rate depreciation.

(iii) No reason to believe that bulk of non-resident sterling holdings are particularly volatile.

CONTACT POINT: MR ALLAN 233-3496

EXCHANGE RATE AND COMPETITIVENESS

Factual

(i) Sterling has risen around 7½% against dollar and 6½% in effective terms since the Budget. On 21 November it stood at $ 2.3640 (77.4 effective).

(ii) Exchange rate determined primarily by market forces. Intervention by authorities limited to smoothing excessive fluctuations.

(iii) Sterling's underlying strength derives from possession of North Sea oil and market confidence in Government's commitment to defeat inflation.

(iv) Latest estimates of competitiveness:

		Relative normal unit labour costs	Relative export prices	1975 = 100
1978		96.5	108.4	
1979		111.7	115.8	
1980	Q1	126.1	123.3	
	2	134.0	127.2	
	* 3	140	130	*Unpublished Treasury projections. For use only if pressed
	* 4	145	130	

[In terms of relative normal unit labour costs, our competitiveness is about 40%-/50% worse than in 1978]

Positive

Appreciation of sterling has helped to contain inflation.

Defensive

(i) Current level of sterling not sought as deliberate policy.
(ii) Impossible to control the exchange rate while giving priority to meeting the monetary target.

(iii) Greater part of competitiveness loss stems from UK's relatively high wage increases than from rise in exchange rate. Vital that all take account of competitiveness pressures in negotiating wage settlements.

/continued

(iv) Sustained intervention could not guarantee lower rate but would risk adding to money supply with inflationary consequences.

(v) No reliable relationship between interest rate and exchange rate movements. Interest rates must be determined by domestic considerations.

(vi) Inflow controls unlikely to be effective for more than short period, given sophistication of London's financial markets.

(vii) Some underlying factors may exert downward pressure on rate in future: private sector outflows are growing could accelerate, as could overseas borrowing in sterling market.

(viii) The Industry Act forecast projects little movement in exchange rate from mid-November level. This is a conventional assumption - not a prediction of the actual movement in the rate.

CONTACT POINT: Miss O'Mara 233-4621
Mr Allan 233-3496

D1. MONETARY POLICY: ROLL FORWARD AND INTEREST RATES

Factual

(i) The Chancellor does not propose to roll forward the present monetary target range of 7-11 per cent annual rate for period February 1980 to April 1981. He will announce a new target in the Budget together with whatever further measures are necessary to ensure that the thrust of the medium term financial strategy is maintained.

(ii) Maximum allowable growth over 14 months at top of range was 12.9 per cent. Actual growth from February to October has been about 15½ per cent or about 13 per cent after adjustment for corset distortions. Expressed in annual rates, recorded £M3 has been growing at 23.8 per cent. Underlying rate, after allowances for unwinding of corset distortions, around 20 per cent.

Positive

(i) Accept almost certain overshoot of current target, but recent statistics for £M3 growth seriously distorted by reintermediation after ending of corset controls in June. Full extent of distortions not yet clear.

(ii) Rate of monetary growth expected to slow in rest of target period, particularly in New Year when the public sector moves into surplus. Also substantial sales of National Savings expected and signs that growth in bank lending starting to decline.

(iii) National Savings initiatives (see D3) will reduce reliance on the gilt-edged market and, by making it possible to achieve monetary objectives at lower rates of interest, encourage revival of corporate debenture market.

(iv) In view of above factors, overshoot compared with target will not be large and certainly very much less than figures so far might suggest. Government has decided not to roll forward the monetary target now but to wait until the Budget.

D1.

(v) Fiscal measures in Budget will be designed to validate the target for 1981-82, maintaining thrust of medium-term financial strategy.

Defensive

(i) No suspension of monetary target. There will be some overshooting, but £M3 will slow appreciably in rest of target period. We shall not be far above top of range by April, certainly nothing like as far as the growth so far might be thought to imply.

(ii) MTFS not abandoned: The Government remains firmly committed to a progressive reduction in money supply growth. A new target which maintains the thrust of the strategy, will be announced at the time of the Budget. At the same time, whatever fiscal decisions necessary to validate the strategy will be announced. Some decisions, with a long lead time, announced today.

(iii) Not true that an interest rate target has replaced money supply target. Commitment remains to reduction in rate of growth of money supply. Interest rates will need to be adjusted from time-to-time to that end.

(iv) Clawback of excess growth in new target? Obviously, no decisions have been reached on form of target or the range for 1981-82 and later years. Need to reassess carefully at Budget time the underlying excess this year. Will decide target then in the light of this reassessment, the growth of other aggregates and developments in the economy generally.

(v) Will recent excess growth produce inflationary burst in 12-18 months? No. Important not to draw conclusions based on short period. The latest Greenwell's bulletin, not always supportive of Government policy,points out the error of this approach. We expect second half-year monetary growth to be much lower. Inflation is coming down sharply and the forecast for the next 12 months is 11 per cent.

D1.

SECRET AND PERSONAL

until after Statement 24.11.80
then Unclassified

Essential that monetary growth should decelerate sharply to avoid re-acceleration of inflation as economy returns to fuller capacity use.

Contact point: H DAVIES 233-4533

D2 MONETARY CONTROL TECHNIQUES: MBC

FACTUAL

1. As foreshadowed in Green Paper, Reserve Assets Ratio will be abolished as soon as consultations with banking system regarding alternative prudential arrangements can be completed.

2. No decision for or against Monetary Base Control now, but:

(i) Bank and Treasury considering future of $1\frac{1}{2}$ per cent cash ratio.

(ii) Statistics to be collected for "retail" money (akin to old M2 series).

3. Changes will be introduced in the Bank of England's methods of intervention in money markets:-

(i) Less emphasis on discount window (lender of last resort) lending, and more on open market operations.

(ii) Aim of open market operations will be to keep very short term interest rates within band determined by the authorities. Band will not be announced.

(iii) At appropriate stage, Bank might cease to announce MLR, and would normally charge a rate above market rates on its discount window lending.

4. Bank has issued a briefing note for the press on these changes.

Line to Take

1. Government is attracted by the idea of moving towards MBC, but no firm decision can be made on basis of present knowledge. Evolution of monetary control system must be gradual, learning from experience.

2. Monetary base control would not provide short-term control of £M3 or other wide monetary aggregates. Entails setting targets either for a relatively narrow aggregate (eg. "retail" deposits) or for base itself. Market would determine short-term interest rates consistent with that target. Already take some account of narrow aggregates in setting interest rates under present system.

3. To judge the potential of MBC, more information needed:-

(a) For non-mandatory MBC, need to know extent of banks' demand for balances with the Bank of England, and its relation to money supply and price level. Cannot learn this whilst 1½ per cent requirement in force.

(b) For mandatory MBC, need to know characteristics of "retail" deposits, since a reserve requirement related to wholesale deposits would produce distortions similar to those observed under SSD scheme.

4. Other steps announced today are desirable in own right and appropriate to evolution towards MBC:

(a) More flexible approach to money market operations will give market more of a role in determining structure of short-term interest rates. Banks will no longer be certain that they have access to unlimited supply of cash at known price; will, therefore, have more incentive to keep their lending rates in line with market.

(b) Abolition of Reserve Assets Ratio will remove a factor distorting relative yields between Treasury bills and other short-term financial instruments. The Bank will be examining potential for developing wider market in short-term central government debt. This might help monetary control by providing greater flexibility to funding programme.

5. The Bank will discuss operational details of changes with institutions affected as soon as practicable. New arrangements should be in place in Spring.

DEFENSIVE

1. Nothing Here to Improve Control of £M3

Control of £M3 a medium-term objective to be achieved by the general thrust of government policies including fiscal policy and debt sales. Commitment to MTFS stands.

2. Will Government be Abandoning £M3 in Favour of Narrower Aggregate?

No, under any system we shall need to control wider aggregates in the medium term.

3. How Will More Flexible Interest Rates Help Monetary Control?

May change way banks charge for advances and accelerate changes in overdraft system - bank lending will then become more responsive to market interest rates. Will reduce drama associated with MLR changes. May pave way for a later decision to set objectives for monetary base instead of interest rates.

4. How do the New Arrangements Allow a Greater Role for the Market in Determining Short Term Interest Rates?

The Bank will only act to limit movements in very short term interest rates (overnight, 7 day rates). Band within which it will seek to keep these rates will not be announced. Authorities' views will therefore be less overt, leaving market more of a role in determining the structure of other interest rates.

5. Will the Band Be Set With Reference to Movements In the Monetary Base?

Authorities will take account of same factors as now determine choice of MLR. When more information is available about the behaviour of the base, it might become appropriate to take this into account too.

6. How Much Volatility in Short-Term Interest Rates will the Bank Tolerate?

No precise answer possible. But intend to proceed gradually. Wild gyrations in short-term rates can be ruled out.

7. Will MLR Disappear?

At some stage the Bank may cease to announce a MLR. Not possible to be more precise; changes to the status of MLR could have legal implications which must be examined further.

8. Is This a Return to the Formula System for MLR?

No. The relationship between MLR (or its successor) and comparable market rates will be at discretion of authorities. No set formula.

9. Money Market Assistance: Does It Go On?

Measures necessary to prevent RAR from undesirably affecting interest rate levels and perhaps artificially inflating money supply ("round tripping"). Green Paper explained why it is neither necessary or suitable for controlling money supply. Solution depends on replacing RAR by alternative prudential arrangements. In meantime, Bank is considering transitional measures to relieve reserve asset pressure which would reduce need to give substantial amounts of money market assistance (eg. by modifying definition of reserve assets).

10. Will the Discount Houses Disappear?

New methods of operating in money markets assume a continuation of the discount market in its present form. Discount window facilities will continue to be confined to members of London Discount Market Association.

11. Why not abolish RAR now if counter productive for monetary control purposes?

Reserve asset ratio has a prudential function in determining bank's holdings of liquidity. Premature to abolish it until alternative arrangements have been made. Further consultations with banks required.

Contact Point: Mrs Lomax 233 5570

D3 NATIONAL SAVINGS

Chancellor announced eligibility to purchase Index-Linked National Savings certificates will be widened in future to maintain momentum of National Savings and attract at least £3 billion next year. (At present those aged 60 and over may buy up to £3,000 of Second Index-Linked Issue, which went on sale at Post Offices and Trustee Savings Banks on 17 November.)

Positive Points

(i) Government planning to secure about £1.5 billion of additional funding from new issue during current financial year as major component of overall contribution from National Savings of about £2 billion.

(ii) Extensive campaign of TV and press advertising.

(iii) Making current issue available to men aged 60 and over ends previous discrimination in favour of women.

(iv) Substantial contribution from the personal sector will reduce need for gilt sales and should help revive long-term debenture market.

Defensive Points

(i) Effect on building societies: Some of inflows to National Savings will be at expense of building societies, but their loss expected to be less than half gain to National Savings. Inflows to societies have recovered strongly in recent months, while demand for housing finance appears to have slackened.

(ii) Inflows in excess of £3 billion into National Savings will indeed establish new records for this source of funding but are consistent with what has been achieved before in terms of a proportion of personal sector's savings.

Contact Point: Mr G Ward 233 5466

D4 THE STATEMENT AND THE MTFS

Factual

(i) The MTFS set out the government's commitment to reduce the rate of inflation and thereby secure the conditions for sustainable growth.

(ii) The principal means to ensure the fall in the rate of inflation was a commitment to declining monetary growth (to a target range of 4-8 per cent during 1983-84). There were no precise targets for the intervening years 1981-82 and 1982-83.

(iii) Control of the money supply is not to be achieved by persistently high nominal interest rates, but by control of public sector borrowing.

(iv) There are no targets for the PSBR. The projections of the PSBR in the MTFS were purely illustrative.

> "Fiscal policy will be operated so that the PSBR for any particular year will be consistent with declining monetary growth in the particular circumstances of the time." (MTFS, paragraph 12)

Positive

(i) The extra revenues, the cuts in public expenditure volumes (to offset increases in other categories), and the firm control on public sector pay will contribute towards control of the PSBR in 1981-82.

Defensive

(i) Does the failure to control the money supply and the PSBR in 1980-81 mean that the financial strategy has failed? No. The government is just as firmly committed to declining monetary growth in future years as at the time of the MTFS.

/continued

(ii) Will the likely failure to achieve the 1980-81 target result in changes to targets for later years? The government intends monetary deceleration to be broadly along the lines set out in the MTFS. The only target is for monetary growth of 4-8 per cent in 1983-84. The target rates of growth in the intervening years will be set at the time.

(iii) PSBR in 1981-82 to be too high to achieve monetary growth consistent with MTFS? The government will take whatever measures are necessary to achieve a satisfactory PSBR in the particular circumstances at the time of the 1981 budget. The measures set out in the Chancellor's statement are not the 1981 budget.

(iv) Is allowing the PSBR to rise in a recession contrary to the MTFS? No. In a recession a higher PSBR than usual should be consistent with a particular growth of the money supply (at acceptable interest rates). The judgement on what PSBR is right for 1981-82 will be taken at the time of the budget.

Contact point: G R LEWIS 233-3093

E1. PUBLIC SECTOR BORROWING REQUIREMENT

Factual

(i) PSBR out-turn in first half of financial year 1980-81 was £8 billion seasonally adjusted. High out-turn reflects partly uneven timing of receipts and expenditures, over-spending on defence and lower than expected tax revenues. Borrowing should be lower in rest of financial year - reflecting rising North Sea tax revenues , receipts from asset sales and refund from EC Budget.

(ii) PSBR for 1980-81 as a whole now expected to be around £11½ billion (5 per cent of GDP at market prices) compared with £8½ billion FSBR forecast. Increase reflects at least partly unanticipated effects of recession on public spending and on trade of nationalised industries. (See B2 Industry Act forecast)

(iii) PSBR prospect for 1981-82 is for some fall as a percentage of GDP on the basis of the fiscal and monetary policy assumptions used in the Industry Act forecast i.e. taking account of the fiscal decisions announced by the Chancellor.

Positive

(i) Government remains committed to MTFS. PSBR consistent with declining monetary growth.

(ii) Final decision about PSBR to aim for in 1981-82 must await the Budget, but tax and spending measures announced today demonstrate Government's determination to check public borrowing.

(iii) PSBR for 1981-82 will be consistent with Government's monetary objectives.

(iv) Interest rates (See D1).

Defensive

(i) Government is not abandoning MTFS. It was always made clear that fiscal policy would be operated so that PSBR for any particular year was compatible with the Government's monetary objectives (FSBR - page 18). There is no PSBR target.

(ii) Realistic to allow for some increase in public spending and borrowing as a result of recession. But totals must be consistent with financial strategy and continued reduction in inflation if sustainable growth is to be renewed.

(iii) PSBR forecasts subject to wide error margins - emphasised at time of Budget forecast (± £3 billion). Uncertainties for 1981-82 must similarly be stressed.

CONTACT POINT: A R H BOTTRILL 233-5886

F1 CHANGES TO NORTH SEA FISCAL REGIME

Factual

(i) New tax on UK oil revenues will take effect from 1 January 1981. Additional to existing petroleum revenue tax (PRT). (Timing of payments still to be decided).

(ii) It will be charged, on a field basis, on gross revenues less a deductible allowance - as in (v) below. (PRT, by contrast, is charged on revenue less deductions for actual expenditure and a deductible oil allowance.)

(iii)It will be deductible for PRT and Corporation Tax purposes.

(iv) It is intended to increase net yield from oil taxation by about £1 bn in 1981-82 and by significant amounts (though less than £1 billion) in later years. (For expected North Sea revenues see F2)

(v) For illustrative purposes, increased yield would be achieved by setting rate at 20% and deductible allowance at value of 1 million tonnes of oil for each field for each year.

(vi) Detailed proposals will be introduced in 1981 Finance Bill after discussions with the industry.

(vii)Ministers will also examine present scheme of PRT reliefs (uplift, safeguard, oil allowance) in light of changed conditions (oil price increases, cost increases, technical experience, production and tax changes) since reliefs introduced. Again, changes will take effect from 1.1.81 and be introduced in 1981 Finance Bill after discussions with the industry.

(viii)No decision taken yet about abolition or retention of the PRT advance payment system.

(ix) Outline of proposals set out in Inland Revenue Press Release.

Positive

(i) Need to strike fair balance between nation and companies in sharing fruits of North Sea.

(ii) Oil companies have benefited from very substantial increase in oil prices in last two years (and despite two tax changes). Since fourth quarter 1978, world price of oil (in $) has risen 150 per cent. Rise in £ exchange rate means rise in £ price is less - 110 per cent. This is still considerably greater than rise in general prices level.

(iii)The new tax is justified on its own merits in the light of the profitability of the North Sea. The increase in yield will obviously help with the PSBR (and therefore interest rates).

(iv) Announcement in advance allows time for companies to have meaningful discussions with IR on details.

/continued

Defensive

(i) Why a new tax? PRT currently narrowly-based; so being presently paid by relatively few companies in relatively few fields. Could not yield same extra revenues without undue pressure on those companies and those fields. New tax will spread effect more fairly than charges in PRT raising equal amount of revenue.

(ii) Penalising profitable companies? Charges should not deprive companies of a fair return on North Sea projects and exploration.

(iii) Effect on company profitability? Will depend on type of fields owned by Company. In general likely rates of return only slightly reduced. Proposed deductible allowance will help to shelter smaller fields.

(iv) Effect on exploration and development? North Sea activity currently buoyant - shortage of some equipment. Very conscious of need to preserve attractiveness of North Sea as an area for new investment.

(v) Effect on 7th Round Licensing? No reason to believe proposals will discourage companies from taking up and exploiting any acreage they are offered. The proposals have been developed in full consultation with Departement of Energy.

(vi) Impact on marginal fields? Proposed allowance intended particularly to help shield marginal fields.

(vii)Stability assurances? Fully appreciate importance of stability for industries with long lead-times for investment. But never ruled out change in any circumstances. Oil world and UK economy have changed greatly since PRT introduced; changes have become too great for PRT to cope with.

(viii) Changes to PRT reliefs. As PRT rate has increased from its original level, some of PRT reliefs may have had unforeseen effect. Full proposals in 1981 Finance Bill. But IR will discuss possible changes with industry.

(ix) World oil prices now stable? True they have been more or less stable since mid-1980. But have risen over last two years. Government now had further time to consider implications of the second oil price explosion for the N. Sea fiscal regime.

Contact point: Mr Haigh IRD 438 6670

F2 FORECASTS OF GOVERNMENT REVENUES FROM OIL AND GAS PRODUCTION IN THE NORTH SEA

Factual

(i) Industry Act forecast includes forecasts for total North Sea revenues. These are:-

£billion at 1980-81 prices [1]	
1980-81	4
1981-82	4½ - 5

Figure for 1981-82 includes the additional revenue to be raised by means of supplementary tax announced in the Chancellor's Statement. (See F1).

(ii) Figures cover royalties, PRT, corporation tax, and (for 1981-82) [extra revenue from] the supplementary tax. They include receipts from all companies operating in North Sea including payments by BGC and BNOC. They exclude operating surpluses of BGC and BNOC.

(iii) In spite of the additional revenue in 1981-82 from the announced tax changes c. £1billion at current prices - the total government take at constant 1980-81 prices will be only £0-½billion higher than forecast at the time of the Budget.

(iv) Downward revision to the forecast of government take (if the effects of the supplementary tax are ignored) is partly the result of lower production and upward revision to forecasts of investment. (The oil production estimate for 1980 of 81 million tonnes given in the new Industry Act forecast is below the centre of the 1980 Brown Book range.) [IF PRESSED: the same may be true next year.]

(v) After 1980 Budget, Government published forecasts of its North Sea revenues for each financial year until 1983-84 (ie. the period of the MTFS). There are no revised forecasts for 1982-83 and 1983-84. [IF PRESSED: Revised forecasts for later years will probably be available at or after the 1981 Budget.]

Defensive

(i) Forecasts of government revenues from the North Sea take account of developments so far this year in world oil prices and exchange rate./Because

1 North Sea revenues with effects of general inflation removed by deflating with GDP market price deflator

Because prospects for these are inherently uncertain, forecast of government revenues in 1981-82 is subject to a wide margin of error.

(ii) How does latest forecast for the real price of oil relate to that used at the time of the Budget?

Budget forecasts of North Sea revenues were based on assumption of a world oil price constant in real terms at roughly the level obtaining at end of first quarter 1980. So far this year, real world oil price has turned out to be a little higher than this; but this has been offset by £ exchange rate being a little higher. Current assumption for 1981 is that real world oil price is likely to remain fairly flat, perhaps rising by 1 per cent year on year.

(iii) Are Government's forecasts for NS revenues too low (as suggested by TCSC)?

No. It is true that some outside forecasters were suggesting much higher North Sea revenues at time of Budget, but these other forecasts have since tended to be revised down, bringing them much closer to the government's projections. (At Budget time outside forecasters had no knowledge of the lower production ranges later published in 1980 Brown Book).

Contact Point: P Sedgwick 233 8931

F3 STOCK RELIEF

Factual

(i) The new scheme announced on 14 November will:-[1]

(a) virtually remove the threat of clawback for continuing businesses;

(b) limit relief to the effects of price changes on a business's opening stocks;

(c) base the relief on the change in a new "all stocks" index;

(d) restrict relief in the largest cases (i.e. where stocks exceed £1 million) to the extent that stocks are financed by trade credit or other borrowings; and

(e) abolish the "profit restriction".

(ii) Cost and distribution: The new scheme will, in present circumstances, give significantly more relief to industry and direct it to those businesses which need it most.

(ii) Full details of proposals in Consultative Document and Inland Revenue Press Notice (both on 14 November).

Positive

(i) Removal of Clawback: A major benefit to industry at a time when many businesses having to reduce stocks to ease liquidity problems. Under new scheme, the threat of clawback will virtually disappear for continuing businesses.

(ii) Extra relief: Scheme will give significant extra relief. Difficult to be precise: figure depends on level of stocks, profits and rate of inflation. [If pressed: the figure of £300 million/revenue foregone quoted in the press may not be far wrong.]

(iii) Benefit to manufacturing:/ Increases in manufacturing industry's share of relief will increase [from about 45% of total to around one-half. — IF PRESSED].

(iv) Small businesses: Will benefit from ending of profit restriction; many more will get relief.

---

1 Clawback is the recovery of past relief, when the book value of stock falls.

/continued

(v) Tackling misuse of present scheme: New scheme will deal with 2 points which have attracted widespread criticism:-

(a) full relief will no longer be given in respect of increases in volume of stocks (which has encouraged the boosting of stocks at year end);

(b) relief will be abated where large businesses have financed stocks on credit, so that the inflationary costs are borne not by the business but by its suppliers.

Defensive

(i) Credit restriction: This is necessary to withdraw relief from those who do not bear the inflationary costs of holding stocks. And small businesses need not worry about it (because of £1 million threshold).

(ii) Use of single index: The reasons why the Government have opted for this (arguments of principle and practicality) are set out in the Consultative Document.

(iii) Not SSAP 16: Both Statement of current Accounting Practice No.16 on current cost accounting and the new scheme share same broad objective, i.e. to take account of the effect of price changes on profits. The Consultative Document explains why stocks adjustment in SSAP 16 could not be used for tax at present. This does not rule out development of both systems in light of experience.

(iv) The £2,000 de minimis limit: Profit restriction in the present scheme saves a lot of work on small claims where tax is relatively insignificant. The £2,000 will do same.

(v) Stockbrokers Phillips and Drew claim no extra benefit will accrue to business overall and that manufacturers will lose out and retailers gain. They also raise question of current cost accounting.

(vi) Problems over Vesting Clauses
Suggestion that companies might face large back tax bills is being looked at urgently; Ministers will ensure no question of past relief being withdrawn and that stocks concerned will continue to qualify for relief.

CONTACT POINT: Mr McGivern IRD 438-6412

G1: NATIONAL INSURANCE CONTRIBUTIONS

1. Factual

Chancellor announced following changes for 1981-82. (Further details in Bill and Government Actuary's Report published to morrow Tuesday 25 November.)

(i) Employees' Class 1 contributions increased by one percentage point from 6.75 per cent to 7.75 per cent, made up as follows:

(a) 0.25 per cent to maintain the Fund in balance;

(b) 0.25 per cent to increase the NHS allocation from 0.4 per cent to 0.65 per cent;

(c) 0.5 per cent to make up the income lost to the Fund (about £500 million) caused by the reduction in the Treasury Supplement (from 18 per cent of contributions to the NI Fund to 14.5 per cent).

(ii) Contribution paid by employees earning between £27 a week (old rate £23 pw) and £200 a week (old rate £165 pw). Above upper earnings limit, cash contribution remains constant.

2. Employee (not contracted out) individual liability is shown below:-

Weekly earnings £	1980/81 Contribution £	Changes on account of increased earnings limits £	Increases on account of increased contribution rates £	total increases	1981/82 total contribution £
23	1.55	-1.55		-1.55	NIL
27	1.84	-	+0.25	+0.25	2.09
60	4.07	-	+0.60	+0.60	4.67
100	6.77	-	+1.00	+1.00	7.77
130*	8.79	-	+1.30	+1.30	10.09
165	11.14	+0.01	+1.66	+1.67	12.81
200	11.14	+2.36	+2.00	+4.36	15.50

*Approximate current average weekly earnings of full-time male employees.

3. No increase in employers' rate (currently 10.2 per cent) and no change in the NI surcharge (currently 3.5 per cent).

4. Rates for self-employed and voluntary contributors will be adjusted but excluding element 1(i)a above. Other rates to be adjusted as appropriate.

5. Estimated yield will be about £1 billion in 1981-82.

Positive

Reasons for the change

(i) Reduction in Treasury Supplement reduces PSBR in 1981-82. Contributions have to be raised to keep NI Fund in balance;

(ii) Expenditure from Fund will increase in 1981-82 because of the increase in unemployment and higher upratings. Income from contributions no more than expected increased expenditure on benefits.

(iii) Treasury Supplement has stood at 18 per cent of contributions since 1975. Substantial increase in non-contributory (ie. wholly Exchequer-financed) benefits over the years. Government considers appropriate time to readjust balance of financing social security budget between insured persons, employers and general taxpayer.

(iv) Burden of adjustment will fall on insured persons not employers. Employers have taken more than fair share of burden of economic adjustment so far. Ratio of employers' contributions to employees' contributions (excluding NIS) has increased from 1.1:1 to 1.6:1 between 1966 and 1979.

(v) Allocation to NHS has declined as proportion of total health expenditure over years. If Government is to preserve its commitment to maintain spending on health service, contributor must pay more.

Defensive

(i) This is an increase in the tax burden. No. This has nothing to do with tax. Merely asking insured people to finance more of expenditure on benefits and health service from contributions, rather than expecting the general taxpayer to finance them.

(ii) Will you then reduce taxes to compensate? Wait for the Budget. The Chancellor will then consider the tax burden in the wider context in the light of the options open to him. Decisions on contributions are needed now.

(iii) Isn't this regressive? This is the normal way of financing National Insurance. It is progressive between the earnings limits of £27 pw and £200 pw.
If pressed. True that NIC bites at lower level of income than income tax; but real increases in income tax are also laid upon the lower paid; especially if they take the form of lowering real tax thresholds.

(iv) The NI Fund has substantial balances, why not use them? That would incur a current deficit on this fund and increase the PSBR. Balance in fund has declined in real value over the years.

(v) Why not raise more from e.g. taxes on drink and tobacco? This is not a Budget. Tax options will be considered in the usual way nearer to the Budget.

(vi) Is NI Surcharge affected by these changes? NIS is unchanged. It will continue to be levied, as a surcharge on employers' NICs, at the rate of $3\frac{1}{2}$ per cent on gross weekly earnings up to the upper earnings limit (£200 after April 1981).

(vii) But you are increasing contributions while reducing benefits? Decisions on uprating benefits have little impact on overall finances of NI Fund in 1981-82. Any adjustment in contributions to reflect any lower expenditure on benefits will be considered at next contributions review (November 1981).

(viii) Increase in employees' contributions inconsistent with attempts to hold down wage increases. Main objective is to reduce PSBR; if PSBR inconsistent with our medium-term financial strategy result would be worse inflation.

(ix) Adjustment in Treasury Supplement undermines the basis of the new pension scheme. No effect on new pension scheme. Earnings limits and contribution rebate are not affected by adjustments in Treasury Supplement.

(x) Why not abolish upper earnings limit? Not possible to abolish UEL without significant restructuring since it sets a limit for entitlement to earnings-related pensions and for main pension guaranteed by contracted out schemes.

(xi) How much of increased contribution can be attributed to higher unemployment? Wait for the Government Actuary's report. As the Industry Act forecast indicates, thelevel of unemployment is expected to be higher in 1981. Government Actuary has been asked to assume that average level of GB unemployment in 1981-82 will be 2.3 million excluding school leavers.

Contact Point: D Butler (SS1) - 233 - 3932

H1 PUBLIC EXPENDITURE: 1981-82

(All figures are in 1980 Survey Prices)

Factual

(i) The Government has now completed its review of the expenditure plans for 1981-82 as part of the normal public expenditure planning cycle.

(ii) The main underlying problem which it has had to face has been the effect of a recession which is rather steeper and heavier in its impacts on both sides of the public accounts than foreseen earlier.

(iii)Allowance has to be made for substantial increases in certain open-ended programmes, eg. social security expenditure.

(iv) The external financing limits for nationalised industries (excluding British Steel) have been increased by £620 million, reflecting the deterioration in trading conditions. The industries are being required to secure substantial economies of more than £750 million.

(v) There is an increase of £245 million in provision for special employment measures and some £50 million in provision for selective assistance for investment and support for industrial research and development.

(vi) Substantial reductions of nearly £1.1 billion have been made to other programmes. Main reductions include:

	£m
Local Authority current expenditure (3% rather than 2%)	165 (England)
Defence	200
Social Security - not carrying forward excess uprating and other measures	66

(vii)RSG 1981-82 to be calculated on basis of lower percentage than present 61% England and Wales (68% Scotland). Government will consult local authorities. [IF PRESSED: "lower percentage" means maximum of 60 per cent (England and Wales).]

(viii)There will be European community refund in 1981-82 of some £650 million.

Positive

(i) Government maintains its commitments to reduce the volume of public expenditure in the medium-term. Volume of planned expenditure is being redistributed, with substantial reductions in some programmes partly offsetting increases due to the recession.

(ii) Cash limits are being set to slow down very sharply the rate of growth of costs, especially on public service pay.

(iii)Shift away from the plans of the previous administration made last year is being sustained although some adjustment to the earlier plans to take account of the changed economic circumstances is now thought appropriate. Planned total for next year will still be some £5 billion below level planned by previous government.

(iv) Aim is to keep planning total for volume of public expenditure in 1981-82 about 1% below outturn now expected for the current year.

Defensive

(i) Final planning total has not yet been set - that will be included in next public expenditure White Paper. Precise figure will depend both on economic assumptions then thought appropriate and on decisions still to be taken (notably British Steel Corporation EFL and child benefit).

/BACKGROUND INFORMATION: figures quoted by Chancellor for outturn for this year and aims for next year point to planning total in the range of £78 billion - £78.5 billion. The press can be helped with this arithmetic, but no official imprimatur should be given to a specific figure at this stage - that is for the White Paper to do./
For comparison of 1980 survey prices with Cmnd 7841, see Press Notice.

(ii) White Paper will be published with Budget, when it can be set against tax plans, and when remaining decisions both for next year and following years have been taken.

(iii)Present statement is about the expenditure decisions which have to be taken at this stage if the various spending authorities - nationalised industries, local authorities, health authorities, Government departments etc - are to have time to put the plans into effect.

(iv) The services breakdown of reduced volume plans for LA current spending will be given in the RSG consultative document later this year.

(iv) Rate increases need not be excessive - despite lower RSG support - if councils plan in line with cost targets on volume, and stick to tough pay bargaining posture. Manpower may be key to success.

Contact Point: Miss M Peirson 233 7208

/H1 ANNEX

SECRET

until after Statement 24.11.80

H1 (Annex)

SUMMARY OF PUBLIC EXPENDITURE POLICY DECISIONS

A. Volume

1. The changes in expenditure programmes for 1981-82 due to policy decisions since the March Public Expenditure White Paper (Cmnd 7841) are:

		1981-82 £m at 1980 Survey Prices (b)
Nationalised Industries		
Increases in EFLs (other than for British Steel) including revised provision for shortfall		+620
Other policy increases (a)		
Special employment measures	+245	
Industrial support	+ 52	
Industry (other)	+ 10	
Health (withdrawal of some proposals for new charges)	+121	
Civil superannuation (accelerated retirement of civil servants)	+ 64	
Trade	+ 21	
		+510
Other significant policy changes: (a)		
(i) Local Authority Current Expenditure (England) - reduction by about 3% instead of 2% from planned level for 1980-81	-165	
(ii) Further changes in Departmental programmes (excluding elements of local authority current expenditure included in (i))		
Agriculture Departments	- 36	
Department of Employment	- 25	
Department of Transport	- 21	
Department of Environment (including PSA)	-158	
Home Office	- 17	
Department of Education and Science	- 52	
Office of Arts & Libraries	- 10	
Department of Health & Social Security (health)	- 25	
(iii) Other Departments		
Defence	-200	
Foreign & Commonwealth Office	- 16	
Export Credits Guarantee Department	-166	
Department of Health & Social Security (social security)	- 66	
Scotland, Wales and N. Ireland (including changes to local authority current expenditure in Scotland and Wales)(c) (about)	- 90	
Other (about)	- 15	
		-1,060
EC refund agreed on 30 May 1980		- 650

/ Footnotes - see next page

2. The changes take account of the salary savings expected in 1981-82 from the progressive reductions in Civil Service numbers to 630,000 by 1984.

3. The list does not include changes where the exact amount will be decided later eg British Steel and Child Benefit. Nor does it include the estimating adjustments, eg for demographic and economic factors, which will be made in the public expenditure White Paper to be published at the time of the Budget. The White Paper will include further details of the policy changes for 1981-82 and will set out the plans for 1982-83 and 1983-84.

4. The figures are in the prices used for the 1980 Public Expenditure Survey. "1980 Survey Prices" means for most expenditure broadly the prices of late 1979; which were some 18 per cent higher than the 1979 survey prices used in Cmnd 7841. For transfer payments (including overseas aid), 1980 survey prices are generally estimated average prices for 1979-80, ie about the same as those in Cmnd 7841, as a result of a change of definition since that White Paper.

B. Cash limits

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

6. The cash limits for the Rate Support Grant and for the Universities' Grant will include allowance for increases in earnings of 6% in annual settlements due before 1 August 1981, and also provisionally of the same amount for annual settlements due after that date. The allowance for pay in other cash limits, and Votes, will be so set that the pay of the relevant groups is dealt with broadly within the same financial disciplines. The outcome of settlements in particular cases will depend on the way in which the cash is allocated.

Contact Point: Miss M Peirson 233 7208

(a) The increases and reductions shown include the net effect of various minor policy changes.

(b) Total changes are rounded to the nearest £5 million.

(c) The exact changes to Scotland, Wales and Northern Ireland programmes, in parallel with those to English programmes, will be given in due course

H2 1981-82 CASH LIMITS

Factual

(i) The rate support grant cash limit will provide for 6 per cent annual increase in earnings from due settlement dates. On expenditure other than pay it will provide for increases in prices of 11 per cent between the average level of 1980-81 and 1981-82.

(ii) Exepnditure in other parts of the public service will be handled within broadly the same financial disciplines.

(iii) As made clear in Chancellor's letter of November 24 to Mr du Cann, (reproduced in Treasury Press Notice) Government will discourage staging or delaying implementation of pay awards. Cash limits will be set to ensure that no financial advantage can be gained in this way.

Positive

(i) It is the Government's policy that pay should be negotiated in the framework set by cash limits. Cash limits reflect what can be afforded.

(ii) 6 per cent is not a pay norm. It is for managers to decide how to allocate the money available. Earnings increases can be higher or lower. If they are higher it will be necessary to make offsetting savings e.g. through further manpower economies or on other expenditure. If they are lower it will be easier to achieve departmental programmes.

(iii) Staging can be a way of avoiding the discipline of cash limits. It enables wage bill to be accommodated in one year's cash limit at expense of carrying additional costs forward to following year.

(iv) If an award is staged in future, the cash limit will be set so that the element of the cost deferred into the following year by staging willmean that correspondingly less cash is available for the new pay award in that year.

/H2 continued

Defensive

(i) No decisions have been announced to apply the 6 per cent provision to pay other than to local authority employees.

(ii) 6 per cent relates to earnings. Implication for settlements depends on the circumstances for individual groups.

(iii) Figure of 6 per cent applies to settlements falling in 1981-82 and in the remainder of 1980-81. For settlements after 1 August 1981 (i.e. next pay round) is provisional. Government will decide what can be afforded for public service settlements in next pay round nearer the time.

(iv) 11 per cent is consistent with the RPI figure in the Industry Act forecast. It relates to particular transactions of the public services, not to retail prices generally. Based on increase between financial years, not between fourth quarters.

(v) Squeeze on volume of expenditure in 1980-81 is always possible. It depends on actual price increases on the particular goods concerned. It is not anticipated that these factors will produce any significant squeeze.

(vi) Certain awards were staged in the 1979-80 pay round. Provision will be made in 1981-82 cash limits for the staged element in these awards. They were entered into in good faith and it would not be appropriate to apply a retrospective penalty by refusing to provide for extra cost in 1981-82.

(vii) Providing for awards staged in 1979-80 pay round will add some £275 million, or about 1 per cent to public service pay bill in 1981-82. Groups concerned are teachers (over £200 million), non-industrial civil servants (about £60 million) and university staff (about £15 million).

(viii) Increase in public services paybill between 1980-81 and 1981-82 depends on planned numbers, settlement dates and financing of staging. Financing past staging adds about 1 per cent to the paybill. For public services as a whole the increase is likely to be around 7 per cent but this will vary for individual groups.

/H2 continued

(ix) Public service employees real pay being reduced? Workers throughout the economy likely to find have to take reductions in real earnings. Public services have had substantial rises recently. They enjoy greater job security.

(x) How will public services pay/rises compare with others? This is what public service employers can afford. Private sector workers must settle for what their employers can afford.

CONTACT POINT: S A ROBSON 233-8635

H3 PUBLIC EXPENDITURE 1980-81 (All figures current prices)

i. Factual

(i) The volume of public expenditure in 1980-81 is now expected to be some 1½% above the levels in the last public expenditure White Paper (Cmnd 7841).

(ii) The FSBR put the estimated outturn on Cmnd 7841 planning total after shortfall at £91.6 million. (Table 16 of Red Book)

(iii) On top of the increased volume of expenditure there have also been additions to public spending arising from pay and price increases; the most notable example is the £203 million increase announced in the defence cash limit.

(iv) There have been 40 changes to cash limits so far this year giving rise to a net increase of £220 million on a cash limits total of some £46½ billion.

(v) The main increase to cash limits have been defence (+£203 million), fisheries aid (+£13 million) and Northern Ireland (+£16 million). The main reduction Energy R & D (-£16 million) and labour market services (-£10 million).

Positive

(i) Cash limits are being respected. Expenditure is being closely and effectively monitored. There have been difficulties on defence, on local authority current expenditure and on local authority capital expenditure on housing. In each case the problems were quickly identified and action taken.

(ii) In certain areas expenditure programmes are necessarily open-ended and cannot be subject to cash limits or controlled within the year eg social security expenditure depends on unemployment. The depth of the recession is increasing expenditure in these areas.

(iii) Winter Supplementary Estimates (to be presented to the House on December 2) have been taken fully into account in the Chancellor's statement and in the Industry Act PSBR forecast for 1980-81.

Defensive

(i) Major extra cash needs for volume increases in the planning total include special employment measures (+£200 million), agricultural support (+£100 million), social security (+£350 million) and reduced shortfall (+£800 million). To be set against this there is the EC refund of £650 million.

(ii) These increases reflect the increased numbers of qualified recipients (employment measures, social security) and harvests (agriculture). Part of the reduction in shortfall reflects the speed at which work is being done by industry in the recession.

(iii) In addition to the increase over the planning total the PSBR is also raised by additional debt interest (+£500 million) and also by increased spending arising from pay and price rises (eg defence cash limit increase of £203 million).

(iv) There have been other increases in the volume of programmes arising from decisions. These have been met from the contingency reserve and so do not add to the planning total in Cmnd 7841 or to the PSBR. Major examples include the increases in the EFLs for British Shipbuilders (£65 million), British Steel (£400 million) and British Rail (£40 million).

CONTACT POINT: MR ROBSON 233-8633

H4 CASH LIMITS 1980-81

Factual

(i) The 1980-81 Rate Support Grant cash limit provided for 13% increase in costs between 1979-80 and 1980-81 arising from price increases and new pay awards.

(ii) Other cash limits provided for 14% increase in earnings from due settlement dates as result of new pay awards. On current expenditure other than pay, provision was made for 14% increase in prices between 1979-80 and 1980-81. Somewhat larger provision was made for price increases on capital expenditure.

(iii) There have been 49 changes to cash limits so far this year, giving rise to a net increase of £220 million against a cash limit total of some £46½ billion.

(iv) The main increases to cash limits have been Defence (+ £203 million) Fisheries aid (+ £13 million) and Northern Ireland (+ 16 million). Main reductions have been energy R & D (-£16 million) and labour market services (- £10 million).

Positive

(i) Expenditure this year is not out of control. It is being closely and effectively monitored.

(ii) There have been difficulties on defence, on local authority capital expenditure on housing and on local authority current expenditure. In each case the problems were quickly identified and action taken.

(iii) Cash limits are being respected.

(iv) In general, increases to cash limits have been met from contingency reserve and so within planned levels of public expenditure and PSBR.

/continued

(v) Winter Supplementary Estimates (to be presented to the House on 2 December) have been taken fully into account in the Industry Act PSBR forecast for 1980-81.

Defensive

(i) The increase in the defence cash limit was not charged to the contingency reserve. As a result this fell on the PSBR. The reserve is a control on decisions to add to the volume of expenditure; the increase in the defence cash limit reflected pay and prices and was not an addition to the volume of the programme.

(ii) Local authorities may respond to the witholding of £200 million rate support grant by equivalent extra borrowing. This would mean no benefit to the PSBR. Aim of the witholding arrangement is to give authorities every incentive to reduce spending and so benefit the PSBR.

CONTACT POINT: S A ROBSON 233-8633

H5 NATIONALISED INDUSTRIES' EFLs

Total External Finance

		1979-80	1980-81	1981-82
		£million 1980 Survey prices		
1.	Cmnd 7841 revalued	2,700	1700	750
2.	Announced change in 81-82	-	-	+620
				1570

Factual

(i) The announced change for 81-82 does not include provision for BSC. This will be announced following receipt of the industry's Corporate Plan. Provision for the remaining industries has been increased by £620 million which reflects the impact of adverse trading conditions at home and abroad, offset by substantial economies in each industry's requirements. Three quarters of this has been met by removal of the standard shortfall allowance (£470 million) asssumed in Cmnd 7841.

(ii) Individual cash limits corresponding to this provision are being separately announced by the CST in a Written Answer PQ (on 24 November).

Positive

(i) The industries have made a substantial contribution to the overall adjustment needed for 81-82. They have been required to secure economies of more than £¾ billion in order to limit their increased provision to that shown in line 2.

Defensive

(i) Investment. The cuts in investment which these economies may involve should be relatively small in relation to the industries' overall spending on investment (about £5,000 million). Their investment programmes have not been cut back with the severity of much of the private sector; on the other hand, it is right that they should take some of the burden of adjustment which would otherwise fall entirely on the private sector.

(ii) Pay A rigid pay assumption has not been imposed on the industries; pay settlements are the responsibility of the industries

/H5 continued

themselves and will reflect the different circumstances of different industries. Nevertheless individual industries assumption for pay, along with other key assumptions, have been discussed with them and external financing levels have been set on the assumption that each industry will reach reasonable pay settlements this round, broadly comparable with those likely to be reached in the private sector.

Prices

(iii)/ In context of general inflation, further rises in NI prices are inevitable, and effects of these are taken account of in the figures. But rate of increase of NI prices is expected to slow down markedly in coming year.

Efficiency

(iv)/ Recent Monopolies and Merger Commission Reports indicate that there may be substantial scope for improving efficiency in the NIs. To the extent that the economies required can be met in this way, reduction in investment or price increases, can be avoided.

(v) Nationalised industries "off course"? Critics at TCSC hearings in spring were right?

We said at the time that the estimates for the nationalised industries external financing requirements were very uncertain, since they depend on trading conditions. But it remains Government's intention to achieve a substantial turn-round in the nationalised industries' financial position.

Questions on individual industries should be addressed to sponsor departments.

Contact point: C R SMALLWOOD 233-3980

H6 DEFENCE

	£m 1980 Survey prices		
	1979-80	1980-81	1981-82
1. Total programme Cmnd 7841 (revalued)	9290	9616	9942
2. Announced change in 1981-82			-200

Factual

(i) /(Background: NOT FOR USE)

There is a difficulty in expressing the increase in 1981-82 which will result from the cut. 1980-81 baseline is uncertain: it depends by how much MOD exceed their cash limit. For purposes of this announcement we assume in calculating increase from 1980-81 to 1981-82 that MOD stick to the cash limit of £10,492 million, which would give them estimated volume outturn of £9500 million at 1980 survey prices. If, as we privately expect, they exceed cash limit by substantial amount there could be actual decline in real size of defence programme between 1980-81 and 1981-82. But increase in the two years taken together will still be nearly 5%.7

(ii) Outturn for current year still uncertain: there is a danger, as has been recognised, that the cash limit of £10,492 million will be exceeded. For purpose of calculating increase (2½%) from 1980-81 to 1981-82 Chancellor has used estimated outturn for 1980-81 which would be consistent with cash limit (£9,500 million at 1980 Survey prices).

Positive

(i) Defence expenditure grew by 3% in 1979-80 and is expected to grow by some 2½ per cent both this year and next.

(ii) UK's performance in relation to NATO 3% target compares favourably with other European allies. UK devotes greater share of national income to defence than any of major European allies. Defence expenditure continues to rise strongly under this Government, in marked contrast to declining trend under Labour.

Defensive

(i) NATO target is to aim at "real annual increases in the region of 3% pa". UK will be doing just that. Many Allies have fallen short of it with much less justification than UK's current economic situation would provide.

(ii) Any cuts affecting defence procurement must have industrial consequences, but defence industries will still be faring better than manufacturing industry in general.

Contact point: C J A Chivers 233-8119

CONFIDENTIAL

H7 SOCIAL SECURITY

	£ million 1980 Survey prices		
	1979-80	1980-81	1981-82
1. Total Programme Cmnd 7841 revalued	19,272	19,731	20,183
2. Announced change in 1981-82			- 66

Factual

(i) Lines in table do not represent resulting programme. There will be significant likely additions to it in respect of revised economic assumptions - mainly effect of paying unemployment benefits to higher number of unemployed.

(ii) Abatement of public service pensions applies to those pensions linked to the State retirement pension by the 1971 Pensions (Increase) Act. Broadly this covers retired civil servants, NHS workers, teachers, police, firemen, local government officers, judges, MPs and Ministers. Also covered are ex-members of the Armed forces whose increases are made by Royal Warrant. Does not directly affect other public sector bodies of most of nationalised industries.

Positive

(i) Government has kept to its commitment to maintain real value of retirement pension over time. Most of net announced change in 1981-82 is from decision to uprate pensions and other benefits in November 1981 by one percentage point less than movement of prices over that year, to take account of increase in real value of benefits at November 1980 uprating.

(ii) Expenditure on social security in 1981-82 will still be over £20 billion, and increase over 1980-81.

Defensive

(i) Social security programme takes quarter of public expenditure; could not therefore be exempted from need to secure economies.

(ii) Amounts saved are most that could be secured without breaking Government's commitments to pensioners and to protect those most in need.

(iii) Uprating of benefits announced at Budget time and paid from 24 November 1980 was 16½ per cent for most benefits. (This was forecast movement of prices between November 1979 uprating and

continued

November 1980). We now expect prices movement over that period to be 15½ per cent. So there has been an increase in the real value of benefits. We do not expect earnings in 1981-82 to increase as fast as prices. At this time we cannot afford for those out of work to have real advantage over those in work. But Government wishes to maintain its pledge to protect real value of pensions over time. Hence decision to take back 1980 overpayment at November 1981 uprating.

(iv) Those who receive less than full price protection at November 1980 uprating (unemployment benefit, sickness benefit, invalidity benefit and maternity allowance) will be treated in same way as retirement pensioners and others. Decision to abate their uprating was related to the decision to bring them into tax (UB from April 1982, other benefits as soon as possible thereafter). Position will not have changed at November 1981 uprating.

(v) Certain benefits are exempt from the one percentage point. They include war pensions, mobility allowance and attendance allowance. There will be no change in other benefits which are not uprated every year (e.g. maternity grant, death grant etc).

(vi) Decision on uprating of child benefit will be taken at Budget time. Announced changes make no assumption about level of child benefit.

CONTACT POINT: C D BUTLER 233-3932

J1 LABOUR PARTY/TUC

Factual

(i) Labour and trade unions concerned over decline in business activity and high unemployment; blame Government's fiscal and monetary policies as deflationary; expect 3 million jobless next summer (Mr Healey).

(ii) Labour and trade unions say monetary policy too tight; call for reduction in interest rates (Mr Healey: 4% off MLR).

(iii) Labour and trade unions have criticised public spending cuts; call for more spending on industry and special employment measures.

(iv) Labour Party and TUC have urged higher PSBR during recession (Mr Healey: £3-4 billion above PSBR forecasts):

(v) Government accused of using unemployment to moderate pay after exacerbating inflation by own actions (nationalised industry price rises; VAT increase in June 1970; local authority rates and rents).

(vi) TUC Council and some Labour spokesmen favour an incomes policy but Congress in September voted for free bargaining.

(vii) Present over-run on money supply means, on Government premises, rising inflation will re-emerge in 1981/82 while present fall in inflation rate reflects last Government's monetary control.

(viii) Both TUC and Labour NEC call for controls on imports.

Positive

(i) Chancellor's statement re-affirms strategy that economically responsible Opposition members recognised as necessary - at least when in office.

/continued

(ii) Interest rates: See D1

(iii) Inflation now on firmly downward trend.

(iv) Expansion of special employment measures; selective assistance for investment; support for industrial research.

(v) Opposition spending plans were unrealistic.

Defensive

(i) Higher National Insurance contributions. Appropriate for those in work to help finance benefits for jobless and those in good health to pay more towards cost of NHS.

(ii) Public spending cuts: needed to check PSBR and allow monetary targets to be met without excessive interest rates. 6% figure in cash limits not an incomes policy: right to look for much lower growth in public service earnings in the coming year than the recent past. Both are necessary to fiscal policy.

CONTACT POINT: MISS DEYES 233-7426

J2 CBI AND BUSINESS INTERESTS

Factual

(i) Support expressed for Government aims of bringing down inflation and creating conditions for trading sector of economy to flourish. But critical of some details and timing of strategy.

(ii) High interest rates: 4 percentage points off MLR request by CBI President (also West Midlands group of Chambers of Commerce) now reduced to "significant" cut in excess of 1 percentage point.

(iii) High exchange rate: seen as linked with high interest rates and a burden on exporters.

(iv) National insurance surcharge: seen as penalising home products vis à vis imports.

(v) Private sector felt to be bearing brunt of recession. Government is urged to do more to cut public spending, public sector pay and public sector employment and get borrowing down to relieve pressure on interest rates.

(vi) Use of North Sea oil revenues - should be used to finance tax cuts that would benefit business, not to finance living standards.

(vii) Energy costs for UK industry - disproportionate to those in competitor countries.

Positive

(i) Interest rates - see D1.

(ii) MTFS strategy to bring down inflation re-affirmed. Offers best prospect for business in longer term.

(iii) Government determined to keep public spending, public sector borrowing and monetary growth in check. Firm stand on public sector pay.

Defensive

(i) Spending cuts inadequate?

Government still committed to lower public spending in medium term.

(ii) Spending cuts harmful to industry? Excessive public spending and borrowing worse for industry in long run.

(iii) Exchange rate suggestions for direct action misguided. See C1.

(iv) NIS - brings in substantial revenue; reduction would have to be financed from some other source.

(v) Revenue raising from petroleum production and concentration of national insurance increase on employees mean no extra burden on hard pressed sector of private industry.

(vi) Energy Costs

Government willing to discuss energy price anomalies with fuel industries and press other Governments to eliminate any energy subsidies. But energy prices must reflect marginal costs of supply.

Contact Point: Miss M M Deyes 233 7426

J3 POVERTY/CONSUMER PRESSURE GROUPS

Factual

(i) Child Poverty Action Group and others argue against reducing real value of social security and/child benefit.

(ii) National Council of Voluntary Organisations want expanded programmes to help young and long term unemployed; last report from Supplementary Benefits Commission predicted social conflict.

(iii) Low Pay Unit and others continue to worry about numbers depending on low incomes from work, and likely to lose jobs.

(iv) National Consumer Council wants ceiling on nationalised industry price rises.

Positive

(i) Inflation coming down; this is especially important to worst-off: Chancellor's statement affirms strategy to achieve lasting reduction in inflation.

(ii) Increase in pension this week 16½%; we now expect November 1979 to November 1980 price increase to be 15½%.

(iii) Defeating inflation essential for strong economy, more jobs, higher incomes and wealth creation to finance support of families, pensioners etc.

(iv) Measures to help young and long term unemployed expanded.

Defensive

(i) Next year's increase in pensions one percent under expected price rise: justified by this year's up-rating one percent above actual price rise.

(ii) National insurance contributions increase: see G1. Frank Field (former CPAG director) conceded in recent letter to Financial Times right for workers to pay more towards financing benefits for jobless.

(iii) What about child benefit? Wait for the Budget.

(iv) Nationalised industries: some price rises inevitable but rate of increase should be slower in coming year.

Contact Point Miss M M Deyes 233 7426

CONFIDENTIAL until
after Statement 24.11.80

J4 CONSERVATIVE PARTY CRITICS

Factual

(a) Some critics want more curbs on public sector spending, especially pay, to bring down PSBR (Mr Critchley, Mr Higgins, Mr du Cann).

(b) Some concerned about industry and unemployment urge relaxation of monetary policy and lower interest rates (Monday Club Mr Rippon, Mr Heath). Mr Macmillan in TV interview called for some reflation.

(c) Some concerned about effect on industry of high exchange rate (Mr Lewis, Mr Dorrell, Mr Baker, Mr Higgins). Tory Reform Group paper calls for "balance of payments policy".

(d) Some criticise form taken by spending cuts (Mr Rippon wants concentration on current spending Mr McCrindle wants to save social services even at a cost of raising taxes; Mr Churchill critical of defence cuts).

(e) Many critical of suggestion of raising taxation; Mr Latham wants tax cuts to boost demand and encourage pay moderation: Mr Latham and the two Pattens want cut in NIS

Positive

(i) Interest rates - see D1

(ii) MTFS strategy to bring down inflation reaffirmed.

(iii) Government determined to keep public spending, public sector borrowing and monetary growth in check.

Defensive

(i) Suggestions for action on exchange rate remain misguided - See C1.

(ii) Revenue raising from petroleum production and concentration of national inusrance increase on employees mean no extra burdens loaded on hard pressed sector of private industry.

(iii) Defence spending still rising strongly. UK meeting NATO target.

Contact point: Miss Deyes 233-7426

SECRET

cc Mr. Lankester

12

10 DOWNING STREET

PAYMASTER GENERAL

Public Expenditure : Chancellor's Statement

I have discussed further with Michael Bridgeman in the Treasury the point that concerned us all at your meeting this morning in the Chancellor's Statement on public expenditure.

The Treasury are quite adamant that they cannot complete the table they proposed to publish in the Official Report in such a way as to provide totals, or changes in planned totals. There are five substantial uncertainties, and although assumptions exist within the Treasury for covering them, the Treasury cannot risk being bound by stating those assumptions now. The assumptions relate to the size of the reserve; the shortfall; the EFL for BSC; child benefit; and the performance of the economy.

But in an attempt to meet the point that the public are expecting some indication of the overall effect next year of the public expenditure decisions, two new passages will be inserted in the Statement. The first will be that the planning total for public expenditure in 1980/81 is now some 1½% higher in volume terms; and the second will be that the Government's aim is to keep the volume of 1981/82 public expenditure about 1% below the out-turn now expected for 1980/81 - much the same rate of reduction as indicated in the March White Paper. (The March White Paper actually indicated a planned reduction of 1.2%.)

The hope is that public attention will be focussed on individual programmes and on relative totals as between 1980/81 and 1981/82, rather than on figures for the totals. Given the additional complication of the revaluation for 1979 survey prices

/to

SECRET

to 1980 survey prices, only the serious commentators are likely to attempt a calculation of the overall picture, and the Treasury will just have to cope with them as best they can. Certainly the Statement that public expenditure next year is still likely to be significantly lower than public expenditure this year is helpful, but there will be some who will say it is a fraud, because both are now at a higher level than previously planned.

J.M.M. VEREKER

21 November 1980

SECRET

11

cc Mr. Ingham

Mrs. Gilmore (HMT)

2

MR. LANKESTER

Prime Minister

To see.

Chancellor's Statement : Briefing for Ministers

21/11

At the Paymaster's meeting this morning we discussed briefly my draft speaking note for Ministers, to be issued after the Chancellor has spoken on Monday, and I have now revised it in the light of Treasury comments. You and the other recipients may wish to see this, and you may wish to consider whether the Prime Minister should also see it; the missing paragraph on page 3 relates to MLR, and has been blanked out on all copies except for the master, which I shall retain until after the Chancellor has spoken.

J.M.M. VEREKER

21 November 1980

SECRET

THE ECONOMIC STRATEGY

Objective

The Chancellor's statement on 24 November has naturally aroused considerable public interest not only in the short term measures, but in the whole direction of the Government's economic policies. It is important to reaffirm that the fundamental objectives are unchanged, and that the Government are working in the framework of a coherent strategy, rather than reacting to problems as they arise. In particular, the Government are determined to adhere to the medium term financial strategy set out in the Financial Statement at the time of the Budget. This note is therefore designed for use by Ministers in all their speeches, broadcasts and writing this week and in the weeks to come.

Presentation

The objectives of Government economic policy are unchanged. They are to achieve a permanent reduction in the rate of inflation, and to create the conditions for a sustainable growth of output and employment.

In order to achieve these objectives, the Government published, at the time of the last Budget, a medium term financial strategy. The key elements in that strategy were control of the money supply, and a steady reduction in public expenditure.

We said that the annual growth of money supply would be reduced to about 6 per cent in 1983-84; and we suggested some ranges for annual growth between now and then. There is no doubt that, partly because of technical distorting factors associated with the removal of the "corset" imposed by the previous administration, so far there is more money in the system than we intended. But we are confident that monetary growth will come down in the future; and that we are still on course for our target in 1983-84. The Chancellor's measures included new steps to make the technical control of monetary growth

/more

more effective and to ensure that fiscal policy next year is consistent with our objectives.

And we said that public spending would fall each year between now and 1983-84. As the Chancellor indicated on Monday, it will still be lower next year than this, although the fall is not quite as much as we had intended. That is in large part due to the worst international recession since the war, from which Britain is suffering particularly badly. At such a time considerable elements of public spending, such as social security payments and the borrowing needs of the nationalised industries, are bound to rise.

Despite these difficulties over the money supply and public spending - and let us be frank about them, the difficulties have been more severe than we expected - we are making good progress towards our objectives.

Above all, inflation is coming down rapidly - much faster than most people expected. Retail prices have risen by less than 1% in each of the last six months and wholesale prices have risen more slowly still. We expect the rate of inflation next year to be not far above single figures.

Pay settlements have moderated substantially. The figures published last week, of the increase in average earnings in the year ending in September, do not at all reflect the new climate of realism we have seen this autumn. In fact, the CBI estimate that a clear majority of the settlements in manufacturing industry this pay round have been in single figures. As for the public sector, we have told local authorities that we are making available only enough money to finance a 6% increase in their pay bills; and the Prime Minister has confirmed that the rest of the public service will be subject to the same sort of financial discipline.

The Chancellor's statement was not a "mini-budget", but an indication of some of the decisions the Government have taken affecting 1981-82. The final Budget judgement will not of course be made until next spring; but the Government are determined to

/keep

keep the amount of public borrowing next year within reasonable limits, so some action has been taken now which will enable us to raise revenues. We have chosen employees National Insurance Contributions, and an additional tax on petroleum revenues, because they do not affect the group which have suffered most from the recession - the unemployed.

The Outlook

The way ahead is not an easy one. The recession will continue this year and well into next. Unemployment is bound to rise still further. Living standards are bound to fall, even for those who are still employed.

But when the upturn comes - and this recession, though deeper than others, will like all recessions end in a period of growth - the conditions for a sustainable period of increasing production and increasing employment will be there. Above all, inflation will simply not be let loose again.

Responsible pay bargaining isn't just a sacrifice that everyone is being asked to make this time round. It is an essential ingredient of our ability to seize the opportunity that the end of the recession will bring. Never again must people generally expect to be paid more and more pounds carrying less and less purchasing power. Stable prices, more jobs, and increased prosperity are within our grasp if we don't let greed overcome commonsense.

SECRET

10

MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1
Telephone 01-~~XXXXXX~~ 218 2111/3

MO 8/2/12

21st November 1980

Dear John,

PUBLIC EXPENDITURE

My Secretary of State has seen the material circulated by the Chancellor under cover of his minute to the Prime Minister of 20th November.

My Secretary of State is not happy with the paragraph (B6) in the draft statement on defence expenditure. He thinks that this should be clearer about growth rates and he also considers that the reference to NATO allies is likely to be gravely misunderstood and resented by our principal partners. He would like the paragraph reworded to read:-

"Defence expenditure grew by 3% in 1979/80 and is expected to grow by 2 - 3% in 1980/81. Planned expenditure for 1981/82 is reduced by £200m, which will mean an estimated 2½% growth in real terms over the outturn consistent with the cash limit for the current year."

I am sending copies of this letter to Clive Whitmore (No 10), George Walden (FCO), Terry Mathews (Chief Secretary's Office); and David Wright (Cabinet Office).

Yours ever,
Brian Norbury

(B M NORBURY)

A J Wiggins Esq

SECRET

Econ Pol
Pub Exp.
TL 9/12

COPY No.1 OF 4 **9b**

PM seen and said - "no action".

SECRET

Prime Minister
Mr Howell is now arguing against the oil tax increase - on 'political' grounds. But he offers no alternative. The Chancellor is convinced he must proceed. (and he says that Mr Howell did not repeat these points with him).
Shall I say - 'go-ahead'?
R
20/11

PRIME MINISTER

R 8/12

ADDITIONAL TAX REVENUE FROM THE NORTH SEA

In his minute to you of 14 November *attached* on his latest tax proposals for the oil industry, Geoffrey Howe fairly records my discussions with him and mentions my reluctance to see this completely new tax imposed.

Could I make it clear that my reluctance stems not from the belief that it is wrong to extract further revenues from the oil industry but from my strong conviction that the proposed means of doing so will be politically extremely damaging.

The oil industry has few friends and therefore tends to be regarded as "fair game". So far, in this country, we have successfully struck the balance between the need to extract substantial benefits for the community and the need to retain the industry's confidence and trust, both here and overseas.

The gains we get as a government from sustaining a reputation for consistency of treatment and fairness towards the international oil industry go far beyond the energy sector. They help give Britain its present robust and trusted reputation internationally - no small asset in our struggle to establish sound policies here at home.

I hate to see this jeopardised by what is now proposed. I think it will give our critics new allies - which they have so far lacked - in international business circles.

I thought it right to explain to you, as I have to the Chancellor, the essentially political reasons for my reluctance over what he proposes on this front to deal firmly with the formidable budgetary problems the government faces.

I am copying this minute to the Chancellor of the Exchequer and to Sir Robert Armstrong.

DH.

SECRETARY OF STATE FOR ENERGY

20 November 1980

SECRET

SECRET

Original on:—
Econ Pol: Strategy

Mr Hoskyns
Mr Vereker
PA 7

Prime Minister
This seems alright.
Do you have any comments?

9A

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

See B.9.
MS.

29/4

PRIME MINISTER

PUBLIC EXPENDITURE

At Cabinet yesterday, I undertook to clear with the colleagues directly concerned the references in my statement to public expenditure.

..... 2. I now enclose the present draft of that part of my statement which refers to public expenditure. I also enclose the ..... summary of changes to be circulated in the Official Report. The latter has been cleared at official level, subject to one point. I should be grateful to know during the course of Friday whether you, or any other members of the Cabinet to whom I am sending a copy of this minute, have any comments on the drafts.

3. The one outstanding point is the way in which we treat the increase in the EFLs for nationalised industries, but I am sure that can be resolved satisfactorily bilaterally between myself and the Secretary of State for Industry, and I need not trouble you and the others with it.

4. Immediately after the statement I propose to write to Edward du Cann, as Chairman of the Treasury and Civil Service Department Committee, about the treatment of pay in cash limits. This caused a good deal of misunderstanding between

SECRET

us and the Committee last year, so I want to make what we are doing absolutely clear to the Committee from the outset. ...... I enclose a draft of the letter which I would send to Mr. du Cann, and put out in a Press Release at the same time as the other material.

5. I am sending copies of this minute to the other members of the Cabinet, to the Minister of Transport and to Robert Armstrong.

for (G.H.)

20 November 1980

(Approved by the Chancellor and signed in his absence)

Public Expenditure

As hon members will know, the PSBR during the first half of 1980-81 is estimated to have been about £8

B1. I expect the PSBR to be much lower in the second half of the financial year, but it could be around £11½ bn for the year as a whole [Much] of this is due to the effect of the recession, particularly on public expenditure.

B2. We have reviewed public expenditure plans for 1981-82. In conditions of continuing recession in the UK, some increases in expenditure arising from the recession must be expected and planned for. However, the total increase in expenditure and in public borrowing must be consistent with the medium term strategy and with a continued reduction in inflation. That is essential for a resumption of sound sustainable growth.

B3. It is realistic to assume a higher level of spending on unemployment and other benefits this year than allowed for in the White Paper of last March. The changes in trading conditions are reflected in the external financing limits for the nationalised industries for 1981-82 which, excluding steel, are being announced separately [today]. These industries are being required to secure substantial economies.

B4. My rhf the Secretary of State for Employment announced last week extension of the special employment measures which will cost nearly £250 million next year. The Government have also decided to increase the provision for selective assistance for investment and support for industrial research and development at a cost of £50 million next year. These amounts, and the other public expenditure changes I shall mention, are in the 1980 survey prices at which the decisions have been taken - that is broadly the prices of a year ago.

B5. In view of these increases, we must now plan to cut the volume provision for the majority of spending programmes. We must also restrict the cost, and so the cash requirements, of the public sector. Our aim is to hold the planning total for the volume of public expenditure in 1981-82 below the outturn now expected for 1980-81. The latter is some £[1] billion higher in volume than envisaged at the time of the last White Paper. I am publishing in the Official Report [and making available in the Vote Office now] a summary of the effect on expenditure programmes in 1981-82 of these decisions. Details of these changes, and of the changes in the provision for later years, will be set out in the public expenditure White Paper to be published at the time of the Budget.

B6. I should mention some of the main changes. We must, like some of our other NATO allies, adjust the rate of growth of our defence expenditure. Planned expenditure in 1981-82 will now be £200 million less than allowed for in the last White Paper. This will be nearly 8% higher than the level achieved in 1978-79.

B7. In broad terms, we shall be seeking a 3% reduction in the volume of local authority current spending compared with the level we planned for this year. We also propose to calculate the Rate Support Grant on the basis of providing a lower percentage of the reduced volume than the 61% (for England and Wales) in recent RSG settlements. My rhfs the Secretaries of State for the Environment, Scotland and Wales will be consulting their local authority associations on these proposals before the RSG settlements next month.

B8. In 1980 prices have increased less than we allowed for when we decided on the uprating of social security benefits for this November. There will accordingly be some increase in real value of benefits. We intend that the increase in retirement pensions and other benefits in 1981 will be such that the excess adjustment over prices, estimated at one percentage point, is not carried forward into future years. This will maintain the real value of the retirement pension over time. Public service pensions will be treated in the same way. Any further action on index linked pensions will follow the report of the Scott Enquiry. A decision on child benefit uprating will be taken at the time of the Budget. We have also decided that the earnings rule limit will remain unchanged.

B9. But the cost of public expenditure programmes, especially pay, is as important as volume. It is essential to our fiscal policy, and fair, to look for a much lower growth in public service earnings in the coming year than in the recent past. It has already been announced that the Rate Support Grant limit will allow for a 6% annual increase in earnings from due settlement dates in the current pay round. It

Please look at drafting? This looks like 6% on each person's earnings will provide for an increase in prices other than pay of 11% between the average levels for 1980-81 and 1981-82. Expenditure in other parts of the public services will be subject to broadly the same financial disciplines.

TEXT FOR CIRCULATION IN THE OFFICIAL REPORT

SUMMARY OF PUBLIC EXPENDITURE POLICY DECISIONS

A. Volume

1. The changes in expenditure programmes for 1981-82 due to policy decisions since the March Public Expenditure White Paper (Cmnd 7841) are:

	1981-82 £m at 1980 Survey Prices (1) (3)	
Nationalised Industries		
Increases in EFLs (other than for British Steel) including revised provision for shortfall		+620
Other policy increases (2)		
Special employment measures	+245	
Industrial support	+ 51	
Industry (other)	+ 10	
Health (withdrawal of some proposals for new charges)	+121	
Civil superannuation (accelerated retirement of civil servants)	+ 64	
Trade	+ 21	
		+510
EC refunds agreed on 30 May 1980		-650
Other significant policy changes: (2)		
(i) Local Authority Current Expenditure (England) - reduction by about 3% instead of 2% from planned level for 1980-81	-165	
(ii) Further changes in Departmental programmes (excluding elements of local authority current expenditure included in (i))		
Agriculture Departments	- 36	
Department of Employment	- 25	
Department of Transport	- 21	
Department of Environment	-158	
Home Office	- 17	
Department of Education and Science	- 52	
Office of Arts & Libraries	- 10	
Department of Health & Social Security (health and personal social services)	- 25	
(iii) Other Departments		
Defence	-200	
Foreign & Commonwealth Office	- 16	
Export Credits Guarantee Department	-166	
Department of Health & Social Security (social security)	- 66	
Scotland, Wales and N. Ireland (including changes to local authority current expenditure in Scotland and Wales)(4) (about)	-100	
Other (about)	- 15	
		-1,070

/ Footnotes - see next page

2. The changes take account of the salary savings expected in 1981-82 from the progressive reduction in Civil Service numbers to 630,000 by 1984.

3. The list does not include changes where the exact amount will be decided later eg British Steel and Child Benefit. Nor does it include the estimating adjustments, eg for demographic and economic factors, which will be made in the public expenditure White Paper to be published at the time of the Budget. The White Paper will include further details of the policy changes for 1981-82 and will set out the plans for 1982-83 and 1983-84.

B. Cash limits

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

5. The cash limits for the Rate Support Grant and for the Universities' Grant will include allowance for increases in earnings of 6% in annual settlements due before 1 August 1981, and also provisionally of the same amount for annual settlements due after that date. The allowance for pay in other cash limits, and Votes, will be so set that the pay of the relevant groups is dealt with broadly within the same financial disciplines. The outcome of settlements in particular cases will depend on the way in which the cash is allocated.

---

(1) The figures are in the prices used for the 1980 Public Expenditure Survey, ie those of late 1979 or in some cases on average in 1979-80. In the case of transfer payments the definition of survey prices has been changed since the last public expenditure White Paper (Cmnd 7841) from the average of the financial year in which the survey takes place to the average of the last completed financial year.

(2) The increases and reductions shown include the net effect of various minor policy changes.

(3) Total changes are rounded to the nearest £5 million.

(4) The exact changes to Scottish, Welsh and Northern Irish programmes, in parallel with those to English programmes, have yet to be determined.

Draft Copy

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

November 1980

The Rt. Hon. Edward Du Cann, MP
House of Commons

1981-82 CASH LIMITS

My statement today covers certain general aspects of the 1981-82 cash limits relating to pay in the public services. To avoid any misunderstanding I am writing now to inform you and the Treasury and Civil Service Committee of two further specific points; and I am releasing this letter to the press.

First, the prospective increase in the paybill between financial years. In particular cash limits or Votes, the actual percentage increase between 1980-81 and 1981-82 in the provision for pay will differ from the announced provision for the increase in earnings from due settlement dates. The number employed may change. In some cases the settlement date is not 1 April, so that 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 been staged in 1980-81, with increases paid later than the usual settlement dates, but such staging not being repeated in 1981-82. This last will contribute some 1 per cent to the increase in the total public service paybill between the two years.

Second, staging. 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 comparisons of the growth of earnings.

/The Government

The Government thinks it desirable for the future to avoid the delaying on staging of awards, and will avoid it where the Government is itself the employer. If, this general policy notwithstanding, a public services employer were to delay or stage an award, the Government, when setting the relevant cash limits for the subsequent year, would not allow for the element of the award which had only been made compatible with the cash limit by such delay or staging.

GEOFFREY HOWE

CONFIDENTIAL

Tim

This has not been sent to the PMG, following our discussion. The Treasury understand that the para on MLR is only a piece of contingency drafting, and are not circulating the draft outside a small circle anyway. Brian Unwin is coming with Rosalind Gilmore to the meeting tomorrow. J

10 DOWNING STREET

cc:- ~~R Prescott, Paymaster-General's Office~~
Mr Ingham
Mr Lankester

20 November, 1980

ECONOMIC STATEMENT

I mentioned to you this morning that, in preparation for the meeting that you and I and Bernard Ingham will have with the Paymaster tomorrow at 11.00 am, I would be circulating to all the participants an early draft of the guidance that the Paymaster might send out to his colleagues immediately after the Chancellor speaks next week. I am sure the Paymaster will want, at his meeting, to consider the questions relating to media treatment on the day - and you undertook to let us have the latest draft of the Chancellor's statement - but I think we should also prepare carefully for the way in which other Ministers are going to put across the extent to which the economic strategy is still in tact.

- superseded see Vereker 21/11

I therefore enclose a draft, which cannot of course be finalised until next week. For obvious reasons I have not been specific on the subject of interest rates, and the draft will have to remain confidential until all the announcements are made.

JOHN VEREKER

Mrs R Gilmore,
HM Treasury

CONFIDENTIAL

3

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon George Younger TD MP
Secretary of State
Scottish Office
Dover House
Whitehall
London SW1A 2AU

20 November 1980

Dear George,

RATE SUPPORT GRANT 1981-82: SCOTLAND

Thank you for your letter of 19 November making proposals for the rate support grant settlement for 1981-82. I can agree most of them, with two important exceptions.

The first relates to the grant percentage. I believe that a reduction of 1.9 percentage points is justified, composed of two parts: a 1.1 percentage point cut pro rata to the 1% agreed for England and Wales (the higher rate of Scottish grant support justifying a marginally higher cut), together with a 0.8% reduction on account of regularising the existing arrangements for an arbitrary reduction because of the effects of the 1978 rating revaluation. Following precedent, this would round to 2% rather than the 1.5% you propose. I appreciate your reasons for not wishing the settlement to seem unduly harsh on Scotland, but I am sure that you will recognise that the only substantive change is that resulting from the decision of Cabinet to decrease grant support to local authorities; the remainder is no more than formalisation of the existing unsatisfactory arrangements.

Secondly, I should prefer not to adopt the arbitrary reduction of £10 million you suggest in order to insure against overpayment of grant should interest rates fall before the end of the year. Instead, I believe that you should calculate the increased grant due on account of interest rate movements since the last settlement in the same way as has been done for England and Wales. Michael Heseltine's letter of 21 October explains. Apart from the obvious difficulty of explaining a discrepancy in the assumed interest rates if you were to use a different one from that employed in England and Wales, this method avoids the need for justifying in public any particular interest rate path for the next few months, by adopting instead an authoratitive Treasury model which there is no need to explain. No grant loss will be suffered by local authorities as a result of this method of calculating the increased grant due on loan charges, because the balance due will of course be made good in the second Increase Order next year.

I understand that Michael Heseltine's present intention is to announce the outline of the RSG settlement for England, including the grant percentage, on 24 November. It would be helpful to know when, and in what form, you propose to make the corresponding announcement for Scotland.

I am sending copies of this letter to the Prime Minister, to the other members of Cabinet, Norman Fowler and Sir Robert Armstrong.

Yours

John Biffen

JOHN BIFFEN

21 NOV 1980

CS

CONFIDENTIAL

DEPARTMENT OF HEALTH & SOCIAL SECURITY

Alexander Fleming House, Elephant & Castle, London SE1 6BY

Telephone 01-407 5522

From the Secretary of State for Social Services

The Rt Hon Michael Heseltine MP
Secretary of State for the
Environment
2 Marsham Street
London
SW1

20 November 1980

Dear Michael,

COUNCIL HOUSE SUBSIDIES AND RENTS: RATE SUPPORT GRANT

Thank you for copying to me your letters of 14 and 17 November 1980 to Geoffrey Howe.

I have no objection to your proceeding as suggested in the second letter which, in all the circumstances, would seem to be the most appropriate arrangement.

Yours ever

Patrick

CONFIDENTIAL

nr

CONFIDENTIAL

Ceam PSl

23

DK to see

MS

DEPARTMENT OF EDUCATION AND SCIENCE

ELIZABETH HOUSE, YORK ROAD, LONDON SE1 7PH

TELEPHONE 01-928 9222

FROM THE SECRETARY OF STATE

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

19 November 1980

Dear Secretary of State

COUNCIL HOUSE SUBSIDIES AND RENTS: RATE SUPPORT GRANT

Thank you for sending me a copy of your further letter to Geoffrey Howe of 17 November about the RSG settlement.

Your letter crossed with Janet Young's of 18 November to you. As she explains there, I am to meet the Select Committee on Education on Wednesday 17 December, the very time that you now propose for the RSG Consultative Council which I ought also to attend. I hope therefore that the Consultative Council can be held on the previous day.

I am also concerned about the suggestion that you should make your statement about local authority expenditure on Tuesday 25 November if Geoffrey Howe makes his general statement on Monday 24 November. I say this because I myself am first for Questions on Tuesday 25 November; and it would be clearly unsatisfactory if your statement followed my Answers. The only way round this that I can see is for Geoffrey Howe to include in his statement (or publish in Hansard) the service breakdown of the local authority totals. In any event I shall be glad to see as soon as possible a draft of what it is proposed to say about this breakdown.

Otherwise I am content with what you propose, including the draft of your letter to the local authority associations.

I am sending copies of this letter to the Prime Minister, the other members of the Cabinet, Norman Fowler and Sir Robert Armstrong.

Yours sincerely

PAShaw

for MARK CARLISLE

(approved by the Secretary of State and signed in his absence)

CONFIDENTIAL

CABINET 19/11/1980

SECRETARY OF STATE'S PROPOSED REDUCTIONS

I would be prepared to go along with the following items of those listed in Section A of the officials' note:

First: 1% off all benefits, if the price movement does in fact show there has been overprovision in November 1980 of this amount. This is Item (a) together with partial implementation of Items (b) and (c). Worth together £144 million.

Second, hold back on child benefit to the same extent as tax thresholds. This is Item (d). And worth £84 million.

Third: Freeze the pensioners earnings rule again. This is Item (f) and worth £10 million. 15.3 / 4.3 /

Together these savings would amount to £238 million in 1982-83. Coupled with the extra £100 million saving to the PSBR which results from my agreement to raise the upper earnings limit on insurance contributions, not to £190, but to £200, I think this is as far as I can go.

16.5.

It is on top of savings of nearly £1400 million, or more than 7% of the social security budget, in 1982-83 as a result of all the previous cuts.

4 photocopies shredded 20/11 GB.

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

Nick MS

CONFIDENTIAL

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

19 November 1980

Dear Geoffrey,

In the light of this morning's discussions I have been thinking about the difficulty which a series of statements on RSG next week by Michael Heseltine, Nicholas Edwards and me would present to the business managers. It seems to me that, if you are to announce on Monday what you propose in your letter of 18 November to Michael, if necessary with some additions, there would be no need for another three separate statements to be made.

This would seem to me to be very desirable, and I would therefore be ready to forego making a statement in that case. I could not, however, avoid making one if there were to be further statements on RSG in England and in Wales. I would not in any case want to say anything about the breakdown by services until the final settlement meeting with Scottish local authorities.

I feel that in this way you could cover all that is necessary, and save us all from the Parliamentary nonsense of having three consecutive statements on the same subject. It would, of course, be quite simple for Michael, Nick and I to speak direct to our respective local authority associations to fill in the details.

I am copying this letter to the Prime Minister, members of the Cabinet, Norman Fowler and Sir Robert Armstrong.

Yours ever,

George.

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

18 November 1980

Spare PA
MS

The Rt. Hon. Michael Heseltine, MP.,
Secretary of State for the Environment

Dear Michael

COUNCIL HOUSE SUBSIDIES AND RENTS: RATE SUPPORT GRANT

Thank you for your letters of 14 and 17 November outlining the changes in the rate support grant timetable which will be necessary as a result of the delay in the programme of consultation on council house subsidies. I accept with regret that there is no option but to defer the date of the RSG settlement and that this means the RSG debate will now have to take place after Christmas.

I am broadly content with the programme of announcements sketched in your letters, with one reservation. As things now stand, it will probably be appropriate for me to make a statement on Monday, 24 November putting in context the announcement of our main decisions on public expenditure for next year; but a final decision on the form and timing of my announcement will have to await the settlement of the topics to be discussed each day during the Queen's Speech debate. Clearly my statement will need to say, as one of our main decisions, that we are asking the local authorities to cut back their current spending by 3 per cent, as compared with this year's planned level, rather than the 2 per cent provisionally announced earlier. We need to do everything possible to ensure that this statement is well received by commentators, as adequate and consistent with the Government's overall monetary and fiscal strategy. In particular we need to discourage suggestions that the 3 per cent reduction is a 'paper' cut which the local authorities will fail to deliver. Hence in my view it is desirable to say in the initial statement that reductions in the RSG percentages will be calculated on the basis of providing 60 per cent of the reduced volume (in England and Wales) rather than 61 per cent as previously. I shall then say that you will be giving fuller details in your statement on the following day. No doubt George Younger and Nicholas Edwards will be considering how best to convey parrallel information about Scottish and Welsh local authorities.

/I have

I have no objection to your writing to the leaders of the local authority associations on the general lines you suggest, subject to a minor adjustment to the wording. I would like the final sentence of paragraph 1 and the first of paragraph 2 recast to read:

> "Regrettably, I am not in a position to make more information available at this stage. As you know, the rate support grant settlement is always considered in the context of the Government's wider review of public expenditure, about which we are not ready to make a statement this week, though we hope to give some indication of our intentions next week.
>
> Accordingly ,.. but to await the further information on the outcome of the review I have mentioned. I should expect ..."

Copies of this letter go to the recipients of yours.

GEOFFREY HOWE

7

Ref: A03594

SECRET

PRIME MINISTER

Public Expenditure
(C(80) 72)

BACKGROUND

This is the fifth meeting in the current series to resolve the main public expenditure issues for next year and the following years of the PES period. It will be necessary to deal with all the outstanding items if the Chancellor is to make a comprehensive statement at the beginning of next week.

2. As agreed at the last meeting, the Chancellor of the Exchequer has circulated a memorandum (C(80) 72), summarising the decisions reached so far and indicating their wider implications for the Government's economic strategy. His figures distinguish between Case A - no further cuts beyond those already agreed or offered - and Case B which assumes that all the Treasury's outstanding proposals for Defence, Social Security and Health, and Scotland are accepted in full. In practice the Chancellor recognises that he will not get Case B in full (which assumes, for example, £500 million for Defence), but he is looking for an outcome as close as possible to it.

3. The Chancellor advises that it will not be possible to reduce the further provision of £157 million for the External Financing Limits of the nationalised industries in 1981-82 as approved by E Committee. I understand moreover that not all the sponsor Ministers have yet reached agreement with their chairmen on the reductions necessary to implement the E decisions.

HANDLING

4. You might open the discussion by inviting the Chancellor to set the scene for Cabinet's examination of the outstanding public expenditure proposals by making an introductory statement based upon C(80) 72. The Cabinet has already expressly accepted that its failure to produce enough public expenditure savings necessarily involves an even higher increase in taxation than might in any case have been needed. The Chancellor's arithmetic shows

that this extra burden will be heavy; it also shows that because of the public expenditure increases in the later years, there could well be difficulties in making any significant reductions in the tax burden then. To the extent that the outstanding proposals now before Cabinet are not approved this task will be even more difficult.

5. I suggest that you take the detailed items in the order: Defence; social security; health; and Scotland.

<u>Defence</u>

6. Summing up the discussion on 4th November you said that:-

> "The Cabinet accepted that the cuts on the Defence Budget would have to be less than the £500 million which the Chancellor had sought but more than the £152 million offered by the Secretary of State for Defence, which did not even meet the requirement of £188 million representing the general 2 per cent cut in cash limited expenditure."

7. I sent you a note yesterday on the present state of play on the amount of the cut, and indications of the possible range for decisions on the Secretary of State for Defence's conditions.

<u>Social Security</u>

8. The reductions at issue are summarised in Part II of Table 3 attached to C(80) 72. The Chancellor will circulate at the meeting copies of his minute, which he has sent today to you and the Secretary of State for Social Services, covering a detailed note by Treasury and DHSS officials.

9. In dealing with these Social Security proposals there is no alternative but to work through the detailed points in paragraphs 4 and 5 and in Sections A and B of the note by officials. A number of the proposals would, if approved, require legislation. The Chancellor will suggest that this could best be enacted by extending the scope of the Social Security Bill which is already in the programme to give effect to the Employers' Statutory Sick Pay Scheme. The Secretary of State for Social Services will no doubt point out that this is

already a controversial Bill and that each new item added to it will add to the controversy and the difficulties of getting it through the House. This Bill is additional to the Social Security (Contributions) Bill which will be introduced very shortly to give effect to the decisions on the Employees' National Insurance Contributions.

10. Paragraph 4 of the note draws attention to two omissions from the proposals: the Christmas bonus and the reflection of alcohol and tobacco duties in up-ratings. You will wish to confirm that Cabinet still agree (as they were inclined to last week) that these options should be ruled out.

11. Paragraph 5 reports that the Chancellor and the Secretary of State wish to have it recorded that the upper earnings limit for National Insurance contribution purposes will be set at £200 per week from April 1981 rather than £190. This will reduce the PSBR by a further £100 million. Unless any member wishes to dispute this decision the Cabinet can simply take note.

12. You will then wish to turn to the proposals listed in Section A -that is those agreed between the Chancellor and the Secretary of State - and Section B - those proposed by the Chancellor alone. It will be necessary to record decisions on each of them.

13. Proposal (a) is to increase retirement pensions, long term supplementary benefits, and all other benefits not caught by subsequent proposals, by 1 per centage point below full price up-rating. This would reflect the 1 per cent over payment in the 16.5 per cent up-rating this November. Thus it can be argued that it would not breach the pledge to keep pensions in line with prices and would still be consistent with the Government's action to make up a shortfall left by the Labour Government of 1.9 per cent in November 1979. But it will no doubt lead to a great political row and strenuous charges of breach of commitments. The question for Cabinet is whether all that, which would involve controversial legislation, is worth it for a 1 per cent reduction.

14. Proposals (b) and (c) are to abate increases in unemployment benefit, sickness benefit and maternity allowance by 3 percentage points in November 1981. This would not require legislation. The 3 per cent would reflect the 1 per cent over-payment in November 1980, the extent to which

earnings are likely to fall behind prices in the coming year, and the effect of indirect tax increases on alcohol and tobacco prices. It would require 220 additional DHSS staff. It will be pointed out that it hits the disadvantaged, and the unemployed at a time of rising unemployment.

15. Proposal (d) is to abate the November 1981 increase in child benefit by the same percentage as tax threshold increases are abated in the next Budget. No legislation is necessary and the full year's savings are worthwhile - £84 million a year.

16. Proposal (e) is to extend from 3 to 6 the waiting days before flat rate unemployment and sickness benefits are paid. Legislation would be needed. This would hit the same groups covered by proposals (b) and (c) for a 3 per cent abatement in up-rating.

17. Proposal (f) is to freeze the pensions earnings rule. Under the present rule a person can earn up to £52 a week before his pension is docked. Unless the level is up-rated with earnings it becomes increasingly penal. The Manifesto says 'It is wrong to discourage people who wish to work after retirement age, and we will phase out the earnings rule during the next Parliament'. Thus to freeze the earnings rule for one year is not directly contrary to a pledge, but it limits still further the time available to phase out during this Parliament. Legislation would be needed. The savings are relatively small.

18. Proposal (g) is to abolish child dependency additions to unemployment and short-term benefits. This addition is being phased out anyway. The proposal is to accelerate the process. It would require legislation.

19. The remaining proposals in Section B, (h), (i) and (j), are those which the Secretary of State for Social Services does not accept.

20. Proposal (h) is to abate the up-rating of short-term supplementary benefits by 2 percentage points in addition to the 1 per cent proposed under (a) to take account of the over-payment in the November 1980 increases. This would not require legislation, but the Secretary of State for Social Services considers that he is pledged to maintain the real value of the supplementary benefit safety net.

21. Proposal (i) is to hold back supplementary benefit childrens rates. The Chancellor argues that this is necessary to stop a widening of the cash differential between these benefits paid to those people out of work and child benefit paid to those in work. No legislation would be needed, but the Secretary of State for Social Services points out that the proposal would hit the poorest families.

22. Proposal (j) is for a further 2 per cent abatement in the November 1981 increases in unemployment and sickness benefit and maternity allowances. No legislation would be needed. This 2 per cent would be in addition to the 3 per cent proposed under (b) and (c). It would need additional staff of over 150.

Health

23. It had been agreed that the cash controlled health programme should be exempted from the general 2 per cent cut on the grounds that the funds could be raised through increasing the National Insurance health stamp The increase of 0.25p in the stamp has now been agreed. At the last meeting you suggested that, in view of the failure to secure more substantial reductions on Social Security, it would be necessary to look at this again, and you suggested that reductions of, say, 1 per cent might be found by improvements in efficiency.

24. The Chancellor proposes a reduction of £60 million a year in England which would represent 1 per cent of the cash limited programme or $\frac{3}{4}$ per cent of the total NHS programme (this would lead to further cuts under formula arrangements totalling £12 million in Scotland, Wales and Northern Ireland). The Secretary of State for Social Services believes that £25 million is the most that he can offer with the possibility of doing something better in the later years when his current proposals for improving efficiency will be beginning to take effect. The Cabinet will have to decide on a figure somewhere between £25 million and £60 million.

Scotland

25. At their last meeting the Cabinet reluctantly accepted the political arguments put forward by the Secretary of State for Scotland against a cut of £90 million, but accepted an offer of £10 million which the Secretary of State

for Scotland judged as the most he could offer within the present framework; and invited him to consider with the Chief Secretary what further savings he might offer in addition to that £10 million.

26. The Secretary of State for Scotland will be meeting the Chief Secretary immediately before Cabinet to discuss this, and he will report the outcome orally. Insofar as cuts are agreed in the Health programme for England, cuts on the Scottish Health programme will follow automatically under the formula arrangements. The question before Cabinet will be what should be the cuts, if any, additional to the £10 million offered, and to the Health formula cuts. The Chancellor of the Exchequer proposes additional cuts of £10 million in 1981-82 and £20 million in each of the two later years - see Part II of Table 3 of C(80) 72.

1982-83 and 1983-84

27. There will be no announcement yet of the figures for these years and it is not necessary for them to be discussed in detail or approved tomorrow. Where there are any difficulties - such as the points raised in the Minister of Transport's letter of today to the Chief Secretary - they can be discussed bilaterally between the spending Minister and the Chief Secretary. The Chief Secretary can then put revised figures to Cabinet - for information or, if necessary, for discussion.

The Chancellor's Statement and the wider Economic Strategy

10.20.30

28. Assuming that all of the outstanding issues have been resolved, you may then want the Chancellor to indicate the broad lines of the statement he will be making to the House of Commons next week. At the end of this part of the discussion the choice will lie between asking the Chancellor to take account of the points made; and asking him to circulate a draft of his statement to colleagues, or at any rate a few senior colleagues, for comment later this week.

D.J. Wright

(Robert Armstrong)

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

18th November 1980

SECRET

cc Defence Budget Pt4.

FILE

VLS
6

10 DOWNING STREET

cc HO
FCO
LPO
HMT
CO

From the Principal Private Secretary

18 November 1980

Dear Brian,

Public Expenditure: Defence Budget

The Prime Minister and your Secretary of State met this evening to discuss the future level of the defence budget in the context of the review of public expenditure which the Cabinet will resume at its meeting tomorrow.

They agreed that the defence budget for 1981/82 should be reduced by £200 million at late 1979 prices, subject to the following conditions:

(i) In accordance with agreed cash limits policy and with the treatment of overspends on the defence cash limits in 1978/79 and 1979/80, any overspend on the 1980/81 defence limit would require a compensating deduction from the limit for 1981/82.

(ii) If the decisions taken by the Government in the light of the recommendations of the Armed Forces Pay Review Body entail an increase in the Armed Forces' pay bill beyond the 6 per cent already provided in the defence cash limit, the cash limits will be increased by the full amount involved.

(iii) The prices factor for the cash limit on defence budget expenditure other than pay will be 11 per cent, but in recognition of the special considerations affecting price increases in this programme the limit will be subject to review in the light of changing circumstances.

SECRET

/ (iv)

(iv) The Government adheres to its commitment to NATO to increase defence spending in real terms by 3 per cent a year, economic circumstances permitting, and trusts that economic circumstances will permit the United Kingdom to resume this rate of growth in 1982/83 and later years.

The Prime Minister and Mr. Pym agreed that these decisions should be reported to Cabinet tomorrow morning. I have already conveyed them to the Chancellor of the Exchequer.

The Defence Secretary told the Prime Minister that he would now need to consider the implications for the defence programme of the reduction of £200 million in next year's defence budget. He said that he would probably wish to bring to OD in due course his proposals for adjusting his programme: these might include a recommendation that there should be a review of our defence commitments.

I am sending copies of this letter to John Halliday (Home Office), George Walden (FCO), John Wiggins (HM Treasury), Jim Buckley (Lord President's Office) and David Wright (Cabinet Office).

Yours ever,

Clive Whitmore.

B. M. Norbury, Esq.,
Ministry of Defence.

SECRET

Copied to:
Nat Ins: Social Services
Nov 79

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

Prime Minister
Agree X ?
S.T. Pike 18.11.

PRIME MINISTER

PUBLIC EXPENDITURE - SOCIAL SECURITY AND HEALTH

Following Cabinet last Thursday the Secretary of State for Social Services and myself have discussed further the social security and health programmes.

2. Proposals for reduction in these programmes are to be considered further at Cabinet tomorrow (Wednesday), and in order to help discussion Treasury and DHSS officials have prepared the attached note. As you will see this includes tables which show; in Section A, proposals in respect of social security which the Secretary of State and myself jointly recommend to Cabinet; in Section B, proposals in respect of social security which I put forward but which the Secretary of State does not agree to; and in Section C, differing proposals by myself and the Secretary of State in respect of health.

3. I should point out that due to absence abroad the Secretary of State has not himself seen the attached note and tables, but I believe them to be an accurate reflection of the position we reached together in our discussions.

X 4. If you are agreeable, I will hand the attached papers round at Cabinet as a guide to our consideration of these programmes.

5. I am copying this letter to the Secretary of State for Social Services and to Sir Robert Armstrong.

GH
(G.H.)
18 November, 1980

SECRET

 Copy No 2 of 28 Copies

PUBLIC EXPENDITURE - SOCIAL SECURITY AND HEALTH

Note by Treasury and DHSS Officials

Following Cabinet on 13 November, the Chancellor and the Secretary of State have further considered proposals for public expenditure savings on social security and health. (These are in addition to the savings in changed timing in payment of Child Benefit, the reduction in cash controlled administration expenditure, and minor additional bids, all of which are agreed.)

2. The attached note sets out :-

In Section A, proposals in respect of social security which are agreed between the Chancellor and the Secretary of State;

In Section B, proposals in respect of social security which the Chancellor makes but which are not agreed by the Secretary of State;

In Section C, differing proposals in respect of health.

3. If agreed, the proposals in Section A and B would take effect from November 1981. They would be announced in detail at Budget time, but would also be announced earlier, in general terms, as part of the Chancellor's forthcoming statement.

4. The Chancellor and the Secretary of State have asked that attention be drawn to the two omissions from proposals below :-

(a) Christmas bonus. Suspension of the Christmas bonus otherwise payable at Christmas 1981 would save £84 million in the year 1981-82. In light of other priorities both Ministers would be prepared to see it suspended for 1 year (or more). The previous administration did not pay the bonus at Christmas 1975 and Christmas 1976, when it was worth rather more than it is now. Against that, however, there is a manifesto commitment that "The Christmas bonus .... will continue", and legislation was passed last year which would need amendment if it were to be suspended even for one year.

(b) Reflection of alcohol and tobacco duties in upratings. The Chancellor and the Secretary of State drew attention to the fact that there is a case for ignoring the effects of the RPI of increases in duties on alcohol and tobacco when uprating pensions and other benetifts. This could be worth about $\frac{2}{3}$ of a percentage point on the RPI. Nevertheless alcohol and tobacco prices enter into the general level of prices, and the view of both Ministers is that to abate pensions uprating on this score would be difficult to reconcile with the pledge that the pensions should keep pace with prices.

5. The Chancellor and the Secretary of State also wished to have it recorded that the Secretary of State has agreed to the Chancellor's proposals that the "upper earnings limit" for National Insurance contribution purposes should be set at £200 per week from April 1981, rather than the £190 per week which the Secretary of State had wished. This does not affect Public Expenditure totals but it increases the surplus in the National Insurance Fund by about £100 million and thus reduces the PSBR by the same amount in 1981-82.

Conclusion

6. Ministers are invited :-

(a) to consider the joint proposals of the Chancellor and the Secretary of State, at Section A below;

(b) to consider the further proposals which the Chancellor makes, at Section B below;

(c) to consider the differing proposalsof the Chancellor and the Secretary of State, at Section C below.

(d) To note the points made in paragraph 4 and 5 above.

[illegible]IAL SECURITY

Section A

Proposals which are agreed between the Chancellor and the Secretary of State

				£m 1980 survey prices
	1981-82	1982-83	1983-84	Manpower changes
(a)(i) Increase in retirement pensions and long term supplementary benefits etc in November 1981 abated by one percentage point below full price uprating	41	111	112	neg.
(ii) Ditto for all other benefits (except those reflected at (b) and (c) below.)	7	20	20	neg.

The Chancellor and the Secretary of State feel that the overpayment* likely this year could reasonably be deducted next year, while still maintaining in full the pledge that pensions should keep pace at least with prices over time. It will be recalled that the Government made up a shortfall left behind by the Labour Government of 1.9%, in November 1979.
Legislation needed.

	1981-82	1982-83	1983-84	Manpower changes
(b) Increase in unemployment benefit in November 1981 of 3 percentage points less than required to give full price uprating	6	16	16	+140
(c) Ditto for sickness benefit and maternity allowance	6	18	18	+80

3% reduction reflecting (inter alia) the 1% over payment* in November 1980, the expectation that earnings will fall behind prices in the coming year, and the effect of indirect tax increases on alcohol and tobacco prices.
No legislation needed.

	1981-82	1982-83	1983-84	Manpower changes
(d) Increase in child benefit in November 1981 abated by the same percentage as tax threshold increases are abated (provisionally put at 4.3%, to be reviewed at Budget time)	34	84	84	neg.

No legislation needed.

	1981-82	1982-83	1983-84	Manpower changes
(e) Extend "waiting days" for flat rate unemployment and sickness benefits (broad estimate)	20	30	30	some increase

There are already three waiting days. The proposal would extend it to six.
Legislation needed.

*Pensions and other benefits are to be uprated on 24 November by 16.5% (11.5 for some short-term benefits), representing the Budget forecast of price increases between November 1979 and November 1980. The Chancellors' latest forecast for inflation over this period is 15.5%.

	1981-82	1982-83	1983-84	Manpower changes
	£m 1980 survey prices			
(f) Freeze pensions earnings rule again	3	10	10	none
There is a manifesto commitment to abolish the earnings rule during the existence of this Parliament, but freezing it runs up against no pledges. Legislation needed.				
(g) Abolish child dependency additions to unemployment benefit and short-term benefits	11	16	8	some saving
The dependency addition is being phased out anyway. This proposal merely brings it forward. Legislation needed.				
Total of Section A	128	305	298	

Section B

Proposals which the Chancellor wishes to make but which the Secretary of State does not agree

	1981-82	1982-83	1983-84	Manpower changes
(h) Increase in short-term supplementary benefits by 2* percentage points below that needed to give full price uprating	7	20	20	nil

The Chancellor suggests that for the same reasons given in respect of (a)/(c) above there is no reason why the supplementary benefit safety net should necessarily be fully prices protected. There is an incentives argument here, though the Chancellor accepts that many who would be affected are not in that area. Nevertheless there is nothing magic about the level of the safety net, and at a time of economic difficulty it is not unreasonable that it should not be fully price protected. The Secretary of State considers that in the context of reductions in other benefits it is essential to maintain the real value of the safety net and that he is pledged to do this.
No legislation needed.

*in addition to the 1% at (a) above.

	1981-82	1982-83	1983-84	Manpower changes
(i) Hold-back supplementary benefit childrens rates so that the cash differential between this and child benefit does not increase	5	16	24	nil

In the interest of incentives the Chancellor feels that it is essential that the cash differential payable in respect of children to those in work and to those out of work should not widen. The Secretary of State points out that the majority of families including ⅔ of the children are either chronic sick or single-parents and thus the (i) incentive argument does not run for them. The proposals would hit the poorest families. No legislation is needed.

	1981-82	1982-83	1983-84	Manpower changes
(j) A further 2% off short-term benefits at (b) and (c)	8	22	22	150+

The Chancellor suggests that these benefits could stand this further deduction. Anyone in real hardship will be able to resort to supplementary benefit. The Secretary of State considers that 5% following last year abatement, making 10% in total, is intolerable at a time of rising unemployment. No legilsation needed.

	1981-82	1982-83	1983-84
Total of Section B	20	58	66
Grand total proposed by the Chancellor	148	363	364

HEALTH

Section C

(k) Deduction to represent efficiency improvements to be expected. An amount equivalent to:-

	1981-82	1982-83	1983-84
Chancellor's proposal - 1% off cash limited programme (approximately ¾% off NHS programme)	60	60	60

The Secretary of State takes the view that this is more than can possibly be achieved by improved efficiency, and that a figure of this order would consequentially represent a breach of the manifesto commitment and involve damanging service cuts. He considers that £25 million is the most that should be taken into account at this stage, though efforts to see if further savings could be achieved in the later years will be considered in next year survey.

	1981-82	1982-83	1983-84
He proposes	25	25	25

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

CONFIDENTIAL

The Rt Hon John Biffen MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

R 15/1

18 November 1980

Dear John,

RATE SUPPORT GRANT (SCOTLAND): 1981-82

Colleagues agreed on 6 November that you and I should consider bilaterally my proposals for the 1981-82 RSG settlement in Scotland, in the light of the decisions taken for England and Wales.

2. A number of detailed points still need further discussion by officials. In particular it will take a few days to work through to individual programmes the effect of decisions recently taken on overall levels of public expenditure in Scotland. I cannot therefore propose at present a precise figure for relevant expenditure, but hope that it will be possible for officials to reach agreement soon on this and other outstanding issues. Otherwise my proposals for the main elements of the settlement are as follows.

Grant Percentage: Rates on Local Authority Properties

3. In considering the extent of the reduction in the nominal grant percentage, we need to look at two separate issues. First, a reduction might be made in the light of the reduction of 1 percentage point for England and Wales. Second, you will recall our agreement last year that, if possible, a permanent solution should be found to the awkward problem inherited from the previous administration arising from the relatively high revaluation factor for local authority properties in the 1978-79 rating revaluation.

4. Without an offsetting adjustment this would have led to an unjustifiable increase in rate support grant. For last year I continued the previous expedient of calculating total grant by first applying the percentage to relevant expenditure (including total expenditure on local authority rates) and then abating the result. Officials have considered this issue exhaustively and I am satisfied that there is no third option: the choice lies between repeating this expedient in 1981-82 or reducing the rate of

grant. I am very reluctant to reduce the rate of grant on this count because this would result in a higher nominal reduction in Scotland than the 1 percentage point already determined for England and Wales and there would be a severe risk of misrepresentation suggesting that in substance Scotland had been more harshly treated. I am however prepared to proceed in this way provided you agree that the reduction in the nominal rate should be no more than 1.5 per cent.

Cash Limit 1979-80

5. I propose that as in England and Wales the full amount remaining within the cash limit (£19m) should be paid in a second increase order for 1979-80 together with additional grant amounting to £5.5m which is due to be paid on loan charges.

1980-81

6. I propose to pay, through the increase order in December, the full amount of the cash limit (£194m) subject to a reduction of £0.9m in respect of a revaluation error. In addition I propose to pay additional grant on loan charges (£27.4m) less an abatement of £10m to be held in reserve against the possibility that a fall in interest rates will reduce the amount of grant payable. If this did not occur, the full amount held in reserve would fall to be paid through a second increase order.

Cash Limit 1981-82

7. I agree that the cash limit for 1981-82 should be calculated, when we have a volume figure, on the same basis as agreed for England and Wales.

Settlement Price Base

8. There are a number of technical issues still under consideration by officials but there is one which I should mention to you at this stage. I understand that Michael Heseltine has made allowance in the settlement price base for a 13 per cent award to APTC staff effective from July 1980. This was in anticipation of the decisions to be taken following the arbiter's award. It is not open to me under statute to make provision for wholly notional pay settlements and there would have been a difficulty had the arbiter's finding not become available. As you know, it recommends an award of 13 per cent plus 2 per cent effective from next April. I appreciate that it will be necessary for both the employers and Ministers to consider carefully their attitude to the supplementary 2 per cent. I propose however to take the main element of 13 per cent into the settlement price base. This will result in consistency of approach as between Scotland and England and Wales.

Distribution

9. My main proposals are to keep domestic relief at the present level of 3p, to change the ratio of needs to resources from 7:1 to 9:1 (in order to restrict additional grant, through resources element, to high spending

CONFIDENTIAL

authorities), and to seek a high degree of stability in grant per capita through the demographically based formula used in the distribution of needs element. You are already aware of my proposals to reduce grant payable to authorities which plan excessive and unreasonable levels of expenditure. The Bill extending these powers will be introduced early in the new Parliamentary session.

Rating Effects

10. As my officials indicated to yours on 20 October, rating effects in Scotland are expected to be broadly in line with the projections made for England and Wales - an overall estimated increase, on common assumptions, of something over 20 per cent. That remains the position.

11. I hope that you are content with these proposals. In view of the proposals in Michael Heseltine's letters of 14 and 17 November (on which I shall be commenting separately) it would be helpful to have an early reply or to arrange an early meeting if you see any major difficulties in my proposals.

12. I am copying this letter to the Prime Minister and all other members of Cabinet, to Norman Fowler and Sir Robert Armstrong.

Yours ever,

George.

Y SWYDDFA GYMREIG
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switsfwrdd)
01-233 6106 (Llinell Union)

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switchboard)
01-233 6106 (Direct Line)

Oddi wrth Ysgrifennydd Gwladol Cymru The Rt Hon Nicholas Edwards MP From The Secretary of State for Wales

T. Lankester
MJ

18 November 1980

Dear Michael

TL

RATE SUPPORT GRANT

Thank you for copying to me your letters of 14 and 17 November setting out proposals for announcements and consultation in connection with the Rate Support Grant Settlements.

I am content with the general timetable you propose in your letter of 17 November. I agree too that we should announce next week our decision on the Rate Support Grant percentage. However, as I mentioned to you briefly today, I am less happy about your proposal to publish at the same time a service breakdown of local authority current and capital expenditure. This would place me in a very difficult position.

The bulk of Welsh Office PES provision for next year, including provision for local authority expenditure, makes up a block, within which I have discretion to switch between Programmes. The total effect on this block of the decisions by Cabinet in the present PES round will not be known until about a week after final decisions are taken; the changes work through "comparable expenditure" and so the way in which Whitehall Departments attribute their cuts within their own Programmes has to be confirmed. The picture which emerges then has to be reviewed by the parts of the Welsh Office responsible for the various Programmes and advice has to be formulated and submitted to me on the adjustments between Programmes which are considered necessary to meet special Welsh circumstances. The earliest I could expect to be in a position to reach decisions is the week beginning 8 December, assuming that Cabinet reaches final decisions this week.

/If I

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

If I followed your proposal it would therefore mean for me the publication of decisions before I take them.

I have considered whether I could get round this problem by publishing purely indicative service figures next week. However, for that to be sensible I would need to be firm about the total, and I cannot be. For example, I might well want to adjust the provision for Housing capital at the expense of non-local authority provisions. I cannot commit myself one way or the other at this stage.

This leads me to the conclusion that even if you do not feel able to adopt a similar approach, I would not want to go any further next week than an announcement that we will be asking local authorities to cut-back their current spending by 3% and their capital spending by 2%. I believe the Chancellor may be thinking of including such an announcement in his general statement. This should be a sufficient basis, coupled with the announcement of the Grant percentage, for the statutory consultation with the local authority associations.

/ I am copying this letter to the Prime Minister and all other members of Cabinet, to Norman Fowler and to Sir Robert Armstrong.

Ever

Nick

Original returned to Policy Unit

18 November 1980
Policy Unit

PRIME MINISTER

PUBLIC EXPENDITURE - CABINET

1. David drew my attention to Geoffrey's final paragraph 13 in his paper C(80)72. This reads as follows:

> "I consider it essential to the maintenance of our economic strategy and the credibility of our commitment to reduce public expenditure in the medium term that we should make the greater part of the additional cuts now proposed, so that the totals are close to those shown for Case B."

2. It seems to us that Geoffrey is in danger of taking up a last-ditch position in which the entire economic strategy and thus the Government's credibility depends on success or failure with a few hundred million of public spending.

3. While it has obviously been right to press relentlessly for the largest possible cuts, we now seem to be in danger of taking up a position, and making statements which will later be leaked in such a way as to make Geoffrey's own position almost untenable.

4. We suggest, therefore, that you should perhaps set the stage for Cabinet discussion by deliberately cooling it down on the following lines:

- There <u>are</u> some encouraging signs. Inflation <u>is</u> coming down faster than expected, so far; pay claims <u>are</u> moderating; we are now resolved on trying to get a really moderate outturn for public services pay.

- But we do have big problems in other areas. Nationalised industries have posed big problems; the recession is deeper than expected and is thus inevitably putting further pressure on the PSBR.

- The shortfall on public spending cuts is therefore a very serious matter. To the extent that we fail to cut, then we face unpopular tax increases, because if we can't control public spending, we must pay for the excess out of tax revenues. The pressures and problems facing colleagues are fully understood, but let us do our best to give the Treasury team as much as possible of what it is looking for.

5. With Geoffrey and Francis Pym both taking up last-ditch positions, I feel that we may be getting things out of perspective. At one extreme there is the sad example of past Governments, which have simply been unable to sustain the disciplined pressure on public spending for years on end and have simply fudged their way through and abandoned all their goals the moment it got really difficult. At the other extreme, and just as absurd, would be a brittle commitment to particular figures which would be elevated and invested with such significance that any departure from them would be presented (and interpreted by the press) as destroying individual reputations and signalling a complete collapse of Government policy and determination. In the middle there is the tough but balanced position, recognising that we cannot win ten out of ten on every issue, that the problems faced are immensely difficult and that there will be no letting up on the long-term aims.

JOHN HOSKYNS

SECRET

4

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

The Rt Hon John Biffen MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1

18th November 1980

Dear John.

PUBLIC EXPENDITURE: 1982-83 ONWARDS

Your Cabinet paper (C(80)64) recorded the doubts I expressed in my letter of 27 October about carrying forward to later years the cuts on my programmes which I have accepted for next year, and promised further discussions on this. I was therefore surprised to see that Geoffrey Howe's paper C(80)72 records these cuts as agreed. As Wednesday's Cabinet will be considering the later years, I thought I should write to you to set out my position.

The cuts I have accepted for 1981-82 comprise my share of the general 1% cut on local authority current expenditure, a further cut of £15m on local authority road maintenance and a 2% cut on the cash controlled trunk road expenditure and local authority capital spending. If my colleagues agree to a continuation of the 1% cut, I will find my share. But I do not think that it would be realistic to continue the cut on local authority maintenance on top of the general constraint on their current expenditure. Maintenance has been cut by 10% over the last five years, and local authorities are finding it difficult to make further savings against the steady increase in traffic.

SECRET

SECRET

I should find it very difficult to accept continuing cuts on capital expenditure, by my Department and local authorities. I accepted the cuts proposed for next year as a contribution to measures which would fall on all programmes to meet the overriding needs of our financial strategy. In the event, some of our colleagues have felt unable to agree to your proposals, and we may be left with a sizeable excess. For later years, we face a different situation, to which arbitrary cuts are, in my view, not an appropriate answer.

I shall in any event find it very difficult, if not impossible, to maintain the level of trunk road and motorway construction at present planned for later years, because of the growing need for major reconstruction of the motorways. Any further cut on my programme in 1982-83 onwards would be bound therefore to fall on new construction. It would be a further blow to the hard-pressed construction industry, who would lose work to the value of well over twice the amount of any cut in central or local authority capital spending. It would mean very substantial changes in our roads policy announced in the White Paper this June. Investment in roads is of great importance to our national economic performance, and I do not see how we could justify continuing cuts to industry or our supporters.

Copies of this letter go to the Prime Minister and to Sir Robert Armstrong.

Yours ever
Norman

NORMAN FOW~~LER~~

SECRET

2F

cc Mr. Duguid

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

18 November 1980

The Rt. Hon. Michael Heseltine, MP.,
Secretary of State for the Environment

MT

Dear Michael

COUNCIL HOUSE SUBSIDIES AND RENTS: RATE SUPPORT GRANT

Thank you for your letters of 14 and 17 November outlining the changes in the rate support grant timetable which will be necessary as a result of the delay in the programme of consultation on council house subsidies. I accept with regret that there is no option but to defer the date of the RSG settlement and that this means the RSG debate will now have to take place after Christmas.

I am broadly content with the programme of announcements sketched in your letters, with one reservation. As things now stand, it will probably be appropriate for me to make a statement on Monday, 24 November putting in context the announcement of our main decisions on public expenditure for next year; but a final decision on the form and timing of my announcement will have to await the settlement of the topics to be discussed each day during the Queen's Speech debate. Clearly my statement will need to say, as one of our main decisions, that we are asking the local authorities to cut back their current spending by 3 per cent, as compared with this year's planned level, rather than the 2 per cent provisionally announced earlier. We need to do everything possible to ensure that this statement is well received by commentators, as adequate and consistent with the Government's overall monetary and fiscal strategy. In particular we need to discourage suggestions that the 3 per cent reduction is a 'paper' cut which the local authorities will fail to deliver. Hence in my view it is desirable to say in the initial statement that reductions in the RSG percentages will be calculated on the basis of providing 60 per cent of the reduced volume (in England and Wales) rather than 61 per cent as previously. I shall then say that you will be giving fuller details in your statement on the following day. No doubt George Younger and Nicholas Edwards will be considering how best to convey parrallel information about Scottish and Welsh local authorities.

/I have

I have no objection to your writing to the leaders of the local authority associations on the general lines you suggest, subject to a minor adjustment to the wording. I would like the final sentence of paragraph 1 and the first of paragraph 2 recast to read:

> "Regrettably, I am not in a position to make more information available at this stage. As you know, the rate support grant settlement is always considered in the context of the Government's wider review of public expenditure, about which we are not ready to make a statement this week, though we hope to give some indication of our intentions next week.
>
> Accordingly ,.. but to await the further information on the outcome of the review I have mentioned. I should expect ..."

Copies of this letter go to the recipients of yours.

GEOFFREY HOWE

CONFIDENTIAL

15

DEPARTMENT OF EDUCATION AND SCIENCE

ELIZABETH HOUSE, YORK ROAD, LONDON, SE1 7PH

TELEPHONE 01-928 9222

FROM THE MINISTER OF STATE

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

18 November 1980

Dear Michael,

In Mark Carlisle's absence I am writing to thank you for sending him a copy of your letter of 14 November to Geoffrey Howe about the RSG settlement.

In our view the arguments in your letter against a fuller paper for the Consultative Council on Friday are much more powerful than those in favour. We therefore agree with your four proposals for dealing with the situation. We shall, however, be grateful if your officials will consult ours in good time about the details of the information on individual services that you propose to give the associations on the day of the Government's statement, which will presumably be made by Geoffrey Howe himself.

I understand that you are not yet certain on which day in the week beginning 15 December the statutory meeting of the Consultative Council might be held. For two reasons our preference would be for Monday 15 December or Tuesday 16 December. First, on Wednesday 17 December Mark has to discuss the Government's plans for education expenditure this year and next with the Select Committee on Education; and it would be easier for him if all the details of the RSG settlement were by then public knowledge. Second, we need to inform all the local education authorities as soon as possible after the settlement, and certainly before Christmas, of the size of the advanced further education pool in 1981-82 and of the extent to which their claims on it will be met.

I am copying this to the Prime Minister, the other members of the Cabinet, Normal Fowler and Sir Robert Armstrong.

Yours ever,

Janet

BARONESS YOUNG

CONFIDENTIAL

CONFIDENTIAL

2 MARSHAM STREET
LONDON SW1P 3EB

My ref: H/PSO/17618/80
Your ref:
17 November 1980

Dear John

PUBLIC EXPENDITURE: IMPLICATIONS FOR PSA

You wrote to me on the 7 October asking about the allocation within PSA of the July Cabinet savings (which for PSA totalled £9m in 1981-82 and £5m each in 1982-83 and 1983-84), I now of course also have to deal with the implications of the further £10m saving on the PSA PESC which you asked for at the bilateral and which in the face of the acute economic problems we face I felt obliged to accept.

There are no easy options here. PSA provides a service in support of Departments' operations, and cuts thus directly affect Departments' ability to do their job efficiently. The cuts already imposed on PSA have taken up almost all the room for manoeuvre; colleagues collectively will have to accept the consequences of these further reductions.

I had already allocated £5.6m of the July Cabinet cut to major new works. I do no see any alternative but to increase this cut by a further £3m. Annex A attached shows on the basis of an assessment by my officials how such a cut might be allocated. Schemes in Category A could still go ahead; these seemed to be projects which we could not avoid undertaking. Those in Category B whilst accorded high priority by Departments, seemed capable of being deferred if the public expenditure position required this, and they have accordingly been left out of the 1981-82 starts. As the Annex shows this still could leave some scope for starting those schemes in 1982-83 but I do not think that in current circumstances we should seek to settle more than the programme for the coming year. The one exception is computerisation of PAYE where I have shown the total cost, including new starts, in each of the three years. It is worth emphasising that this now takes by far the biggest slice of available funds, although it is a new requirement; it was not included in our 1979 plans, which were subsequently cut by over two-thirds. Many other schemes of considerable importance have been displaced to make way for this requirement. I will of course be ready to look at suggestions from colleagues on the priorities suggested, but I find it hard to see scope for adjusting the scale of resources available for new projects in 1981/82.

Of the £9m cut previously agreed for 1981-82, £3.4m was allocated to running costs. To meet the £10m target, I will have to find another £7m here. Staff savings I have determined for PSA (6.5% in 1981-82) are already allowed for in the figures, and I have in addition to meet increased consultants fees. And much of our expenditure is already committed to payments under existing contracts or leases, or to fuel and utilities. So we have no alternative to cancelling or deferring many of the smaller adaptation schemes in existing buildings which are needed for operational reasons (eg Unemployment Benefit Offices) and cutting down yet further on maintenance, and this will apply to not just offices but Courts, Special Hospitals and a number of other specialised buildings. This will inevitably affect the efficiency of Departments just as much as cuts on the major works projects we have been considering, perhaps more so; we are talking about cutting back on the basic repair and maintenance of the buildings, and hence the operations of government, depend. But I believe that for 1981/82 this is something we must face up to.

I have in this letter dealt only with 1981/82. We need time to consider the implications for the later years of the PESC period of the further £10m in each of these years that you imply, and I must reserve my position on this.

As you suggested I am copying this letter and its Annexes to other members of the Cabinet, Norman Fowler and to Sir Robert Armstrong.

Yours ever

MICHAEL HESELTINE

Rt Hon W J Biffen MP

2F

ANNEX A
September 1979 prices

PSA Office and General Accommodation — NEW STARTS 1981/82

CATEGORY A

		Total Estimated Cost	1981/2	1982/3	1983/4
Replacement Premises					
IR Bishop Auckland	Existing office subject of confirmed compulsory purchase order	0.175	0.175	-	-
DHSS Newcastle. St James	Landlords (Post Office) have served notice to quit; they require for their own urgent purposes	0.120	0.120	-	-
DHSS Johnstone	Temporary occupation; landlords not willing to extend.	0.510	0.250	0.250	0.010
MOD Rehousing	Notice to quit the Adelphi: lease expiring; landlord will not renew	0.790	0.200	0.350	0.240
DHSS Berwick	Previously shown as a scheme to relieve over-crowding. Existing office now subject of notice to quit as landlord has received permission for redevelopment.	0.245	0.200	0.045	-
C&E Empress State Building	Existing leases of present accommodation else-where expire in 1982 and 1985; cannot be extended.	0.200	0.080	0.120	-
CE Royal London House	Notice to Quit - provision of alternative accommodation in Woburn Place	0.120	0.100	0.020	-
Operational Requirements					
IR Durrington	Schemes to provide accommodation or accommoda-tion services to enable essential existing computers to be replaced.	0.790	0.450	0.300	0.040
IR East Kilbride		0.400	0.250	0.150	-
IR Liverpool, Victoria House		0.380	0.240	0.055	0.085
MAFF Guildford		0.300	0.200	0.100	-
PGO Crawley		0.280	0.140	0.100	0.040
DVLC Swansea		3.165	0.500	0.800	1.600
CSD Chessington		0.150	0.145	0.005	-
Procurator Fiscal, Glasgow	To assist Courts programme	0.465	0.050	0.300	0.115
New Government Programmes					
IR Computerisation of PAYE		20.235	1.300	1.910	6.700
DHSS Computerisation of unemployment benefit	Cost not yet known: no provision made at present.	-	-	-	-
	TOTAL CATEGORY A		4.400	4.505	8.830

CATEGORY B

SCHEMES DEFERRED

		TEC	1981/2	1982/3	1983/4
Defence Security					
MOD Bath, Foxhill	Occupational services for computer aided design of ships. Implications: delay to staff and other savings	0.120	0.080	0.040	-
MOD Bath, Ensleigh	Provision for computer based stores system (part of wider MOD funded programme)	0.120	0.100	0.020	-
GCHQ Oakley - F&G II	Refurbishing existing computer areas.	0.550	0.045	0.405	0.100
MOD Old War Office	Move of Defence Data Processing Service from the Metropole. Defer by installing second processor in Metropole. Increased expenditure in later years to achieve move by end of lease.	2.575	1.187	1.200	0.188
MOD, Communications Centre	Occupational services to improve power supplies. Implications: possible failure of communications.	0.325	0.120	0.040	0.165
New Government Programmes					
DTp - Driving Test Centres	Programme to cope with reduction of waiting period for driving tests - Implications: longer waiting lists.	1.030	0.400	0.200	-
Replacement Premises					
JOB Beverley	Scheme now to be a private developer scheme.	0.770	0.375	0.395	-
WOAD Aberystwyth	Possibility of a lease extension	0.790	0.012	-	0.050
MAFF Truro	Scheme to replace an old building which is structurally unsound. Lease to be extended	0.870	0.220	0.200	0.200
Operational Requirements					
DOT AIB Farnborough	Scheme to colocate staff now in Victoria and Farnborough. Implications: delay to savings	0.750	0.280	0.400	0.060
DHSS Fleetwood (Fylde)	Accommodation for replacement computer. Deferred start may be practicable.	2.800	0.630	2.000	0.170

CATEGORY B

SCHEMES DEFERRED (Contnd)

		TEC	1981/2	1982/3	1983/4
CSO Gt George Street	Extra accommodation for computers that handle Treasury/CSO forecasting. Ministerial decision not taken. Computer capacity running out. Implications; limit to forecasting capability	0.475	0.400	0.075	-
JOB Buckie	Rehousing to improve operational efficiency	0.515	0.240	0.240	0.035
Overcrowding and Working Conditions					
JOB Wick	To relieve severe overcrowding	0.160	0.135	0.025	-
DHSS Redhill	Scheme to bring vacant accommodation into use	0.120	0.120	-	-
DE Southwick		0.175	0.010	0.165	-
DE South Shields		0.140	0.140	-	-
DE/DHSS Houghton-le-Spring		0.370	0.455	0.400	0.015
De Liverpool (Belle Vale)	Offices which are severely overcrowded and in some cases substandard	0.205	0.180	0.025	-
DE Shotton		0.360	0.030	0.100	0.300
DHSS Bells Hill		0.100	0.080	0.020	-
JOB Newtown	Replacement of temporary and unsound accommodation.	0.775	0.025	0.100	0.500
OPO	Scheme to install modern fire precautions	0.630	0.356	0.150	0.130
					-
DE Marylebone (Lisson Grove)	Work to meet HSE requirements on ventilation.	0.240	0.160	0.080	-
CE Fishguard	Participation in BR scheme for new permanent accommodation (now in portakabins).	0.140	0.080	0.060	-
DHSS Bridgeton	rehousing from substandard accommodation and provision of an integrated local office.	0.840	0.540	0.280	0.020
DHSS Alexander Fleming House	Improvement of air conditioning facilities	0.160	0.150	0.010	-
Rationalisation of the Estate					
DE Brownhills	To bring vacant accommodation into use	0.080	0.080	-	-
Richmond Terrace	Possibility of privately funded scheme	13.250	1.150	0.900	3.200
Stamford House	Payment to local authority for work to listed building they will then buy from PSA	0.160	0.160	-	-
DOT (Various buildings)	Rationalisation following Rayner proposals which would produce some estate savings.	0.140	0.130	0.010	

ERC

CONFIDENTIAL

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

17th November 1980

Dear Chancellor of the Exchequer

COUNCIL HOUSE SUBSIDIES AND RENTS: RATE SUPPORT GRANT

Since I wrote to you on 14 November I have thought further about the way in which the consultation and decisions on these topics should be handled and announced, and how these might relate to your own economic statement.

As I understand it you are contemplating a major statement on the economy and our public expenditure decision, possibly on 24 November. If that is so I think it would be appropriate for me to follow up the next day with a statement on local government expenditure.

In your own statement you will no doubt be announcing our decisions about the totality of local authority expenditure current and capital. My statement might then follow up with the service breakdown of these totals. I would also announce the reduced grant percentage and possibly say something about the implications of the volume target for local government, and the importance of all authorities playing their part to achieve the reductions.

My statement would also provide a convenient opportunity for announcing whatever decisions we reach this week on the housing capital moratorium.

In this context it would be possible to announce my re-issue of the rents consultation document in the context of an oral statement in this way, rather than by a written answer as I had suggested in my letter of 14 November.

On timing this suggestion will of course reduce the consultation period available for consultation on the rent document by a few days. I therefore propose to hold the Housing Consultative Council on 10 rather than 8 December; and I would put back the RSG statutory meeting by one further day until Wednesday 17 December.

I need to inform the local authority leaders of the proposed timetable by Wednesday 19 November. I shall offer to see them on 21 November as arranged if they want this; but I envisage offering them also the possibility of a meeting of the Consultative Council on Local Government Finance immediately after the statement I am proposing for next week when I shall have more information to give them. I enclose a copy of a letter which I propose to send to the Leaders of the Associations on 19 November.

I am copying this letter to the Prime Minister and all other members of Cabinet, to Norman Fowler and Sir Robert Armstrong. I hope that you and they will still be able to let me have your views by midday on Wednesday 19 November.

Yours sincerely

for MICHAEL HESELTINE

(Letter approved by the Secy of State and signed in his absence.)

The Rt Hon Sir Geoffrey Howe QC MP

DRAFT LETTER TO LEADERS OF LOCAL AUTHORITY ASSOCIATIONS

1. You will be aware that when the Official Steering Group considered a draft of the Government Proposals Paper your officials represented to Sir John Garlick that the information contained in the paper provided an inadequate basis for discussion at the Consultative Council. Regrettably, because the rate support grant settlement has had to be considered in the context of the Government's wider review of public expenditure, I am not in a position to make more information available at this stage.

2. Accordingly, you may consider that it would not be useful to proceed with a meeting of the Council on Friday, 21 November, but to await the Government's announcement of its revised expenditure plans which is due to be made very early next week. I should expect to follow this up with a statement about the fuller implications of that announcement for local government about which I shall advise you in advance. I should be happy to rearrange a meeting of the Council very quickly after that announcement has been made. But I should tell you now that the statutory meeting will not now take place until mid-December. If, nevertheless, you consider that it would be useful to retain the meeting on 21 November, I shall be happy to do so.

Econ Pol
Public Expenditure

2a

Original put to PM
15/11.

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

PRIME MINISTER

ADDITIONAL TAX REVENUE FROM THE NORTH SEA

My recent paper to Cabinet on the economic prospect and the implications for policy (C(80)59) said that I was considering a number of options for raising revenues, including the possibility of obtaining additional revenue from the North Sea. This note sets out my proposals, which I have discussed with David Howell, as well as with all my Ministerial colleagues in the Treasury, including Peter Rees - who has already borne the burden of carrying through the House several changes in the PRT regime. I hope this minute reflects his anxieties, which I certainly respect - but which do not, in the end, dissuade me from the course which I commend.

Economic background

2. The background against which we will be taking important fiscal decisions is the need to achieve our overriding aim of declining monetary growth. After the excessive monetary growth and public sector borrowing during the current financial year, it is essential that we use all available means to reduce the PSBR in 1981-82, and subsequent years, from levels that otherwise will prove uncomfortably high.

3. There are particular reasons for raising substantial additional revenue from the North Sea. The rest of the company sector is in severe trouble as a result of the recession and the high exchange rate, the latter in part the consequence of our having North Sea oil.

/In contrast,

In contrast, the companies operating in the North Sea have enjoyed in the last two years a very substantial increase in prices and profitability. In the two years to the fourth quarter of this year the world dollar real price of oil rose by 90 per cent. The rise in the exchange rate over the same period has reduced the rise in the real sterling price of oil, but this is still 60 per cent higher than at the end of 1978.

4. The world oil price continued to rise until the middle of the year, since when it has been more or less stable, and the sterling price has even fallen with the rising exchange rate. Nevertheless, during the preparation of the 1980 Budget, in which I made a significant tightening of the North Sea fiscal regime, and for a little while thereafter, the oil price rise was still taking place, It is now possible to assess the implications of this second oil price explosion for the system of North Sea taxation. The halt in the upward movement in world oil prices is the result of the current recession. The prospect over the medium term as a whole is for a further significant rise in oil prices, though no-one can predict the precise extent or timing of this rise.

Inter-departmental review

5. It is against this background that a comprehensive review of the existing tax regime in the North Sea was conducted over the last summer and early autumn by David Howell's officials and mine. The purposes of that review were to:-

(i) Consider how far the Government's share of revenues accruing to the oil companies could be substantially increased, particularly in the short term, but also in the longer run.

(ii) Judge whether such additional tax could be secured without damaging the future exploitation of the North Sea.

/ (iii)

(iii) Examine how the tax regime could be made to react with more flexibility to outside events, particularly further increases in the real price of oil.

(iv) Consider whether the existing petroleum revenue tax (PRT) needed to be tightened up to protect existing revenues.

6. After careful consideration of the issues, I have decided that it would be possible to obtain a further £1 billion in tax in 1981-82 without depriving the oil companies of a fair return on their North Sea projects. One cannot avoid some risk that this increased tax might prejudice future exploration and development, but in my view the arrangements I propose will minimise this.

Limitations of the present taxes

7. I have of course carefully considered whether sufficient additional take could be achieved by squeezing more money out of PRT. The maximum we could achieve - by increasing the advance payment rate to 40 per cent, and by tightening up the existing reliefs (which tightening I think we will have to do anyway) - would be £390 million in 1981-82, £660 million in 1982-83 and £710 million in 1983-84 (money of the day). But for a number of reasons connected with the way the reliefs are structured, that tax cannot provide anything approaching £1 billion more than the sums now expected next year. Nor can we be sure that tightening up PRT will provide us with the flexibility which we must have for the future.

8. I have therefore considered three possibilities:-

(i) Complete replacement of PRT by a new tax, which would be more flexible and capable of yielding larger revenues.

/ (ii)

(ii) A new scheme of accelerated payment of PRT to replace the present advance payment arrangements.

(iii) A second special oil tax to be paid in addition to PRT.

Replacement of PRT

9. There is at first blush an attraction in the idea of replacing PRT with an entirely new tax with progressive rates geared to the circumstances of particular oil fields. This was suggested by the Secretary of State for Energy: officials looked at it very carefully, and so have I.

10. While such a tax could certainly be designed its main difficulties are that:-

(i) It could not be introduced for two or three years, and would therefore not produce extra revenue in the short term.

(ii) It would involve maximum disruption and uncertainty for the oil companies (including complex transitional provisions).

(iii) It would, in the event, produce only an extra £350 million or so each year, compared with the present system, even with a top rate of 95 per cent.

11. Unfortunately, therefore, this does not offer a solution.

A new scheme of accelerated PRT

12. A new scheme for accelerated payments would be intended to bring forward, particularly to 1981-82, PRT which is not due to be paid until some years ahead. A scheme of this sort could probably be designed to produce extra revenues on the scale I am looking for in 1981-82.

/ 13.

13. The trouble with such a scheme is that:-

(i) It simply borrows money from the future and would have to be repaid to the oil companies.

(ii) Thus, in reality, it is only a forced loan from the companies - and does not raise new money.

(iii) It will not give the added flexibility needed in relation to any future increases in the real price of oil.

14. It is essentially a short term expedient, and I do not favour it if there is a better permanent solution.

An additional tax

15. My preferred solution is to have a new tax to be paid in addition to PRT. It would be calculated on the gross income of each field above a specified production threshold.

16. Though it is not without difficulties, the advantages I see in this approach are that:-

(i) It could be brought in quickly, and in time to raise extra revenue of about £1 billion next year.

(ii) It could also continue to raise significant extra sums in subsequent years.

(iii) It would provide a much more flexible and easily adjustable tax regime for the future.

17. This involves a difficult judgement about the possible effects on exploitation and investment in the long term.

18. We have examined this carefully, and Department of Energy officials have been fully involved. What evidence we have

/suggests

suggests that the oil companies are now prepared to accept an internal rate of return on our figures nearer to 10 per cent than the 15 per cent hitherto assumed. After the effects of the changes I am proposing, our calculations suggest that IRRs would remain above this level.

19. In these circumstances it is our best judgement that the return to companies after the imposition of a new tax bringing in £1 billion will remain sufficiently high to ensure that exploitation will not be significantly adversely affected. For example, the calculations suggest that the return on the Clyde field, one of the more marginal, would be reduced by only about 1 per cent. We know how keen the companies concerned, Shell, Esso and BNOC, are to get ahead with this field, which John Raisman described recently as a profitable new field.

20. David Howell has been particularly concerned about the effects of any new measures on marginal fields, as indeed am I, and it is our intention that the new tax should as far as possible meet this problem.

21. I have taken the precaution of asking the Law Officers to consider whether we would be open to challenge under international law if we introduced this new tax on top of the existing ones. They take the view that, subject to certain conditions, the tax ought to be defensible against the charge that it is really a disguised royalty or, in some other way, a unilateral variation of an oil company's contractual rights; and that it would be difficult for an existing licensee to establish that the arrangements I am contemplating would be confiscatory.

22. David Howell is understandably reluctant to see an additional impost on the oil companies, but he does recognise the reason for my decision.

/ 23.

23. I will not disguise the fact that this step will be resented by the oil companies, and that they will react strongly against it. They will complain that this is the fourth tax (on top of royalty, PRT and corporation tax) to which they are subject. They will throw back at us that we have raised the rate of PRT to 70 per cent, reduced the rate of uplift and free oil reliefs (upholding the proposals announced by the previous Administration) and have introduced two measures to accelerate the payment of PRT. They will add that Conservative Ministers have on a number of occasions repeated the Dell/Jenkin general assurances about stability in the regime. For example Peter Rees said in Standing Committee on 18 December 1979:

> "I do wish to emphasise [that] an assurance given by Mr. Edmund Dell, which was repeated by Patrick Jenkin, that the framework of the tax should remain unaltered and unimpaired as far as possible because stability is needed in this matter. That is not to say that there are not small areas which need to be considered from time to time. We have done that an will continue to do so."

On the other hand, in giving the most recent assurance, Peter was more guarded. He said in Standing Committee on 26 June 1980 that:-

> "I do not want to create an atmosphere of uncertainty. But, naturally, one must always keep such taxes under review and consider whether the balance and the detail are right."

24. Having said that the strictures of the oil companies will not be easy to handle, but I do not believe that the terms of the assurances rule out any change of this kind; and we shall have to argue that the Government cannot tie itself in all circumstances never to raise additional tax, and that the action is justified in the current situation. Even so Peter Rees,

/because of

because of his close involvement with these earlier assurances, is understandably concerned. I have made it clear to him that I will take the lead in presenting this latest change and he is happy with this. I think we can draw some credit from announcing the proposals (including possible changes in the PRT reliefs) in advance at this stage, and thereby allowing the industry time between now and the Budget to make such representations to us as they think fit.

25. Incidentally, the increase in take of £1 billion which I recommend would not increase the total tax take from the North Sea in 1981-82 above the level expected at the time of the Budget. For a variety of reasons (including lower production and higher capital expenditure) our latest expectation is that the 1981-82 yield from the North Sea would, as it happens, have been about £1 billion lower than expected at the Budget.

Announcement

26. If this proposal has your agreement, I should like to announce the new tax, along with the other matters mentioned in my minute to you of 4 November, in time for its implications to be taken into account in the Industry Act forecast. I shall say why we have come to the conclusion that the North Sea sector can and should shoulder a larger amount of the country's tax burden in present circumstances, and indicate the broad shape of the tax.

Conclusion

27. I seek your agreement that:-

(i) We should plan to introduce a new tax on gross profits from the North Sea sufficient to raise around £1 billion extra in 1981-82, and significant additional revenues in subsequent years.

/ (ii)

(ii) I should announce it later this month in time for its implications to be incorporated in the Industry Act forecast.

28. I am copying this minute to the Secretary of State for Energy and to Sir Robert Armstrong.

R.I.Tolkien (Private Secretary)
for
(G.H.)
14 November 1980

GJ

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:
Your ref:

✓ MS
(overtaken)

14 November 1980

Dear Geoffrey

COUNCIL HOUSE SUBSIDIES AND RENTS: RATE SUPPORT GRANT

Last night in the House I undertook to withdraw the consultation (the local contribution determination (LCD)) paper about council house subsidies for 1981/82 and to reissue it in the next session of Parliament. I should perhaps explain that under the Housing Act 1980 I am obliged to consult representatives of local authorities about the LCD which sets the extra amount which local councils must raise by rents (or rates) to meet their housing costs. There is no obligation to inform Parliament about this statutory consultation but the consultation with the local authority associations must in law be meaningful and they must be given reasonable time to consider the matter.

I propose to reissue the consultation paper on Friday 21 November and to inform Parliament that day by Written Answer. It will be necessary for me to give the local authorities two to three weeks in which to make representations.

This change in timetable means that the timing of the rate support grant settlement (RSG) will slip. The allocation of RSG between individual local authorities is influenced by the amount of local contribution determination. I cannot finally make the rate support grant settlement therefore until I have considered the comments of the local authorities and determined the local contribution.

We therefore cannot now have the statutory meeting, or table the Report and Orders, on the RSG Settlement, until a few days after a Housing Consultative Council meeting on 8 December. Depending upon the outcome of the consulation we could now pencil in Tuesday 16 December as the statutory RSG settlement meeting. This means that the debate on the RSG Settlement cannot take place until some days after Parliament returns in January.

In view of the new timetable, we have to consider how to deal with local government between now and 15 December in relation to the consultative process on Rate Support Grant and the need to influence local authorities in their budget-making and rate-fixing for 1981/82, which is already taking place. I have a general statutory obligation to consult the associations about relevant expenditure in relation to grant, but the timing and content of consultation is not specified.

As part of the consultation process the Consultative Council on Local Government Finance (CCLGF) will consider a 'Government Proposals' paper on 21 November. This contains little of substance: it is now a peg on which to hang a discussion on volume, grant percentage and rate increases before final decisions are announced.

Last Wednesday, however, at a meeting of the CCLGF's Official Steering Group (OSG), the official representatives of the local authority associations argued that the local authority leaders would expect the CCLGF on 21 November to have a fuller paper than I have yet been able to give them because of the continuing public expenditure review.

There are two arguments in favour of a fuller paper. First, it will preserve the conventions established by past consultation. Secondly, it makes it more difficult for the associations to argue against the implication of the ready reckoner in the existing paper that the national average domestic rate increase on certain assumptions might be low. There are also two arguments against a fuller paper. It will pre-empt part of the wider statement on public expenditure decisions which presumably will be made after the 21 November. Secondly, it might be difficult for colleagues to defend indicative public expenditure as a whole.

On balance, I think that the right course in view of the slippage in the timetable for the settlement would be:

- for me to write to the leaders of the associations on Tuesday 18 November to say that we think it would be positively misleading to offer a range of "options" for volume cuts for illustrative purposes a few days before a general announcement on the outcome of the public expenditure review; but to offer to keep the meeting of CCLGF on 21 November on the basis of the existing paper to give them an opportunity to express views;

- for there to be a Government statement at the beginning of the new session on the public expenditure decisions, <u>including</u> the decision on the reduction in the grant percentage, so that local government should know as soon as possible not only that Government have set them a lower volume target but also that they will have a lower total of grant;

- to provide the local authority associations on the same day as a public expenditure statement full details of the volume reduction, by service, with appropriate technical calculations; and

- to hold the statutory RSG settlement meeting on 15 December, at which we would give full details of the grant distribution by authority based on block grant; and to announce the local contribution determination and the housing capital expenditure allocations on the same day.

These proposals will have implications for George Younger and Nicholas Edwards as regards the RSG Settlements in Scotland and Wales.

C O N F I D E N T I A L

I should be grateful for your views and those of other colleagues concerned by close of play on Tuesday 18 November as I must inform the local authority leaders by the following day of my response to their request for a fuller paper for CCLGF on 21 November.

I am copying this letter to the Prime Minister and all other members of Cabinet, to Norman Fowler and Sir Robert Armstrong.

Yours ever

Michael

MICHAEL HESELTINE

The Rt Hon Sir Geoffrey Howe QC MP

14 NOV 1980

Y SWYDDFA GYMREIG
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switsfwrdd)
01-233 6106 (Llinell Union)
Oddi wrth Ysgrifennydd Gwladol Cymru

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switchboard)
01-233 6106 (Direct Line)
From The Secretary of State for Wales

The Rt Hon Nicholas Edwards MP

R 14/11

14 November 1980

Dear Nigel

LOCAL AUTHORITY BORROWING

Michael Heseltine copied to me his letter of 11 November to you on this subject.

I must say I agree with Michael that it would be very damaging to our other interests if we took precipitate action here. The very complexity of the matter, and the apparent likelihood of having to go back on something we have said whatever course we take, argues for a careful approach.

The proposal for an early meeting once the RSG Settlement is out of the way is one which I endorse. I should like to take part in whatever discussion is arranged.

/ I am copying this to the Prime Minister, Michael Heseltine and George Younger.

Yours ever

Nick

Nigel Lawson Esq MP
Financial Secretary
HM Treasury
Parliament Street
LONDON SW1P 3AG

Treasury Chambers, Parliament Street, SW1P 3AG

14 November 1980

Rt Hon M Heseltine MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
LONDON
SW1

Dear Michael

LOCAL AUTHORITY BORROWING

Thank you for your letter of 11 November.

I am glad that you share my concern about the level and volatility of local authority borrowing, although obviously I am disappointed that you find it impossible to reduce block borrowing allocations (as a proportion of capital allocations) or to adjust the terms of the RSG settlement in 1981-82. In the circumstances I reluctantly agree that we should not seek to use either of these mechanisms to influence local authority borrowing next year. I can therefore agree that the guidance note on the capital control scheme to local authorities should issue as drafted.

We should certainly explore what might be done to restrain local authority borrowing in the future. I should be glad to discuss the scope for further work with you as soon as the present activity related to the RSG settlement permits; I envisage, as a first step, an official working party under Treasury chairmanship to set out the options and their merits for our consideration, and to take account of the parallel Treasury/Bank work on possible measures to restrain market borrowing by the local authorities.

It seems inevitable that we will need to consider options requiring new and undoubtedly contentious legislation if any real progress is to be made. It will also be necessary to face the prospect that discipline of local authority borrowing will intensify the upward pressure on rates - an inevitable consequence of giving priority to controlling the PSBR. Rate increases will, of course, be moderated if local authorities achieve the substantial expenditure reductions envisaged in our expenditure plans, and in this the introduction of block grant should help. But I am under no illusion that we can consider local authority borrowing without taking into account its effects on the rest of local government finance.

I am copying this letter to the Prime Minister and to George Younger and Nicholas Edwards.

Yours ever
Nigel

NIGEL LAWSON

SECRET

Prime Minister.

~~T.~~S.S. Collings
Duty Clerk
18/11/80

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

May we discuss the thing.
MT

PRIME MINISTER

ADDITIONAL TAX REVENUE FROM THE NORTH SEA

My recent paper to Cabinet on the economic prospect and the implications for policy (C(80)59) said that I was considering a number of options for raising revenues, including the possibility of obtaining additional revenue from the North Sea. This note sets out my proposals, which I have discussed with David Howell, as well as with all my Ministerial colleagues in the Treasury, including Peter Rees - who has already borne the burden of carrying through the House several changes in the PRT regime. I hope this minute reflects his anxieties, which I certainly respect - but which do not, in the end, dissuade me from the course which I commend.

Economic background

2. The background against which we will be taking important fiscal decisions is the need to achieve our overriding aim of declining monetary growth. After the excessive monetary growth and public sector borrowing during the current financial year, it is essential that we use all available means to reduce the PSBR in 1981-82, and subsequent years, from levels that otherwise will prove uncomfortably high.

3. There are particular reasons for raising substantial additional revenue from the North Sea. The rest of the company sector is in severe trouble as a result of the recession and the high exchange rate, the latter in part the consequence of our having North Sea oil.

/In contrast,

SECRET

In contrast, the companies operating in the North Sea have enjoyed in the last two years a very substantial increase in prices and profitability. In the two years to the fourth quarter of this year the world dollar real price of oil rose by 90 per cent. The rise in the exchange rate over the same period has reduced the rise in the real sterling price of oil, but this is still 60 per cent higher than at the end of 1978.

4. The world oil price continued to rise until the middle of the year, since when it has been more or less stable, and the sterling price has even fallen with the rising exchange rate. Nevertheless, during the preparation of the 1980 Budget, in which I made a significant tightening of the North Sea fiscal regime, and for a little while thereafter, the oil price rise was still taking place, It is now possible to assess the implications of this second oil price explosion for the system of North Sea taxation. The halt in the upward movement in world oil prices is the result of the current recession. The prospect over the medium term as a whole is for a further significant rise in oil prices, though no-one can predict the precise extent or timing of this rise.

Inter-departmental review

5. It is against this background that a comprehensive review of the existing tax regime in the North Sea was conducted over the last summer and early autumn by David Howell's officials and mine. The purposes of that review were to:-

(i) Consider how far the Government's share of revenues accruing to the oil companies could be substantially increased, particularly in the short term, but also in the longer run.

(ii) Judge whether such additional tax could be secured without damaging the future exploitation of the North Sea.

/ (iii)

(iii) Examine how the tax regime could be made to react with more flexibility to outside events, particularly further increases in the real price of oil.

(iv) Consider whether the existing petroleum revenue tax (PRT) needed to be tightened up to protect existing revenues.

6. After careful consideration of the issues, I have decided that it would be possible to obtain a further £1 billion in tax in 1981-82 without depriving the oil companies of a fair return on their North Sea projects. One cannot avoid some risk that this increased tax might prejudice future exploration and development, but in my view the arrangements I propose will minimise this.

Limitations of the present taxes

7. I have of course carefully considered whether sufficient additional take could be achieved by squeezing more money out of PRT. The maximum we could achieve - by increasing the advance payment rate to 40 per cent, and by tightening up the existing reliefs (which tightening I think we will have to do anyway) - would be £390 million in 1981-82, £660 million in 1982-83 and £710 million in 1983-84 (money of the day). But for a number of reasons connected with the way the reliefs are structured, that tax cannot provide anything approaching £1 billion more than the sums now expected next year. Nor can we be sure that tightening up PRT will provide us with the flexibility which we must have for the future.

8. I have therefore considered three possibilities:-

(i) Complete replacement of PRT by a new tax, which would be more flexible and capable of yielding larger revenues.

/ (ii)

(ii) A new scheme of accelerated payment of PRT to replace the present advance payment arrangements.

(iii) A second special oil tax to be paid in addition to PRT.

Replacement of PRT

9. There is at first blush an attraction in the idea of replacing PRT with an entirely new tax with progressive rates geared to the circumstances of particular oil fields. This was suggested by the Secretary of State for Energy: officials looked at it very carefully, and so have I.

10. While such a tax could certainly be designed its main difficulties are that:-

(i) It could not be introduced for two or three years, and would therefore not produce extra revenue in the short term.

(ii) It would involve maximum disruption and uncertainty for the oil companies (including complex transitional provisions).

(iii) It would, in the event, produce only an extra £350 million or so each year, compared with the present system, even with a top rate of 95 per cent.

11. Unfortunately, therefore, this does not offer a solution.

A new scheme of accelerated PRT

12. A new scheme for accelerated payments would be intended to bring forward, particularly to 1981-82, PRT which is not due to be paid until some years ahead. A scheme of this sort could probably be designed to produce extra revenues on the scale I am looking for in 1981-82.

/ 13.

13. The trouble with such a scheme is that:-

(i) It simply borrows money from the future and would have to be repaid to the oil companies.

(ii) Thus, in reality, it is only a forced loan from the companies - and does not raise new money.

(iii) It will not give the added flexibility needed in relation to any future increases in the real price of oil.

14. It is essentially a short term expedient, and I do not favour it if there is a better permanent solution.

An additional tax

15. My preferred solution is to have a new tax to be paid in addition to PRT. It would be calculated on the gross income of each field above a specified production threshold.

16. Though it is not without difficulties, the advantages I see in this approach are that:-

(i) It could be brought in quickly, and in time to raise extra revenue of about £1 billion next year.

(ii) It could also continue to raise significant extra sums in subsequent years.

(iii) It would provide a much more flexible and easily adjustable tax regime for the future.

17. This involves a difficult judgement about the possible effects on exploitation and investment in the long term.

18. We have examined this carefully, and Department of Energy officials have been fully involved. What evidence we have

/suggests

suggests that the oil companies are now prepared to accept an internal rate of return on our figures nearer to 10 per cent than the 15 per cent hitherto assumed. After the effects of the changes I am proposing, our calculations suggest that IRRs would remain above this level.

19. In these circumstances it is our best judgement that the return to companies after the imposition of a new tax bringing in £1 billion will remain sufficiently high to ensure that exploitation will not be significantly adversely affected. For example, the calculations suggest that the return on the Clyde field, one of the more marginal, would be reduced by only about 1 per cent. We know how keen the companies concerned, Shell, Esso and BNOC, are to get ahead with this field, which John Raisman described recently as a profitable new field.

20. David Howell has been particularly concerned about the effects of any new measures on marginal fields, as indeed am I, and it is our intention that the new tax should as far as possible meet this problem.

21. I have taken the precaution of asking the Law Officers to consider whether we would be open to challenge under international law if we introduced this new tax on top of the existing ones. They take the view that, subject to certain conditions, the tax ought to be defensible against the charge that it is really a disguised royalty or, in some other way, a unilateral variation of an oil company's contractual rights; and that it would be difficult for an existing licensee to establish that the arrangements I am contemplating would be confiscatory.

22. David Howell is understandably reluctant to see an additional impost on the oil companies, but he does recognise the reason for my decision.

/ 23.

23. I will not disguise the fact that this step will be resented by the oil companies, and that they will react strongly against it. They will complain that this is the fourth tax (on top of royalty, PRT and corporation tax) to which they are subject. They will throw back at us that we have raised the rate of PRT to 70 per cent, reduced the rate of uplift and free oil reliefs (upholding the proposals announced by the previous Administration) and have introduced two measures to accelerate the payment of PRT. They will add that Conservative Ministers have on a number of occasions repeated the Dell/Jenkin general assurances about stability in the regime. For example Peter Rees said in Standing Committee on 18 December 1979:

> "I do wish to emphasise [that] an assurance given by Mr. Edmund Dell, which was repeated by Patrick Jenkin, that the framework of the tax should remain unaltered and unimpaired as far as possible because stability is needed in this matter. That is not to say that there are not small areas which need to be considered from time to time. We have done that an will continue to do so."

On the other hand, in giving the most recent assurance, Peter was more guarded. He said in Standing Committee on 26 June 1980 that:-

> "I do not want to create an atmosphere of uncertainty. But, naturally, one must always keep such taxes under review and consider whether the balance and the detail are right."

24. Having said that the strictures of the oil companies will not be easy to handle, but I do not believe that the terms of the assurances rule out any change of this kind; and we shall have to argue that the Government cannot tie itself in all circumstances never to raise additional tax, and that the action is justified in the current situation. Even so Peter Rees,

/because of

because of his close involvement with these earlier assurances, is understandably concerned. I have made it clear to him that I will take the lead in presenting this latest change and he is happy with this. I think we can draw some credit from announcing the proposals (including possible changes in the PRT reliefs) in advance at this stage, and thereby allowing the industry time between now and the Budget to make such representations to us as they think fit.

25. Incidentally, the increase in take of £1 billion which I recommend would not increase the total tax take from the North Sea in 1981-82 above the level expected at the time of the Budget. For a variety of reasons (including lower production and higher capital expenditure) our latest expectation is that the 1981-82 yield from the North Sea would, as it happens, have been about £1 billion lower than expected at the Budget.

Announcement

26. If this proposal has your agreement, I should like to announce the new tax, along with the other matters mentioned in my minute to you of 4 November, in time for its implications to be taken into account in the Industry Act forecast. I shall say why we have come to the conclusion that the North Sea sector can and should shoulder a larger amount of the country's tax burden in present circumstances, and indicate the broad shape of the tax.

Conclusion

27. I seek your agreement that:-

(i) We should plan to introduce a new tax on gross profits from the North Sea sufficient to raise around £1 billion extra in 1981-82, and significant additional revenues in subsequent years.

/ (ii)

(ii) I should announce it later this month in time for its implications to be incorporated in the Industry Act forecast.

28. I am copying this minute to the Secretary of State for Energy and to Sir Robert Armstrong.

R.I. Tolkien (Private Secretary)
for
(G.H.)
14 November 1980

MR LANKESTER

cc:- Mr Whitmore

The Cabinet Office rang to remind us that the Chancellor intends to table two notes during the Public Expenditure item in tomorrow's Cabinet. The first, on Social Security Public Expenditure, is attached to his note of 31 October to the Prime Minister. The second, on Employees National Insurance Contributions will come from the Treasury tonight.

David ~~Wright~~ Moore is assuming that you will have sufficient copies to circulate promptly when the moment comes.

M.A.P.

12 November, 1980

Ref: A03541

Econ Pol.

Copied to:- Social Services: Nov 79

1

SECRET

PRIME MINISTER

Public Expenditure Programmes
(C(80) 62 and 64)

BACKGROUND

This meeting is the fourth of the current series to resolve the main public expenditure issues for next year and the following years of the PES period. It would be highly desirable for operational reasons if it could break the back of the remaining work. You are, of course, up to date on most of the outstanding points, and this brief does not attempt a fully detailed survey. I have however annexed some notes on points of detail where the earlier briefs need amendment or supplementation.

2. So far the Cabinet has reached agreement on:-

(i) the RSG percentage for next year;

(ii) the cash limits for next year other than for defence and a few 'technical' points outstanding from C(80) 65;

(iii) the further cuts on local authority current expenditure of 1 per cent across the board;

(iv) the 2 per cent cuts on cash limited programmes other than health (where equivalent sums will be raised through increased National Insurance contributions) and Defence;

(v) the additional provision to be made for special employment measures.

3. In addition E Committee (E(39th Meeting, Item 2) has reached agreement on the External Financing Limits to be applied to the nationalised industries in 1981-82. This will require a further provision of £157 million for that year (the Chief Secretary, Treasury, is still sorting out the details with sponsor Ministers).

4. The remaining issues are:-

(i) Social Security - uprating of benefits.

(ii) Social Security - increased National Insurance contributions (not strictly a public expenditure issue but related to (ii)).

(iii) Defence - a 2 per cent volume cut of £188 million and any further specific cuts, together with the related issues of the reconciliation of next year's AFPRB award on pay with the cash limit factor and the accommodation, if any, to be made in the price factor to the differential increase in the cost of defence equipment.

(iv) Scotland - specific cuts on top of the formula percentage cuts.

(v) Wales - additional bids in 1982-83 and 1983-84 for industrial expenditure.

(vi) 1982-83 and 1983-84 generally. Some of the decisions here will be affected by what is decided on the points listed above but generally, and following particularly on their bilateral discussions with the Department of Education and Science, the Treasury now believe that the figures for these years are settled. The Chief Secretary, Treasury, is likely to offer to circulate to Cabinet a note summarising his understanding of the agreed figures for each year so that Cabinet may have the total picture.

5. As you know, the Chancellor of the Exchequer has to publish the Industry Act forecasts in the week beginning 24th November when he is also planning a more general statement on the outcome of the public expenditure discussions. If the Treasury are to complete their work on the Industry Act forecasts within this timescale they need to know tomorrow at least the broad decisions on the outstanding issues - in particular they need to know whether Social Security upratings are to be abated - although it is not essential for them to have final decisions on the details of exceptions if they cannot be resolved tomorrow.

HANDLING

6. You might open the discussion by inviting Cabinet to confirm that full agreement has now been reached on the 1 per cent cut on local authority current expenditure and, with exception of Defence, on the application of the 2 per cent volume cuts on cash limited programmes. Cabinet might also be asked to take note of the decisions by E which lead to further provision of £157 million for the nationalised industries; and that the Chief Secretary, Treasury is agreeing on the details with the sponsor Ministers.

7. I suggest that you then take the remaining issues in the order listed in paragraph 3 above (Social Security; Defence; Scotland; Wales). Before turning to them, you might give the Chancellor of the Exchequer an opportunity to make any general points and to explain to the Cabinet how he now sees the timetable, with reference both to the Industry Act forecasts and to any announcement on the public expenditure cuts in particular.

Social Security

8. The Chancellor proposes to hand out to the Cabinet the paper attached to his minute of 31st October to you, dealing mainly with the proposal to uprate benefits in November 1982 by 3 percentage points less than needed to give full price protection. A detailed note on this is at Annex A.

attached

9. He will also table a note on his proposal for legislation to reduce the Treasury supplement to the National Insurance Fund so as to reduce the PSBR by £500 million, with the difference in income to the Fund made up by raising the rate of employees' contributions payable from 1st April 1981 - see his letter of 10th November to the Secretary of State for Social Services and the Secretary of State's reply of 11th November. This is not a public expenditure question, although it needs to be considered alongside the proposal for abating the uprating i.e. Cabinet will need to take account of the politics of asking people to contribute more for less - to put it at its crudest. A more detailed note is at Annex B.

Defence

10. Summing up the discussion on 4th November you said that:-

> "The Cabinet accepted that the cuts on the Defence Budget would have to be less than the £500 million which the Chancellor had sought but more than the £152 million offered by the Secretary of State for Defence, which did not even meet the requirement of £188 million representing the general 2 per cent cut in cash limited expenditure."

11. The issues for decision now are:-

(i) What should be the volume cut within this range.

(ii) What arrangements should be envisaged to reconcile any difference between the general 6 per cent cash limit for pay and whatever percentage pay increase the Cabinet agree next year in the light of the report of the Armed Forces Pay Review Body - recognising that the commitment to pay comparability for the Armed Forces stands.

(iii) What special arrangement, if any, should be envisaged to cope with the possibility that prices for Defence equipment will tend to increase faster than the general level of prices (for which the assumption in other programmes is, of course, 11 per cent)?

I believe that the Secretary of State for Defence (and the Chiefs of Staff) will attach most importance to the first of ~~these~~ the two cash limit conditions – the one on pay –; and my understanding is that the Treasury is inclined (at official level, at any rate,) to accept that, if the commitment to implement the Review Body's recommendations for Armed Forces' pay is accepted as binding, it is unrealistic to do otherwise than allow for that in an adjustment of the pay factor for the relevant cash limit. If this is conceded, it will be easier to resolve the point on the price factor: that could be left to be agreed bilaterally between the Chancellor or the Chief Secretary, Treasury and the Secretary of State for Defence.

11a. It may be tactically wise not to press these matters — including the volume cut — for decision today, so soon after the meeting with the Chiefs of Staff, but to give time for further discussions with the Defence Secretary, and come back to the matter in Cabinet on Wednesday 19 November.

<u>Scotland</u>

12. The Secretary of State for Scotland has accepted the formula cuts consequent on the equivalent percentage reductions now agreed by other Departments. His memorandum C(80) 62 however strongly disputes the Treasury's wish to have a further £90 million from Scotland to claw back part of the over generous provision for that country as opposed to England. This is discussed in more detail in the note at Annex C.

<u>Wales</u>

52. 37 - 34.

13. The Secretary of State for Wales has agreed to take his per centage cuts, but he wants an additional £20 million in 1982-83 and 1983-84 for factory building in areas affected by steel closures - see paragraph 29 of the Chief Secretary, Treasury's memorandum C(80) 64 and the note at Annex D to this brief.

<u>1982-83 and 1983-84</u>

14. If he does not volunteer it, you might invite the Chief Secretary, Treasury, to circulate a memorandum giving the detailed figures for each programme for each of 1981-82, 1982-83 and 1983-84. It should not be necessary for Cabinet to discuss the two later years either tomorrow or later. If there are any problems Ministers could be asked to sort them out with the Chief Secretary, Treasury, coming back to Cabinet for substantive discussion only in the last resort.

CONCLUSIONS

15. These will follow from detailed discussion of the remaining points at issue. You will also want to record specific endorsement of the 1 per cent local authority cuts and 2 per cent volume cuts on cash limited programmes.

RA

(Robert Armstrong)

<u>12th November 1980</u>

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 proposal 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). It may also be necessary to look ahead to the Chancellor's parallel proposals to increase employees' National Insurance contributions. 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 exception, £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 whether any abatement of public sector pensions 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. This decision has a relatively small effect on the overall arithmetic and could, if necessary, be left to 19th November.

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 (leaving details on the exceptions to be resolved bilaterally or at Cabinet on 19th November;

<u>OR</u> rule out Proposal C.

(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.

<u>12th November 1980</u>

Employees National Insurance Contributions

The Chancellor of the Exchequer and the Secretary of State for Social Services have agreed to two increases, each of 0.25 per cent, in employees' National Insurance contributions, namely:-

(i) in the context of the normal contribution review, to offset an estimated deficit in the Fund of £250 million;

(ii) following Cabinet's discussion on 4th November, in the NHS contribution as an alternative to the 2 per cent cut on health expenditure and to offset the £100 million income lost from charges which will not now be made.

2. They have not however agreed on the Chancellor's proposal that the Treasury Supplement to the Fund should be reduced so as to save £500 million on the PSBR with the Fund balance restored by a further 0.5 per cent increase in employees' contributions.

3. The Chancellor's arguments for this change are set out in paragraph 4 of his note. Even with the public expenditure cuts he is faced with the need to find further substantial contributions towards reducing the PSBR. This proposal would contribute £500 million and make his taxation options easier. The table annexed to his note sets out the effects on incomes of the proposed increase. Paragraph 8 of the note, and the footnotes to the table, argue that raising more from income tax (which effectively means reducing tax thresholds) would hit those on smaller incomes particularly hard; and that increases in indirect taxes would of course have an effect on the RPI.

4. The Secretary of State for Social Services' reservations are summarised in paragraph 5 of the note. He believes the increase would be seen as an improper use of the national insurance system for taxation purposes and would add to the difficulties of getting legislation through the House. He points out that the better-off would be at a relative advantage over those with lower earnings - the table shows that there is no increase in contributions for those with a gross income of more than £190 a week.

5. Legislation, with Royal Assent very early in the New Year, would be necessary to implement both the proposal on the NHS contribution and the reduction in the Treasury Supplement. A Bill has been drafted. Subject to policy approval by the Cabinet, proposals could be put to Legislation Committee at their next meeting on 19th November.

HANDLING

6. The Chancellor of the Exchequer and the Secretary of State for Social Services will each wish to put their case on the proposal in dispute. There seems no reason why Cabinet should call into question the agreement reached between the two Ministers on the normal increase in the contribution and on the increase in the NHS contribution, which follows Cabinet's earlier decision. On the proposal for a further 0.5 per cent increase they may be sympathetic to the points made by the Secretary of State for Social Services. On the other hand, as the Chancellor points out, there are no easy alternatives to this proposal. Even after the public expenditure cuts, tax increases are likely. For the reasons put forward by the Chancellor it seems better to find at least some of this money through national insurance contributions.

CONCLUSIONS

7. In the light of the discussion you will wish to record conclusions:-

(i) Taking note of the two agreed changes - i.e. the normal and the NHS increases (paragraph 2 of the Chancellor's note).

(ii) Either accepting the Chancellor's proposal for a reduction in the Treasury Supplement to the Fund together with a further 0.5 per cent increase in employees' contributions.

OR rejecting this proposal but accepting that in consequence more will have to be raised from taxation.

(iii) In the light of (i) and (ii) inviting the Chancellor of the Exchequer and the Secretary of State for Social Services to put proposals to the next meeting of the Legislation Committee on 19th November.

12th November 1980

£4.000m
£90m.

ANNEX C

SECRET

Scotland

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

Unresolved cuts: £90 million each year.

The Secretary of State has accepted the formula cuts consequent on the equivalent percentage reductions now agreed by other Departments. 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.

12th November 1980

SECRET

Wales
(Section B vi. of C(80) 64)

The Secretary of State for Wales has agreed to take his percentage cuts. However, he wants an additional £20 million in each of 1982-83 and 1983-84 for factory building in areas affected by steel closures.

2. He 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. Edwards free to switch his own resources into his industrial programme if he wishes;

or

(ii) modify the cuts by giving Mr. Edwards the £20 million more he wants for industrial support in 1982-83 and 1983-84.

12th November 1980

CONFIDENTIAL

Copied to Public Sector Pay

Ref. A03539

PRIME MINISTER

Pay Factors in Cash Limits

(C(80) 60, 65 and 70)

BACKGROUND

At its meeting last Thursday the Cabinet agreed that the price factor, throughout the public services, should be 11 per cent (except in the case of defence where a decision was reserved); that for planning purposes the objective on the pay factor for cash limits should be 6 per cent throughout the public services, subject to a deferred decision on the reconciliation of this cash limit with the outcome of the next report of the Armed Forces Pay Review Body; that the 6 per cent pay cash limit should be applied forthwith to the Rate Support Grant settlement; that announcements of cash limits for other parts of the public services should not be made before they were operationally necessary (the public formula being that settlements in the remainder of the public services would be dealt with "broadly within the same financial disciplines" as were being applied to local authorities); and invited the Chancellor of the Exchequer to circulate a memorandum for discussion at the present meeting on the implications of these decisions particularly as regards the timing of any announcements. The memorandum (C(80) 70) by the Chancellor of the Exchequer fulfils this remit, and reverts also to the outstanding "technical" decisions left over from his earlier paper C(80) 65 (dealing with the treatment of "staging" and "overhang").

2. In the course of their discussion the Cabinet accepted that a 6 per cent limit could be very tight, particularly in cases like the NHS where there were no alternative sources of finance and no significant possibility of staff reductions. They also wanted to avoid converting a 6 per cent cash limit into a rigid 6 per cent "norm". In short they wanted to preserve as far as they could a measure of flexibility to deal with the circumstances of particular negotiations as they arise and, as Sir Keith Joseph put it, to be prepared to envisage a "scatter" of settlements in the public services around, but not necessarily at, the 6 per cent figure.

CONFIDENTIAL

3. In effect the Chancellor's new paper is saying that there can be no flexibility around 6 per cent and that the only flexibility available is in the timing of announcements. Even here it is, he argues, necessary to confirm publicly the 6 per cent figure very soon for the universities and the NHS (the next groups to negotiate) and that, while no early announcement need be made about the applicability of 6 per cent to the Civil Service, that figure should be used now for the construction of the estimates in the knowledge that in practice no higher figure is conceivable. In political terms this is no doubt a realistic assessment. Certainly if a 6 per cent figure is announced for the NHS there could be no question of later flexibility for the Civil Service. The key question therefore is whether 6 per cent is realistic for the NHS, both for the immediate negotiations on ancillary staff and later for the nurses, the doctors and the dentists. If colleagues are prepared to run the risks here, the rest follows.

4. Some of the colleagues may complain that, in the treatment by the media of the 6 per cent pay factor in the cash limit for the RSG, and of your Written Answer to a Question the following day, the implication that 6 per cent would be the pay factor in cash limits for other public services as well as for local authorities came across much harder than the Cabinet intended; these Ministers can be expected to reiterate their arguments in favour of retaining as much flexibility for as long as possible on the cash limit for other public services. The Home Secretary may want to reiterate that 6 per cent is a cash limit not a pay norm: he is not happy with a letter which he received from the Secretary of State for the Environment, to the effect that taking that line made life more difficult for the local authority employers in their negotiations on the pay of firemen and other employees.

HANDLING

5. You will wish to ask the Chancellor of the Exchequer to introduce his paper and then call on the Secretaries of State for Social Services and Scotland to comment particularly on the NHS point and the Secretary of State for Education and Science to comment on the universities. If these three Ministers are prepared to go along with the Chancellor's recommendations, the Cabinet will no

doubt readily accept them, including those on the "technical" points in paragraph 7 of C(80) 70. If however serious doubts emerge about the practicality of successfully enforcing a 6 per cent "norm" on the NHS groups (the university groups have no real muscle and must lump it), the choice is between setting a higher figure now for the NHS (which the Cabinet would no doubt be most reluctant to do); accepting that, in the event, there may have to be some give as negotiations unfold (a decision which would become rapidly apparent in the case of the NHS ancillaries and risk the policy as a whole).

CONCLUSIONS

6. The choices would appear to be:-

either

(i) to accept the conclusions in paragraph 8 of C(80) 70;

or

(ii) to accept the conclusions in paragraph 8 of C(80)70 with the proviso that the Government would need to weigh, as negotiations with NHS ancillaries, nurses and doctors proceed, the balance between relatively minor breaches in the cash limit against the costs of disruption.

RtA

ROBERT ARMSTRONG

12th November, 1980

ERC

Gra Pol

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

11 November 1980

R 17/11

Dear Nigel

LOCAL AUTHORITY BORROWING

Thank you for your letters of 17 October to me and 22 October to Tom King about local authority borrowing.

I agree that this is a very important issue. Local authorities' net external borrowing (LABR) is a significant part of the PSBR. I would like to discuss this urgently but it is clearly not an issue that we can settle overnight - our first priority is launching an RSG quickly with a reduction in the volume of current expenditure, a tight cash limit and a cut in the grant percentage. I would however urge that we have the earliest possible meeting after the RSG settlement has been made.

In the meantime I do not think we can go along with the suggestions made in your letters for the reasons set out in the attached note. We cannot hold up the rate support grant settlement in order to accommodate your suggestions for using the RSG system to reduce local authorities' propensity to borrow. This would be very harmful. Local authorities' budgeting processes are going forward day by day and any delay in announcing the settlement could only reduce our ability to influence authorities' spending for 1981/82.

We also cannot cut the 100% borrowing approvals which we have offered local authorities as a quid pro quo for the introduction of a tight control on their capital expenditure. This was a decision of colleagues and we have all committed ourselves too far in public to withdraw. It would in any case be impracticable to try to introduce a control on borrowing for 1981/82: a blanket reduction in the borrowing approval would be impossible because authorities' cash flow positions vary too much, and neither DOE nor Treasury have either the information readily available or the machinery to decide appropriate levels of borrowing for individual authorities.

In view of this I am sure we must issue the memorandum on the capital controls scheme - with its reference to 100% borrowing approvals - as early as possible next week. Our continued failure to produce it is a source of embarrassment as it is holding back effective capital expenditure planning by local government.

I am copying this letter to the Prime Minister, George Younger and Nicholas Edwards.

Yours ever

MH

MICHAEL HESELTINE

Nigel Lawson Esq MP

ANNEX

LOCAL AUTHORITY BORROWING

1. Treasury have suggested that steps should be taken to reduce local government's propensity to borrow - although of course the consequence must be an automatic increase in the propensity to increase rates and/or charges - presumably in order to contain the PSBR in a predictable way. These suggestions appear to fall into three groups: first, to increase the cost of borrowing by reducing the rate support grant (RSG) on interest rates; secondly, imposing quantitative controls on the amount of external borrowing; and thirdly restricting access to the PWLB.

RSG

2. The first proposition is open to three basic difficulties. First, it is not evident that increasing the price of borrowing to local government by reducing the RSG subsidy would reduce the PSBR, because to the extent that this led to an increase in financing capital expenditure from revenue, local government would attract a greater amount of grant - ie on the full capital cost of the financing of capital schemes in a year and not only on the loan charge element. Each £1 financed from revenue attracts on average 61p in grant: each £1 financed by borrowing attracts grant on interest payments of say 15p ie about 9p. The result would be an increase in the central government borrowing requirement (CGBR) offsetting the LABR reduction. Nor would it help to reduce that rate of subsidy on revenue finance of capital, as this would neutralise the incentive for authorities to switch away from borrowing. Secondly, it would tend to undermine one of the fundamental objectives of the RSG, which is to equalise the resources of all local authorities, as it would put greatest pressure on authorities with the lowest resources. Thirdly, under the existing RSG system, if local authorities borrow more than the forecast agreed for the settlement each year, they bear the full cost themselves in that year.

3. Any scheme based on a reduction in the proportion of loan charges accepted for RSG would in any event require primary legislation. This means that such a scheme could not be implemented before 1982-83, because it is clearly too late to introduce such a controversial proposal into the Local Government Planning and Land Bill. One variant could be introduced without primary legislation - to cash limit loan charges for the RSG settlement for 1981/82. This runs into the difficulties mentioned in paragraph 2 above. Furthermore, if it was presented as a signal of a tighter control of the LABR in later years, it might prompt local authorities to borrow more in the next financial year than might otherwise be the case.

QUANTITATIVE CONTROLS

4. The second proposal requires the imposition of a quantitative control on local government borrowing ie that a lower limit might be placed on the amount of borrowing approvals which would be given to local authorities in the next financial year which is the first year of operation of the new capital expenditure controls scheme.

5. Such a limitation on new borrowing approvals would not be effective because even if a reasonable formula could be found for deciding how much each authority should get by way of borrowing approvals those authorities with substantial balances could circumvent any new borrowing limit by converting internal to external loans ie the internal loans are backed by valid loan sanctions. There could also be offsetting increases in the PSBR by additional revenue borrowing which

authorities might have to resort to, and by additional central government borrowing to cover the additional RSG which would have to be paid on the extra capital spending financed from revenue.

6. It has also been agreed that as part of the "quid pro quo" of greater operational freedom in return for the imposition of a tight control on the total of annual capital expenditure, local authorities should be given the right to finance their annual capital expenditure allocations in any way they chose in the first year, including external borrowing, although it has of course been made clear that this freedom would be reviewed after the first year of operation of the scheme. It would be reneging on this undertaking to say there will be lower limits of borrowing approvals next year. It is now too late and the Government would be accused of bad faith. DOE Ministers have all made reference in Parliament to the new freedom to finance expenditure from borrowing or revenue at local authorities own discretion. In any event, the Government's argument has been that the need is to control expenditure and that the old system of controlling borrowing can be relaxed because the new scheme will be more effective. It would be embarrassing that the Government should now have to admit that having forced the new scheme through Parliament they now believed it to be inadequate.

PWLB

7. The third proposition concerned restricting the access of local authorities to sources of loan finance, notably the PWLB. This presumably could put up the price of borrowing to local authorities, and might also reinforce any tendency for a two-tier local authority market to develop. Further discussion is needed on this whole question of making use of market disciplines to influence borrowing behaviour.

LA CONTRIBUTION TO PSBR

8. The local authority contribution (LABR) to the PSBR has steadily diminished from 1968/69 when it was $2\frac{1}{2}$ times the total PSBR to 1978/79 when it accounted for only 13.9%; in 1979/80 it increased again to 29.5%. Local authorities have been able to hold down their net external borrowing in recent years by financing much of the overall agreed annual expenditure level from their internal balances and funds. This has been in constrast to the performance of central government which, by running large deficits on current account, has had to resort to higher levels of borrowing. The increase in local authority borrowing in 1979/80 was itself at least in part the result of central government policies since the volume squeeze caused by tight cash limits on rate support grant and unexpectedly high inflation caused authorities to run down their balances and, therefore, the potential for internal borrowing.

11 NOV 1980

820

2

Prime Minister

Mr Heseltine is proposing further tough action to prevent the cash limit for housing capital expenditure from being broken.

R. 11/11

cc Mr Lyghan

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:
Your ref:
10 November 1980

Dear John

I have now received and analysed the up-to-date figures requested from English local authorities of their housing capital expenditure in 1980/81 based on their existing commitments and mandatory obligations to pay grant.

The figures show that of the 367 English authorities, 117 consider that they are already committed to expenditure in excess of their total permitted expenditure this year, whilst the other 250 authorities consider their commitments to be below their permitted expenditure.

The total estimated overspend by the 117 overspenders is £78m, whilst the total estimated underspend (assuming no further expenditure) by the underspenders is £133m. The PESC cash limit is £56m below the total that authorities have been told that they are permitted to spend because of the tolerance arrangements which were agreed with you and notified to the authorities.

I should make it clear that the "overspending" authorities are not all by any means incompetent or unwilling to co-operate. Many of them are, indeed, our supporters. Much of the trouble may have come about because existing contracts have proceeded more quickly than expected. Where an authority has a small capital budget, sometimes comprising only one major scheme, this can lead to a large percentage overspend in the year which will be entirely outside their control.

All these figures must be subject to wide margins of error but, taking the worst case and assuming:

a. that all the sums committed by both the overspenders and the underspenders will in fact be paid by authorities in this financial year, and

b. that all the underspenders without exception spend up to their maximum permitted spend in this financial year

we would face an overspend over permitted expenditure of £78m and which taken with the £56m tolerance would lead to an overspend over the PESC cash limit of £134m.

In practice, the worst case is unlikely to arise for two reasons. First, it is improbable that all the money that authorities say is committed at this stage in the financial year will in fact be the subject of actual cash payments in this financial year. Severe weather this winter could be a critical factor. Second, it is well nigh certain that not all of the 250 underspenders will spend all of the £133m within their permitted spend which they have not yet committed. For example, from previous returns we know that some of these authrities do not expect to reach their permitted spend by an aggregate sum of £26m.

However, in view of the risk to the cash limit that clearly exists, I feel that I have no alternative but to take further action to restrain housing capital expenditure for the remainder of this financial year despite the very strong reaction this will provoke from the construction industry, from many local authorities (Conservative as well as Labour) and from the housing lobbies.

I propose to take the following steps:

a. all the 117 overspending will be refused consent to enter into any further non-mandatory commitments during the remainder of this financial year or until such time as they satisfy my Department individually that their commitments this year on a cash payment basis will actually fall below the level of their permitted expenditure;

b. all the 250 underspenders be permitted to resume committing new expenditure subject in the case of each individual authority to their permitted spend in this financial year not being exceeded, but in the event of any authority's outturn expenditure this year actually being below its permitted expenditure this can be added to its allocation next year. I attach importance to this flexibility, otherwise local authorities will be tempted to spend in the last months of 1980/81;

c. the 1981/82 HIP capital allocations, which will be announced in December, will be made on the basis that for each of the 117 overspending authorities an amount equal to the estimated overspend is clawed back at the time that the allocation is made, subject to the clawback being released subsequently in whole or in part to the authority if the overspend does not materialise.

Timing is crucial. Local authorities were very co-operative in submitting thier returns to me in 5 working days. There has been a strong reaction from underspending authorities, many of whom are our supporters. They feel deeply aggriev ed that once again we have had to punish them for overspending which is not their responsibility. Moreover the construction industry has reacted with great bitterness and we have created problems in the acceptance of tenders and letting of contracts which has attracted wide adverse comment in local/national papers, which has fed through to our suppo r ters in the House. We must act quickly and decisively and I should be grateful to you agreement as soon as possible to my proposals.

I am copying this letter to the Prime Minister, other members of E Committee, George Younger and Nicholas Edwards.

Yours ever

MICHAEL HESELTINE

2F

Rt Hon W J Biffen MP

PART 11 ends:-

TL to HMT 7.11.80

PART 12 begins:-

C(80) 70 11. 11. 80

~~1/5 Env to FST 11.11.80~~