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Part 1: May 1979

Part 16: Oct 1981

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~28.10.81~~							
~~9.11.81~~							
11.11.81							

PREM 19/421

PART 16 ends:-

MS to HMT 12.11.87

PART 17 begins:-

CS to PM/CW/MS 13.11.87

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
MISC 62(81) 1	26/10/81
MISC 62(81) 2	27/10/81
E(81) 107	27/10/81
MISC 62(81) 3	28/10/81
MISC 62(81) 1st Meeting, Minutes	29/10/81
MISC 62(81) 4	29/10/81
MISC 62(81) 5	29/10/81
MISC 21(81) 2nd Meeting, Minutes	30/10/81
MISC 62(81) 6	30/10/81
MISC 62(81) 7	30/10/81
MISC 62(81) 8	30/10/81
MISC 62(81) 9	30/10/81
MISC 62(81) 10	30/10/81
MISC 62(81) 11	30/10/81
MISC 62(81) 2nd Meeting, Minutes	02/11/81
MISC 62(81) 3rd Meeting, Minutes	02/11/81
MISC 21(81) 6	02/11/81
Addendum to Misc 21(81) 6	02/11/81
MISC 62(81) 12	02/11/81
MISC 62(81) 13	02/11/81
MISC 62(81) 14	02/11/81
MISC 62(81) 15	02/11/81
MISC 62(81) 16	02/11/81
MISC 62(81) 17	02/11/81
MISC 62(81) 18	02/11/81

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 OWayland Date 17 November 2010

PREM Records Team

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
MISC 62(81) 19	02/11/81
MISC 62(81) 21	02/11/81
MISC 21(81) 3rd Meeting, Minutes	03/11/81
MISC 62(81) 4th Meeting, Minutes	03/11/81
MISC 62(81) 5TH Meeting, Minutes	03/11/81
MISC 62(81) 6TH Meeting, Minutes	03/11/81
MISC 62(81) 20	03/11/81
MISC 62(81) 22	03/11/81
MISC 62(81) 7th Meeting, Minutes	04/11/81
MISC 62(81) 8th Meeting, Minutes	04/11/81
MISC 62(81) 9th Meeting, Minutes	04/11/81
MISC 62(81) 10th Meeting, Minutes	04/11/81
MISC 62(81) 23	04/11/81
CC(81) 35th Meeting, Item 1	05/11/81
E(81) 33rd Meeting, Item 2	10/11/81
CC(81) 36th Meeting, Item 5	12/11/81

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

Signed AWayland Date 17 November 2010

PREM Records Team

File

dl

Econ

PS/

Original filed on:-

Manpower: Special Employment Measures: Pt 6.

10 DOWNING STREET

From the Private Secretary

12 November 1981

I wrote to John Kerr yesterday about the MSC estimate of the cost of unemployment.

I think that we will need a form of words for the Prime Minister to use today. In line with the points she was making on Tuesday I have drafted the following:

> "This figure (i.e. £12.4 billion) is made up of a number of components. Direct public expenditure on the unemployed is estimated in 1981/82 at around £4 billion. To get from that figure to a total cost of £12 billion - and, still more, to an estimate that each extra unemployed person costs the Exchequer £4,380 a year - involves making a range of assumptions, including an assumption that the previous employment of each person joining the register would itself have involved no cost to the Exchequer."

I would be grateful for your comments before Question Time this afternoon on this form of words.

I am sending a copy of this letter to Richard Dykes (Department of Employment).

M. C. SCHOLAR

Miss Jill Rutter,
HM Treasury.

Chancellor of the Exchequer

cc Chief Secretary
Financial Secretary
Minister of State (C)
Sir Douglas Wass
Mr Ryrie
Sir Anthony Rawlinson
Mr Burns
Mr Cassell
Mr Monck
Mr Britton
Mr Bridgeman
Mr Kemp
Mrs Lomax

V. helpful
Discuss
— No.10? You thought not — but now see CST's view
— A.W? — P. Middleton will send it to him, on a personal basis?

INTEREST RATES, THE PSBR AND PUBLIC EXPENDITURE

1. You asked for a note on the PSBR objective for next year. I shall take the argument first and the numbers second.

2. Since the Budget, the monetary prospect and the immediate prospect for inflation has deteriorated:

a. The US has tightened its domestic policies, relying on high interest rates. Other countries have followed. UK and world interest rates are higher than expected.

b. Interest rates worldwide are showing high real rates of return. This may be a return to historic relationships between lenders and borrowers which were disturbed under the impact of high inflation in the 1970s.

c. The sterling exchange rate has weakened and is now delicately poised. It has lost much of its former resilience.

d. Bank lending has proved more difficult to control than we thought. Higher interest rates seem to be needed for a given growth of £M3.

3. These circumstances seem likely to persist for some time. We now think that if we simply stuck to the PSBR which seemed appropriate at Budget time we should be faced with excessively high interest rates or very lax monetary conditions and probably a falling exchange rate.

4. Your October proposals on public expenditure reflected a preliminary judgement about what was now an acceptable PSBR in the new circumstances. Your final judgement will of course be based on the information available to you at Budget time. The assessment in

your October paper to Cabinet looked for a PSBR in 1982-83 of £1½-2½ bn lower than the £9¼ bn implied by the March MTFS (part of this reflected distortions such as those caused by the Civil Service strike, see below). Even with the PSBR at this level there are considerable risks that monetary growth would be excessive - certainly more than the March MTFS. There is also the prospect that interest rates will be a good deal higher than had been hoped in March.

5. The prospect for interest rates next year does however depend on the nature of the reduction in the PSBR. You get very little benefit from some sorts of reduction in expenditure. These are broadly:

a. measures which increase prices. These increase the demand for money for ordinary day to day transactions.

b. measures, such as assets sales, which substitute to a considerable extent for gilts and other forms of public sector debt. These changes have a large cosmetic element so far as interest rates are concerned.

c. financing transactions such as indexed gilts - they do not have the same effect on interest rates as reductions in the PSBR due to lower public expenditure. In any case we should not take whatever benefit there is from more efficient financing by increasing the PSBR when our original aim was to take it in lower interest rates.

6. The Civil Service dispute is a complication of a different kind. This is essentially a matter of timing of money flows over the 3 years 1980-81, 1981-82 and 1982-83. The strain so far has been taken on the PSBR, money supply and perhaps interest rates. It would be very strange to use the recovery of revenue to increase expenditure at the expense of the money supply and interest rates.

7. There is one final strand to the argument - output. We had already allowed for a deterioration in output in the MTFS PSBR numbers. The PSBR for 1982-83 has been raised from the £6 bn (2¼% of GDP) envisaged in the 1980 budget to £9¼ bn (3¼% of GDP) in the 1981 Budget. The prospect for output has not deteriorated further since. So though it could still be argued that the PSBR should be higher because of the recession, it cannot be said that

we could have a higher PSBR for a given money supply and interest rates. This would only be true if the recession looked like proving deeper than we thought, which it does not.

8. I think the argument above is the best and most convincing way to put the case on public expenditure in relation to the PSBR. Things have got worse in the world and in the UK, therefore to avoid continuing very high interest rates a genuinely good outcome on the PSBR is needed. All this is very clear to the markets who will react precipitatively if the expenditure/PSBR exercise goes wrong.

9. I have set out again the calculations you have been used to, with annotations so that you can see how they are derived from the 1981 MTFS, and how they relate to the various public expenditure outcomes. But I would much prefer the presentation in the early part of my note to one based on the arbitrary set of deductions in the first 3 boxes of the table:

a. The world has moved on since last March, and you have to take a view based on the prospects as we now see them. The object is to stick broadly with the logic of the Government's approach to containing inflation. That implies the sort of public expenditure figures you put to Cabinet. If the Government departs on expenditure the markets will enforce the logic through the exchange rate and interest rates if it is not restored by tax.

b. There is a wide spectrum of adjustments of the sort referred to in paras 5, 6, 7 which can be argued about indefinitely. We have tried to take them into account in assessing the prospect. But this cannot be done with any great science. When you start making specific adjustments for some of them, it looks odd and you raise more questions than can be answered about others.

10. Your strength is in your overwhelmingly powerful position to make a judgement about the PSBR and the consequences for tax if expenditure goes wrong. You have nothing much to gain and a good deal to lose by focusing on statistical adjustments rather than financial events which everyone can understand.

11. Once you had reached the judgement on the PSBR, the scope for

public expenditure above that planned was small. The minimum additions to public expenditure would produce a prospect for interest rates, money and inflation which was consistent with the Government's broad policy aims. The maximum additions mean facing the prospect of either:

a. still higher monetary growth

b. still higher interest rates - with little room for a fall from present levels

c. a substantial increase in taxation to get us back to the scarcely tolerable outlook underlying the 20 October paper.

12. You cannot accept (a) and (b) so you would have to increase taxes. £3 bn extra expenditure would require for example about 3p on the income tax to offset it.

13. The arguments in boxes 4, 5 and 6 of the table illustrate different public expenditure outcomes. These boxes refer to the figures in Mr Bridgeman's minute of 10 November and relate them to your 20 October paper. You said there that the <u>maximum</u> PSBR you could go for in 1982-83 was the £7¼ bn referred to in box 2 of the table and is the top end of the range in para 4 of this minute. In fact your opening public expenditure figures - planning total of £113.5 bn for 1982-83 (allowing for the revalorisation of direct and indirect taxes) - would have provided a figure of £6¾ bn around the bottom end of the desired range with a prospect for money and interest rates in the direction indicated by box 3 in the table - still high but coming down. Since then, allowing for changes in the composition of public expenditure, particularly on the local authority side, it looks as though your "best" outcome - £114.5 bn plus a 50% RSG settlement, would in fact produce a PSBR very close to the £6¾ bn you are looking for.

14. If you go higher on public expenditure, you begin to get outside the top end of the range you considered acceptable with the sort of consequences for interest rates or tax referred to in boxes 5 and 6.

PEM

P E MIDDLETON
12 November 1981

Enc

PSBR Arithmetic

	PSBR 1982-83 £ bn (% GDP)	Interest Rates (Short term) UK	US	Monetary Growth in 1982-83	Comments
1. 1981 MTFS (March)	9¼ (3¼%)	Q4 81 12½ Q1 83 10½	13.0 13.0	7%	MTFS suggested a PSBR equal to 3¼% of money GDP; this is equivalent to £9¼ bn given our forecast for money GDP in 82-83.
2. 1981 MTFS adjusted for: £1 bn strike effects £½ bn effects of higher IG sales	7¾ (2¾%)	Present judgements suggest much higher than (1)		Probably higher than (1)	Strike adjustment: next year's PSBR is forecast to be reduced by £1 bn extra tax revenue, as result of unwinding of effects of strike (prov. est). We did not cut PE to offset effects of strike and we cannot increase it next year agaust a purely temporary increase in revenue. So we must aim at a lower PSBR figure, to be consistent. IG's adjustment: Funding through IG's, rather than conventionals reduces debt interest and the PSBR. This is a financing transaction. It does not reduce interest rates to the same extent as a reduction of the PSBR due to lower public expenditure or higher taxes.
3. Judgement underlying 20 Oct paper and Chief Secretary's proposals	6¾ (2¼%)	Higher than (1) but lower than (2)		9%	Reflects a judgement, different from March, about size of PSBR consistent with an acceptable monetary outcome. Monetary prospects have deteriorated; world and UK rates are higher than expected, the exchange rate is lower. Need a lower PSBR for a tolerable monetary outcome. Even on these proposals monetary prospect is worse than March.

PSBR Arithmetic (contd)

	PSBR	Interest Rates	£M3	Comments
4. Public expenditure with minimum additions	$6\frac{1}{4}$	Broadly as in (3)		Broadly consistent with the judgement underlying 20 October paper. No change in tax revenue needed to get back to interest rates in (3) - 20 October proposals.
5. Public expenditure with maximum additions	$8\frac{1}{2}$	see comment		Need £2-$2\frac{1}{2}$ bn extra tax revenue to get back to interest rates in (3) - 20 October proposals: eg 2-3p on standard rate.*
6. Public expenditure with maximum additions <u>plus</u> £1 bn allowance for extra defence	$9\frac{1}{4}$	see comment		A much worse monetary outlook than looked for on 20 October, or expected in March. Recorded PSBR equal to <u>crude</u> figures implied by 81 MTFS %. <u>Implies</u> that all temporary gain in revenue due to strike effects has been used to increase level of public spending. No account taken of adverse developments for interest rates either overseas or at home. Need £3-$3\frac{1}{2}$ bn extra tax revenues to get back to interest rates in (3) - 20 October proposals: eg 3-4p on standard rate.*

*A PSBR neutral increase in expenditure and taxes implies some increase in interest rates. Taxes have less effect on interest rates than public expenditure.

PRIME MINISTER

Public Expenditure

We have now received the Home Secretary's Report on the work of MISC 62 (attached).

He has made substantial progress in narrowing down the number of disagreed issues. The price of this has been that the base line is now £114.3 billion in 1982/83.

From conversations I have had with the Treasury and the Cabinet Office I am convinced that no further progress can be made on the remaining six issues except in meetings under your Chairmanship. The question is whether these should be meetings of the full Cabinet, or smaller meetings taking one item at a time.

It will be impossible to cover all these issues in the meeting of Cabinet on 26 November. There are just too many areas of disagreement. Equally, very great problems arise if the resolution of these difficulties is postponed much beyond 26 November. To meet a 9 March Budget Day departments need to get ahead with the compilation of their estimates. The later this process starts (and it cannot begin until the Cabinet has reached its conclusions) the less time there will be for Treasury scrutiny of the estimates. This will involve a real cost in savings foregone. Further, the Chancellor is arguing (in his minute of 12 November, also in this box) for an increase in National Insurance contributions. I understand that Norman Fowler is moving towards agreement, but that he attaches great importance to synchronising an announcement with his announcement of the public expenditure decisions. To get the new level of National Insurance contributions operative from the beginning of the financial year will mean a decision by the end of November. Quite apart from these practical problems, there are, it seems to me, overwhelming political and market reasons for reaching decisions on or very soon after 26 November: the House will expect the publication of the Industry Act forecast by the end of November,

/ and the impression

and the impression of dissension within the Government which will arise from delaying the announcement of these decisions will be unhelpful in the exchange and money markets as well as more widely.

I am, therefore, driven to the conclusion that you should hold a series of meetings next week on all six issues identified by the Home Secretary. The Chancellor of the Exchequer has indicated that if you are holding such meetings he would very much like to be involved. The Chief Secretary would need to be there as well as the spending Minister concerned. I am sure it would be helpful if the Home Secretary were also present.

Content for us to set up meetings on these lines? Content also for us to circulate the relevant attachments to the Home Secretary's minute to the Ministers concerned?

MCS

Yes mt

P.S. We have provisionally fixed a meeting on defence and FCO/aid on Thursday at 1830.

MCS.

12 November 1981

Econ Pol
Pub Ex

SECRET

HOME SECRETARY

6

PRIME MINISTER

PUBLIC EXPENDITURE

I attach the first draft of my report on public expenditure. This shows the progress made in reaching agreement both in bilaterals between the Chief Secretary and the spending Ministers and in my Ministerial Group (M.I.S.C. 62). It also identifies the issues which remain to be resolved. The purpose of this minute is to give you early advice on how things now stand so that you have an opportunity of holding meetings yourself to try and settle some at least of the outstanding issues before the report is circulated to the Cabinet.

A large number of programmes have now been agreed i.e. Industry (except for Regional Development Grants), Energy, Trade, E.C.G.D., Employment, Transport, Home Office, Education and Science, Arts and Libraries, Forestry Commission, Scotland, Wales and Northern Ireland and the External Financing Limits for all the nationalised industries. (I should of course point out that some of these programmes will be affected by our decisions on local authority current expenditure, and that the programmes for Scotland, Wales and Northern Ireland will be affected consequentially by outstanding decisions on some other programmes.)

As a result of the agreements on these programmes it is already clear that the public expenditure totals will be higher than those proposed by the Chancellor of the Exchequer and the Chief Secretary in C(81)50 and 51. Even assuming the lowest outcome for the programmes not yet agreed, the totals are increased by some £800 million in 1982/83 and the succeeding years. Certain of the proposals already agreed (e.g. on student grants, the "Christmas Bonus" for pensioners, the earnings rule for pensioners and prescription charges) are politically sensitive and this is brought out in the draft report.

SECRET

Leaving aside those matters which are under separate collective discussion (i.e. Regional Development Grants, and the two major and related issues of local authority current expenditure and housing) the remaining programmes which have to be settled are:

Defence;
F.C.O. (including O.D.A.);
Agriculture;
Other Environmental Services and P.S.A.;
Health;
Social Security.

My comments on these outstanding programmes are as follows:

a. Defence

We tried hard in M.I.S.C. 62 to reach agreement but, as you will have seen from the Secretary of State for Defence's minute to me of 3rd November and the Chief Secretary's response of 9th November, we have not been able to arrive at a solution. The sums at stake are £125 million in 1981/82, £374 million in 1982/83, £597 million in 1983/4 and £895 million in 1984/85.

b. F.C.O. (including O.D.A.)

The Foreign and Commonwealth Secretary sees great difficulty in making the savings proposed, and especially a cut of about £50 million a year in overseas aid. There is also an additional bid of £60 million in 1982/83 for aid to Poland which is under discussion in the OD Committee. The sums at stake overall are £128 million in 1982/83, £72 million in 1983/84 and £74 million in 1984/85.

c. M.A.F.F./I.B.A.P.

There is a major difference of view over capital grants; the Minister of Agriculture wants to increase them, mainly for the benefit of producers of agricultural equipment, but the Chief Secretary is seeking a reduction in either rates of grant or coverage. The Chief Secretary was prepared to make various concessions on the agricultural programmes (notably on hill livestock compensatory allowances and on the beef premium scheme) if the Minister would be prepared to agree to a small reduction in capital grants. Agreement could not be reached, and the Chief Secretary's offers therefore lapsed. The sums at stake on both programmes taken together are £93 million in 1982/83, £149 million in 1983/84 and £133 million in 1984/85.

d. Other Environmental Services and P.S.A.

On "other environmental services" the Chief Secretary proposed savings of £120 million in 1982/83 and £165 million in each of the later years. The Secretary of State for the Environment was willing to agree only to savings of £10 million in 1982/83 and £15 million in each of the later years. He accepted that the cuts proposed could be achieved but he thought it wrong in principle to reduce capital expenditure by local authorities and water authorities. M.I.S.C. 62 will however recommend that the Chief Secretary's proposed cuts should be made. So far as the P.S.A. is concerned, the Chief Secretary proposed a saving of £20 million a year over the period. The Secretary of State for the Environment agreed with M.I.S.C. 62 that this saving could be made but wanted other Ministers to realise that their programmes would inevitably be affected; this is being made clear in the report.

e. Health

There are major political issues relating to the level of expenditure on the hospital service, increases in existing health charges, and the introduction of new charges. Although there was a convergence of views between the Chief Secretary and the Secretary of State for Social Services on certain matters, we were unable to secure an overall agreement. M.I.S.C. 62 considered that it would be impracticable, mainly because of public commitments, to implement all the proposals for new charges. The sums at stake for the programme as a whole are £240 million in 1982/83, £427 million in 1983/84 and £543 million in 1984/85.

f. Social Security

This is by far the largest programme and one which is very sensitive politically. Although agreement has already been reached between the Chief Secretary and the Secretary of State for Social Services on some difficult issues referred to in paragraph 3 above, there are some major unresolved issues relating to the uprating of benefits not subject to an absolute pledge of price protection. These are set out more fully in the draft report; the sums at stake are £191 million in 1982/83, £562 million in 1983/84 and £589 million in 1984/85.

I am sure that we should make every effort to reach some accommodation on Defence and Overseas Aid before the Cabinet resumes its discussion on public expenditure. You may also feel that it is worthwhile to try and make more progress on some of the other outstanding programmes. I fear however that we have gone as far as we can in bilateral discussion and in M.I.S.C. 62. I hope that you will be willing to chair some informal meetings yourself with the relevant spending Ministers and the Chief Secretary. If you felt that it would be helpful for me to take part in any of these meetings, I should of course be ready to do so.

I am sending copies of this minute to the Chancellor of the Exchequer, the Secretaries of State for Scotland and for Industry, the Chief Secretary, Treasury, the Chief Whip and Sir Robert Armstrong.

WW.

11 November, 1981

DRAFT

PUBLIC EXPENDITURE

MEMORANDUM BY THE SECRETARY OF STATE FOR THE HOME DEPARTMENT

This memorandum:

(a) reports on progress so far towards agreeing plans for public expenditure, following discussions under my Chairmanship in the Ministerial Group on Public Expenditure (MISC 62) or elsewhere;

(b) lists the remaining programmes which have not been agreed and indicates the main questions still at issue between Treasury Ministers and other colleagues.

PROGRESS SO FAR

2. In his memorandum to the Cabinet on public expenditure (C(81)51) the Chief Secretary, Treasury proposed that planned public expenditure should be £113.5 billion in 1982-83, £118.1 billion in 1983-84 and £124.8 billion in 1984-85: respectively £3.6 billion, £4.2 billion and £5.2 billion <u>more</u> than the cash equivalent of the plans in the last Public Expenditure White Paper (Cmnd 8175); but £3.6 billion, £6.4 billion and £6.8 billion <u>less</u> than the total of Departments' proposals. Cabinet agreed on 20 October that in further discussions on public expenditure the aim should be to get as near as possible to the totals proposed by the Chief Secretary (CC(81)33rd Conclusions, Item 5).

3. Agreement has now been reached on most programmes, including the external financing limits for all nationalised industries. Brief details are in table 2 of Annex A. The present position is as follows. Taking account of progress so far both on agreed programmes and on programmes not yet fully agreed, the lowest possible outcome is £114.3 billion in 1982/83, £118.8 billion in 1983/84 and £125 billion in 1984/85. Leaving aside housing, local authority current expenditure and regional development grants, which are under collective discussion, the sums still at issue are £1.2 billion in 1982/83, £2.1 billion in 1983/84 and £2.5 billion in 1984/85. In

relation to housing, the comparable sums at issue (for the United Kingdom as a whole) are about £650m, £600m and £550m.

4. Certain proposals which have already been agreed are likely to provoke controversy. MISC 62 judged it appropriate to bring the most contentious and politically sensitive of these to the Cabinet's attention. They are as follows:

(a) Student grants

It is proposed that student grants should be reduced by 7½ per cent in real terms in each of the years 1982-83 and 1983-84 (ie approximately frozen in cash terms); and that there should be substantial increases in parental contributions. For example, parents with a residual income of about £8,300 would pay almost £200 more in 1983-84 than now; parents with a residual income of about £13,200 almost £500 more. These measures together will produce savings of approximately £60 million in 1982-83 and £130 million in each of the two subsequent years. The new parental contribution scales, and grant levels, will be set out in an Order subject to negative resolution.

(b) Pensioners' "Christmas Bonus"

All retirement pensioners have received a £10 payment each Christmas since 1972. It is proposed that from 1982-83 the bonus should be increased to £15; but paid only to supplementary pensioners, war widows, war disabled and pensioners over 80. A provision in the Social Services Bill will be necessary. The 1979 Election Manifesto commits the Government to continue the bonus, but there is no commitment as to its coverage. Saving: £50 million a year.

(c) Earnings rule for pensioners

We are committed by the 1979 Election Manifesto to phase out the earnings rule during this Parliament. It had been our intention to remove the earnings rule in November 1983, but no announcement to this effect has been made. It is now proposed that the earnings rule should not be phased out until 1984. Savings: £28 million in 1983-84 and £95 million in 1984-85.

(d) Prescription charges

Our policy of keeping prescription charges in line with cost increases would imply that they should increase in April 1982 from £1.00 to £1.15. It is now proposed that they should rise instead to £1.50. The extra increase would yield savings of £21 million in 1982-83 and 1983-84 and £23 million in 1984-85. Prescription charges are laid down in regulations subject to negative resolution.

5. In MISC 62's judgement, these measures should be taken in order to assist in achieving public expenditure totals as near as possible to those proposed by the Chief Secretary.

Property Services Agency (PSA)

6. MISC 62 agreed to a reduction of £20 million (about 4½ per cent) per annum in planned expenditure by the PSA. The Secretary of State for the Environment pointed out that, to the extent that the PSA are unable to find the required savings by speeding up disposals or increasing efficiency, other Ministers' plans and programmes will be adversely affected.

CONTINUING DISAGREEMENT

7. Expenditure totals have not been agreed for the following programmes: (Annex B gives an outline of the points at issue on each)

(i) Defence

(ii) Foreign and Commonwealth Office/Overseas Aid

(iii) Agriculture (Agricultural Departments and Intervention Board for Agricultural Produce)

(iv) Other Environmental Services

(v) Health

(vi) Social Security

8. I invite my colleagues to decide on the public expenditure totals for these programmes for the years 1982/83 and 1983/84, together with the consequentials for 1984/85.

£ billion

		1981-82	1982-83	1983-84	1984-85
1.	White Paper revalued and adjusted.	104.62	109.96	114.28	119.98
2.	Chief Secretary's proposals in C(81)51*	107.24	113.45	118.01	124.43
3.	Changes agreed (for programmes now fully agreed) since Chief Secretary's proposals	-	+ 0.55	+ 0.39	+ 0.13
4.	Range of outcomes for programmes not yet agreed	-	+ 0.28 to + 2.14	+ 0.43 to + 3.12	+ 0.44 to + 3.54
5.	Resulting total	107.24	114.28 to 116.14	118.83 to 121.52	125.00 to 128.10

* Adjusted for corrections since 20 October.

AGREED PROGRAMMES

£ billion

(a) Programmes other than nationalised industries			1981-82	1982-83	1983-84	1984-85
7.	Forestry	WP revalued	0.059	0.064	0.066	0.069
		Proposal 20/10	0.059	0.062	0.064	0.064
		Agreed	0.059	0.062	0.064	0.064
8.	Industry	WP revalued	1.970	1.460	1.006	1.056
		Proposal 20/10	1.972	1.353	0.854	0.874
		Agreed	1.972	1.401	0.858	0.873
9.	Energy	WP revalued	0.354	0.385	0.398	0.418
		Proposal 20/10	0.362	0.381	0.393	0.422
		Agreed	0.362	0.387	0.405	0.435
10.	Trade	WP revalued	0.287	0.302	0.284	0.298
		Proposal 20/10	0.288	0.289	0.269	0.284
		Agreed	0.288	0.291	0.276	0.278
11.	ECGD	WP revalued	-0.041	0.089	-0.039	-0.041
		Proposal 20/10	0.004	0.144	0.043	0.225
		Agreed	0.049	0.115	-0.011	0.125
12.	Employment	WP revalued	2.320	1.911	1.875	1.969
		Proposal 20/10	2.424	2.741	2.828	2.699
		Agreed	2.440	2.832	2.909	2.924
13.	Transport	WP revalued	2.840	3.036	3.237	3.400
		Proposal 20/10	3.252	3.182	3.300	3.381
		Agreed	3.252	3.197	3.315	3.396
17.	Home Office	WP revalued	3.263	3.529	3.785	3.974
		Proposal 20/10	3.411	3.639	3.920	4.111
		Agreed	3.411	3.639	3.920	4.111
19.	Education	WP revalued	11.315	11.667	12.104	12.709
		Proposal 20/10	11.785	11.952	12.284	12.680
		Agreed	11.785	11.990	12.330	12.735
20A	DHSS PSS	WP revalued	1.657	1.787	1.933	2.030
		Proposal 20/10	1.927	1.927	1.996	2.050
		Agreed	1.927	1.927	1.996	2.050
23.	Scotland	WP revalued	5.628	5.875	6.121	6.427
		Proposal 20/10	5.838	5.870	6.038	6.274
		Agreed *	5.838	5.922	6.130	6.378

£ billion

(a) Programmes other than nationalised industries		1981-82	1982-83	1983-84	1984-85
24. Wales	WP revalued	2.235	2.326	2.415	2.536
	Proposal 20/10	2.275	2.347	2.402	2.500
	Agreed*	2.275	2.360	2.434	2.538
25. Northern Ireland	WP revalued	3.223	3.419	3.630	3.812
	Proposal 20/10	3.272	3.480	3.645	3.868
	Agreed*	3.272	3.496	3.684	3.904

* Subject to formula consequentials of comparable proposals on non-agreed programmes and Welsh housing bid.

(b) Nationalised Industry programmes		1981-82	1982-83	1983-84	1984-85
1. Coal	WP revalued	0.866	0.792	0.652	0.685
	Proposal 20/10	1.117	1.026	0.973	0.962
	Agreed	1.117	1.026	0.973	0.962
2. Electricity (E&W)	WP revalued	-0.210	-0.499	-0.651	-0.684
	Proposal 20/10	-0.165	-0.419	-0.975	-0.860
	Agreed	-0.165	-0.319	-0.450	-0.530
3. Gas	WP revalued +	-0.390	-0.446	-0.825	-0.880
	Proposal 20/10	-0.317	-0.002	-0.341	-0.482
	Agreed	-0.317	-0.002	-0.077	-0.240
4. BNOC	WP revalued	0.360	-0.266	-*	-*
	Proposal 20/10	0.220	-0.120	-*	-*
	Agreed	0.220	-0.075	-*	-*
5. Steel	WP revalued	0.730	0.394	0.266	0.279
	Proposal 20/10	0.730	0.350	0.217	0.203
	Agreed	0.730	0.350	0.200	0.010
6. Telecom	WP revalued	0.180	0.032	-0.034	-0.037
	Proposal 20/10	0.380	0.340	0.222	0.244
	Agreed	0.380	0.435	0.335	0.335
7. Posts	WP revalued	0.011	-0.015	-0.015	-0.015
	Proposal 20/10	0.011	-0.050	-0.242	-0.206
	Agreed	0.011	-0.025	-0.025	-0.025
8. Giro	WP revalued	0.005	0.003	0.001	0.001
	Proposal 20/10	0.012	-	-0.007	-0.008
	Agreed	0.013	-	-	-
9. Shipbuilders	WP revalued	0.150	0.091	0.056	0.059
	Proposal 20/10	0.150	0.125	0.095	0.044
	Agreed	0.150	0.125	0.100	0.060
10 Airways	WP revalued	0.101	0.133	0.156	0.165
	Proposal 20/10	0.101	0.044	0.051	0.018
	Agreed	0.101	0.044	0.096	0.094
11. Airports	WP revalued	0.014	0.072	0.018	0.035
	Proposal 20/10	0.014	0.048	0.037	0.020
	Agreed	0.014	0.048	0.037	0.020
12. Railways	WP revalued	0.920	0.833	0.878	0.922
	Proposal 20/10	0.920	0.925	0.992	0.971
	Agreed	0.920	0.950	1.007	1.057
13. Docks	WP revalued	-0.005	-0.009	-0.008	-0.008
	Proposal 20/10	-0.005	-0.007	-0.010	-0.011
	Agreed	-0.005	-0.007	-0.010	-0.011

(b) Nationalised Industry programmes			1981-82	1982-83	1983-84	1984-85
14.	Freight Co	WP revalued	0·007	-0.002	-0.003	-0.003
		Proposal 20/10	0·007	-0.010	-0.016	-0.016
		Agreed	0·007	-0.010	0.001	0.003
15.	Bus Co.	WP revalued	0·075	0.077	0.084	0.089
		Proposal 20/10	0·075	0.071	0.069	0.065
		Agreed	0·075	0.071	0.074	0.074
16.	Waterways	WP revalued	0·032	0.033	0.035	0.037
		Proposal 20/10	0·032	0.036	0.039	0.041
		Agreed	0·032	0.036	0.039	0.041
17.	Scottish Electricity	WP revalued	0·109	0.224	0.240	0.252
		Proposal 20/10	0·109	0.265	0.254	0.233
		Agreed	0·109	0.245	0.254	0.233
18.	Scottish Bus	WP revalued	0·017	0.017	0.017	0.018
		Proposal 20/10	0·017	0.026	0.024	0.025
		Agreed	0·017	0.026	0.029	0.031

\+ Adjusted for gas levy in later years (ie not adjusted in 1981-82 because BGC has not been set a post-levy EFL)

* All 1983-84 & 1984-85 figures for BNOC now excluded

DEFENCE

£ million

	1981-82	1982-83	1983-84	1984-85
Cmnd 8175 revalued	12270	13624	14881	15625
Secretary of State's proposals	12754	14333	15816	17317
MISC 62's proposals	12629	13959	15219	16422
Gap	125	374	597	895

The Government is publcily committed to increase defence expenditure in real terms by 8 per cent up to the end of 1981-82 and by 3 per cent in each of the three subsequent years. The Cabinet has agreed that those volume targets should be translated realistically into cash and that the defence programme should then be expressed in cash terms. The question at issue, for the next three years, is what realistic translation into cash means. There is a related question concerning the cash limit for the current year.

2. The Secretary of State for Defence proposes that, in addition to the increase in the 1981-82 defence cash limit which has already been agreed to cover the 1981-82 armed forces pay settlement, the limit should be increased by a further £400 million to allow for increased prices of defence equipment; and that this increase should be carried forward into further years (£436 million in 1982-83, £462 million in 1983-84 and £485 million in 1984-85).

3. The Secretary of State also argues that planned expenditure on defence should allow for a 2 per cent annual increase in the future relative price of all defence expenditure other than pay, on the grounds that defence procurement involves the purchase of sophisticated equipment whose prices

typically increase more rapidly than the general price level. The cost would be £169 million in 1982-83, £381 million in 1983-84 and £643 million in 1984-85.

4. The Chief Secretary, Treasury argues that the evidence of recent years supports neither the case for an increase in this year's cash limit specifically to take account of higher prices nor the assumption of a positive relative price effect for defence equipment in future years. He points out that since 1977 the relative price effect for defence equipment has been either minimal or negative; and that the Ministry of Defence's own index of defence equipment costs shows a rise of only about 10 per cent over the last 12 months, compared with the 11 per cent factor used for non-pay items in drawing up 1981-82 cash limits. He contends that to incorporate into the Government's plans provision for a relative price effect for whose recent existence the evidence was so weak would permit defence contractors to agree to high wage demands and would remove pressure on the Ministry of Defence to limit costs. In bilateral discussions with the Secretary of State for Defence he has however accepted that there should be a special transitional addition to the 1981-82 cash limit to ease the pressure on the defence budget as the Government's plans for reshaping the defence programme are put into effect.

5. MISC 62 concluded that it would not be appropriate to translate the Government's plans for defence spending into cash terms other than by using the general expenditure planning factors unless a higher figure could be clearly and precisely justified. Nonetheless the Group recognised the special problems of the defence budget. The Group proposed that the special transitional addition to the 1981-82 cash limit should be £275 million; and

that there should be further special additions to planned expenditure in 1982-83, 1983-84 and 1984-85 of £250 million, £250 million and £225 million respectively. The Group invited the Secretary of State for Defence to consider whether he could agree to this approach.

6. In his minute of 3 November the Secretary of State for Defence has replied that he could settle on the £275 million addition to this year's cash limit, which the Group proposed, but that to do so would leave a risk of overspending; that it is unlikely that the 1982-83 figure can be settled until December, when he will probably wish to put before Cabinet difficult proposals for savings in defence expenditure which will probably be necessary anyway; and that for 1983-84 and 1984-85, he cannot accept MISC 62's proposals without colleagues' knowing of the consequences for the Government's defence effort, which will not be clear until early in the New Year.

7. The Chief Secretary, Treasury in a letter of 9 November has asked the Secretary of State for Defence to consider accepting the MISC 62 proposals as an overall package covering the four years 1981-82 to 1984-85. The offer for 1982-83 is conditional on there being no in-year review clause and no relative price effect allowance, and an agreement to plan to keep within the resulting cash provision. It is recognised that the Public Expenditure White Paper figures for 1983-84 and 1984-85 will be provisional.

FOREIGN AND COMMONWEALTH OFFICE (INCLUDING OVERSEAS DEVELOPMENT ADMINISTRATION)

£ million

	1982-83	1983-84	1984-85
Cmnd 8175	1575	1672	1755
Secretary of State's proposals	1657	1702	1781
Chief Secretary's proposals	1529	1630	1707
Gap	128	72	74

The Foreign and Commonwealth Secretary and the Chief Secretary, Treasury disagree about the level of expenditure on overseas representation, information and other external services; the Commonwealth Development Corporation (CDC); overseas aid; and aid to Poland.

Overseas representation, etc

2. The Chief Secretary proposes cuts of £10 million in 1982-83, £13 million in 1983-84 and £14 million in 1984-85. It is agreed that the BBC, the British Council and international subscriptions should be exempted; the reductions would represent about 3½ per cent of the remaining programmes concerned in 1982-83 and 4.4 per cent in 1983-84. Most of the cuts would need to be taken on overseas representation. The Foreign and Commonwealth Secretary argues that cuts of this order risk doing disproportionate damage to the United Kingdom's overseas interests. It would be necessary to close overseas posts, with harmful effects on British trade and diplomacy.

Commonwealth Development Corporation

3. At issue is the amount which the CDC should be permitted to borrow abroad. This borrowing, like that of the nationalised industries, is part of the public expenditure planning total. The Chief Secretary proposes that the CDC should be permitted to borrow £10 million per annum, the Foreign and Commonwealth Secretary £20 million per annum. He argues that to limit its borrowing to £10 million might lead its Chairman to resign; and that the CDC has considerable Parliamentary support, including among our own supporters.

Overseas aid

4. The Chief Secretary proposes cuts in the aid budget of £48 million in 1982-83, £49 million in 1983-84 and £50 million in 1984-85. The greater part of these savings would involve a general cut of about 3 per cent in overseas aid; but in the Chief Secretary's view, part of the savings arise because the 9 per cent cash factor for items other than pay over compensates for changes in the cost of the aid programme. Such cuts are technically feasible. The Foreign and Commonwealth Secretary argues that further cuts in the aid programme would raise political difficulties both within the United Kingdom and internationally; would be difficult to reconcile with the Prime Minister's remarks about the value of aid at the recent Summit meeting in Cancun; and would imply a 19 per cent cumulative real cut in aid expenditure since the Government took office.

Poland

5. The Defence and Oversea Policy Committee is to discuss on 12 November the possible provision of aid to Poland, for which the Foreign and Commonwealth Secretary proposes that £60 million will be needed in 1982-83. The Chief Secretary argues that no addition should be made to the programme.

AGRICULTURE

Agriculture Departments

£ million

	1982-83	1983-84	1984-85
Cmnd 8175 revalued	976	940	987
Total proposed by Minister	1103	1068	1064
Total proposed by Chief Secretary	1012	946	960
Gap	91	122	104

Intervention Board for Agricultural Produce (IBAP)

£ million

	1982-83	1983-84	1984-85
Cmnd 8175 revalued	593	620	651
Minister's proposal	664	661	677
Chief Secretary's proposal	662	634	649
Gap	2	27	29

At issue is the planned level of expenditure on seven items: hill livestock compensatory allowances; capital grants; marketing; land drainage; research, advisory services and administration; glasshouse heating subsidies; and the beef premium scheme run by the Intervention Board for Agricultural Produce (IBAP). Provisional agreement was reached in MISC 62 on a number of these items, as described in paragraph 10 below.

Hill Livestock Compensatory Allowances

2. The Minister of Agriculture, Fisheries and Food proposes that the existing provision for this service should be increased by £51 million in

1982-83, £58 million in 1983-84 and £64 million in 1984-85. This would permit rates of subsidy in 1982 on average 10 per cent above the 1981 rates and further increases in later years in line with the cash factors. The Chief Secretary points out that the rate of grant was increased substantially in 1980 and 1981 in response to the exceptional difficulties faced by hill farmers but that they are now benefitting progressively from the European Community sheepmeat regime; and that hill farming cannot be exempted from the general pressures on real incomes. He is nonetheless prepared to agree to an addition of £34 million per annum in the provision for these allowances, which would continue the 1981 rates and should produce a 25 per cent increase in real incomes between 1980-81 and 19~~82-83~~ 81-82. There is thus a gap of £17 million in 1982-83, £24 million in 1983-84 and £30 million in 1984-85 between his and the Minister of Agriculture's proposals.

Capital Grants

3. There is a gap of £60 million in 1982-83, £80 million in 1983-84 and £50 million in 1984-85 between the Chief Secretary's and the Minister of Agriculture's proposals for expenditure on farm capital grants. The Minister proposes that the rates and coverage of capital grants should be increased for two years only, at a cost of £30 million in 1982-83 and the same in 1983-84, to stimulate investment and employment in farming, food processing and the British agricultural machinery industry. The Chief Secretary argues that there is no case for singling out this sector for special assistance and that the effects of any short term stimulus would be more than offset by longer term damage from higher interest rates and inflationary pressures. MISC 62 is unable to recommend that this bid be accepted. The Chief Secretary also proposes reductions of about 30 per cent

in expenditure on capital grants (£30 million in 1982-83 and £50 million in the two subsequent years) either by cutting grant rates or by some combination of cuts in rates and making some items ineligible for grant. For either approach a statutory instrument with affirmative resolution would be required. The Minister of Agriculture argues that it would be wrong to reduce planned expenditure on these grants when latest estimates of their take up are £20 million a year less than expected earlier in the year and when the farming sector is facing particular difficulties. The Chief Secretary however points out that these latest estimates of take-up are little different from those implied by the last Public Expenditure White Paper.

Marketing

4. The Minister of Agriculture proposes expenditure of £2 million in 1982-83, £4 million in 1983-84 and £6 million in 1984-85 in support of more effective marketing of British agricultural and food products which would enable producers and processors to compete more effectively with other European industries. The Chief Secretary, Treasury argues that it is up to the industries concerned to improve their performance in this area. MISC 62 is unable to recommend acceptance of this bid.

Land Drainage

5. The Chief Secretary proposes cuts in land drainage capital expenditure, in addition to those which the Minister of Agriculture has already accepted, of £2 million in 1982-83, £6 million in 1983-84 and £10 million in 1984-85. He argues that such savings can be found without serious adverse effects.

The Minister considers that cuts of this order would mean reducing work to remedy inadequate defences of life and property, and preventing farmers from increasing their production.

Research, Advisory Services and Administration

6. The Chief Secretary proposes cuts of £4 million per annum in extra-mural research, equivalent to a small volume reduction. The Minister of Agriculture proposes that the cut should be £3 million per annum, removing the provision for real growth in Agricultural Research Council expenditure.

7. The Chief Secretary proposes savings in in-house research and advisory work of £5 million in 1982-83 and £7 million in each of the two subsequent years. He accepts that reductions of this order could imply redundancies and cuts in expenditure on travel and subsistence but considers that there is scope for economy in this service: other sectors of the economy do not get free advice of this kind paid for from public funds. The Minister of Agriculture argues that the front line advisory work of the Agricultural Development and Advisory Service is an essential component of our policy towards British agriculture.

Glasshouse Heating Subsidy

8. The Minister of Agriculture argues that £4 million should be made available in 1982-83 to assist in partially correcting the competitive disadvantage to British producers stemming from low Dutch gas prices. The Chief Secretary argues that, if agreed, this expenditure must be contained without an addition to the programme.

Beef Premium Scheme

9. The Chief Secretary argues that the scheme, which applies in the United Kingdom only, and only a quarter of the cost of which is reimbursed by the European Community, should be brought to an end, saving £2 million in 1982-83, £27 million in 1983-84 and £28 million in 1984-85. He argues that if the scheme were ended increased intervention buying would give beef producers comparable returns; and, because the costs of intervention buying are almost fully reimbursed from the European Community budget, ending the premium scheme from 1982-83 would give substantial net public expenditure savings from 1983-84 onwards. The scheme has to be considered for renewal at each Common Agricultural Policy (CAP) price fixing; the Chief Secretary points out that in seeking our Community partners' agreement to continuing the scheme we use up some of our negotiating capital and hence prejudice our wider interests on CAP reform. The Minister of Agriculture argues that ending it would adversely effect farmers' confidence and would involve publicly defending intervention buying and degrading beef on a much larger scale than at present. There would also be a small addition to the Retail Price Index.

Scope for Compromise

10. In MISC 62 both the Minister of Agriculture and the Chief Secretary suggested compromises on some of the questions at issue; but it did not prove possible to reach agreement. The Minister of Agriculture was prepared to accept an increase of £36 million a year in hill livestock compensatory allowances (which would permit a £~~3~~2 per head improvement in the rate for cows),* to drop his bid for additional provision for farm capital grants;

to accept the Chief Secretary's proposals for land drainage in 1982-83 and to split the difference between their proposals in the two later years; to accept the Chief Secretary's proposals for extra mural research and to find savings of £3 million, equivalent to a 2 per cent cut in administration expenditure, in other ways. All this was conditional upon the Chief Secretary's agreeing that there should be no cut in expenditure on farm capital grants and that the beef premium scheme should be retained. The Chief Secretary was prepared to agree the Minister of Agriculture's reduced proposals for the hill livestock compensatory allowances; to accept the Minister's revised proposals for savings on land drainage, extra mural research and on administration; and not to pursue the proposal to end the beef premium scheme in April 1982. These concessions however depended on the Minister's agreeing to a small reduction in expenditure on capital grants.

* Officials have now agreed that the cost of this would be £35 million.

B

OTHER ENVIRONMENTAL SERVICES (DOE - OTHER)

£ million

	1982-83	1983-84	1984-85
Cmnd 8175	3669	3875	4069
Secretary of State's proposals	3745	3914	4059
MISC 62's proposals	3635	3764	3909
Gap	110	150	150

34

The Chief Secretary proposes cuts of £85 million in 1982-83 and £100 million in 1983-84 and 1984-85 in capital expenditure by the Regional Water Authorities; and savings of £25 million in 1982-83 and £50 million in each of the two subsequent years in capital expenditure by local authorities on services within this programme (refuse collection and disposal, recreation, planning, assistance to industry, derelict land reclamation and coast protection).

2. The Secretary of State for the Environment points out that these reductions involve substantial cuts in public sector investment and would have an immediate and undesirable impact on the construction industry. Both water industry and local authority investment have, moreover, been drastically cut over the past few years.

80
110

300

60

3. MISC 62 recognises the force of the Secretary of State's objections to the cuts proposed. Given the choice, they are not the sort of reductions which the Government should be making. These reductions can however be easily achieved and involve neither legislation nor the breaking of public commiements. The Group recommends that the Chief Secretary's proposals should be accepted.

HEALTH

	1982-83	1983-84	1984-85
			£ million
Cmnd 8175 revalued	11612	12398	13018
Secretary of State's proposals as modified by discussion in MISC 62	11785	12586	13307
Chief Secretary's proposals as modified by discussion in MISC 62	11545	12159	12764
Gap	240	427	543

The totals above include the effects of the decision to increase prescription charges to £1.50 referred to in paragraphs 4 and 5 of the note; and the effects of increases in charges for dental treatment and spectacles which the Secretary of State for Social Services offered in discussion in MISC 62. They make no allowance for the savings which would result from certain other proposals on charges which the Chief Secretary put to MISC 62 (£2 fees for prescriptions, sight tests and consultations with general practitioners; "hotel charges" for stays in hospital; and half price prescription charges for most of those now totally exempt). MISC 62 judged these proposals to be impracticable; the Chief Secretary withdrew them in discussion in the expectation of reaching agreement on appropriate savings for the programme as a whole.

2. There remain at issue three questions concerning current expenditure on the Hospital and Community Health Service (HCHS); National Health Service (NHS) pay; and charging insurers for the cost of the NHS of road traffic accidents.

Hospital and Community Health Service

3. First, the Secretary of State proposes increases of £41 million in 1982-83, £44 million in 1983-84, and £48 million in 1984-85 to compensate for price increases in 1981-82 in excess of the cash limit factors. The Chief Secretary opposes these increases on the grounds that it is contrary to the principles of cash planning to validate or compensate for pay and price increases in excess of cash limit factors and so to lose the efficiency gains achieved in 1981-82.

4. Secondly, the Chief Secretary proposes that there should be no real growth in HCHS expenditure in 1982-83, saving £93 million that year and £98 million and £101 million respectively in the two following years. The Secretary of State for Social Services points out that the Government is publicly committed to match the real growth (1.7 per cent between 1981-82 and 1982-83) for which the previous administration planned. The Chief Secretary argues that it is necessary to reinterpret the pledge, as has been done in the past.

5. Thirdly, the Secretary of State proposes that the Government's plans should provide for 1 per cent real growth per annum in 1983-84 and 1984-85. The cost would be £86 million in 1983-84 and £182 million in 1984-85. The Chief Secretary considers that the plans should provide for no real increases in expenditure in those years, saving £86 million in 1983-84 and £182 million in 1984-85. The Government is not committed to any particular level of spending on hospitals after 1982-83; but the Secretary of State argues that it would be difficult to defend making no allowance for real growth in this area, bearing in mind for example the increasing proportion of old people in the population.

6. In discussion in MISC 62 both the Chief Secretary and the Secretary of State for Social Services suggested compromises on hospital expenditure but were unable to reach agreement.

National Health Service Pay

7. In his memorandum (C(81)44) the then Secretary of State sought agreement to increased expenditure to permit certain groups of NHS staff to receive increases of more than 4 per cent in the next pay round, and the proposal was discussed by the Ministerial Sub-Committee on Public Service Pay on 27 October. The Sub-Committee endorsed in principle the Secretary of State's proposal, but acknowledged that final decisions on the amount of any extra provision would have to be taken in the context of public expenditure generally. The sums at issue are £100 million in 1982-83, £106 million in 1983-84 and £111 million in 1984-85. The Chief Secretary has reserved final judgement on this bid.

Road Traffic Accidents

8. The Chief Secretary proposes that motor vehicle insurers should be billed for the cost to health authorities fo treating casualties in road traffic accidents, producing savings of £6 million in 1982-83, £93 million in 1983-84 and £101 million in 1984-85. The Secretary of State accepts that there are good arguments in principle for charging insurers in this way, but doubts whether the Government could agree on how this should be done and get the necessary legislation through Parliament. The Home and Social Affairs Committee has twice considered and rejected this idea. MISC 62 took the view that there is no reasonable prospect of the necessary

legislation being passed in the 1981-82 session. (If the legislation were deferred to the 1982-83 session, the savings would be nil in 1982-83, £45 million in 1983-84 and £101 million in 1984-85).

National Health Contribution

9. In discussion in MISC 62 the Secretary of State suggested that it might be possible to make good the gap between the Chief Secretary's and his proposals for this programme by increasing the National Health contribution. This would be a tax change, not a reduction in public expenditure.

SOCIAL SECURITY

			£ million
	1982-83	1983-84	1984-85
Cmnd 8175 revalued	30,197	31,819	33,410
Secretary of State's proposals as modified by discussion in MISC 62	29,894	31,609	33,644
Chief Secretary's proposals as modified by discussion in MISC 62	29,703	31,047	33,055
Gap	191	562	589

The totals above include the effects of the decisions on the pensioners' Christmas bonus and phasing out the earnings rule for pensioners discussed in paragraphs 4 and 5 of the note.

2. There are three questions at issue.

Invalidity pensions

3. The Secretary of State proposes that at the November 1982 uprating of social security benefits the Government should make good the 5 per cent abatement in invalidity pensions which was made in 1980. The cost would be £18 million in 1982-83, £54 million in 1983-84 and £58 million in 1984-85. He argues that at least one specific improvement in social security is necessary to provide some defence against critics of the Government's actions in this area; that the 1980 decision to abate invalidity pensions has been widely criticised as an attack upon the disabled and chronically sick; and that to restore it in the International Year of the Disabled would be a popular measure. The Chief Secretary argues that the abatement should

be restored when benefits become taxable, as we have undertaken to do; but not before. MISC 62 agreed that, if the Secretary of State is to be obliged to defend unpopular cuts in the social security budget, it would help him considerably to be able to point to a specific improvement, such as this. On the other hand, the Group agreed that it would only be reasonable to agree to a bid of this sort if the Chief Secretary's proposals for the programme as a whole were substantially accepted.

Shortfall in non-pensioner supplementary allowances

4. The Secretary of State proposes that at the November 1982 uprating the Government should make good the 2 per cent by which, because of the under-estimate of inflation in the November 1981 uprating, supplementary allowances paid other than to pensioners will have fallen in real terms. The cost would be £28 million in 1982-83, £68 million in 1983-84 and £71 million in 1984-85. (The Chief Secretary's proposals already allow for restoration of the same shortfall for retirement pensions and other benefits whose real value the Government is pledged to maintain. No such pledge exists in this case). He argues that it would be difficult to do otherwise, since in 1981 the Government held down the uprating of these allowances to make up for the extent by which at the 1980 uprating inflation had been over-estimated.

Abatement of November 1982 uprating

5. The Chief Secretary proposes that in the November 1982 uprating short term benefits not subject to an absolute pledge of price protection should be increased by 5 per cent less than the increase in the Retail Price Index.

The main such benefits are supplementary allowances, unemployment benefit, child benefit, sickness and injury benefit and maternity allowances. The saving would be £145 million in 1982-83, £440 million in 1983-84 and £460 million in 1984-85. He argues that such a decision could be defended on the grounds that the incomes of those at work, some of them not much better off than some recipients of supplementary benefit, are increasing less rapidly than prices. The Secretary of State argues that such a decision would be inconsistent with the basis of the Government's social policy.

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Econ PSR RH

Original filed on:-

Manpower: Special Employment Measures: Pt 6

10 DOWNING STREET

From the Private Secretary

11 November, 1981

BF ?

MSC Estimate of Cost of Unemployment

You kindly provided a note for the Prime Minister's use at Question Time yesterday on the Financial Times report of 9 November about the costs of unemployment.

The Prime Minister was yesterday enquiring about the reasons why currency had been given to an estimate on this basis. The estimate of a cost of £4,380 per person a year, as I understand it, rests on the assumption that each unemployed person would, if they re-entered employment, do so in the private sector so that their payments of income tax, national insurance contributions and indirect taxes would all be sourced other than from the Exchequer.

The Prime Minister would like consideration to be given to an alternative method of presenting this figure in future; and to an alternative way of commenting on the published figure. Would not the cost of unemployment be better expressed purely in public expenditure terms in the first instance (i.e. unemployment benefit plus ERS plus rent and rate rebates)? The answer could then go on to give several different estimates of the revenue foregone on different bases - including the basis of the present estimate that all the unemployed if employed would pay their taxes from non-publicly financed incomes.

I am sending a copy of this letter to Richard Dykes (Department of Employment).

M. C. SCHOLAR

John Kerr, Esq,
HM Treasury

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NEW MSC ESTIMATE OF COST OF UNEMPLOYMENT - REPORT IN FINANCIAL TIMES, 9 NOVEMBER 1981

1. The Financial Times report arose from the answer to a written Parliamentary Question from Sir David Price. A copy of the question and answer is attached.

2. MSC's Review of Services to the Unemployed was published in March 1981. It gave a figure, quoted in the question, of a cost of about £300m at 1979/80 prices for each additional 100,000 unemployed. It also explained in some detail how the figure was arrived at. A copy of the relevant extract is attached.

3. In February 1981, the Treasury published in its Economic Progress Report a figure of £3,400 (at 1980/81 prices) for the average annual cost of one unemployed person. The Treasury's current estimate of the average annual cost of unemployment for 1 person is £4,300 at 1981/82 prices - very close to the MSC figure quoted in the answer.

4. The Treasury and the MSC use essentially the same method to arrive at their estimates (although there are some relatively minor differences in approach) and the Treasury were consulted over the figure now published.

5. Max Wilkinson, the author of the article, contacted the MSC Press Office on Friday. He asked for the figures given in the table in the article, to update a similar table which was published with the original estimate. The figures of some £2bn each for the cost of unemployment and supplementary benefit in 1981/82 have already been given in answer to a PQ to DHSS. (Monday 19 October, Hansard Volume 10, Col 65, Answer by Mrs Chalker).

6. The increase between this latest MSC estimate and the estimate given in March is 46%, compared to an increase of some 30% in retail prices between the periods of the

two estimates. The higher increase than in retail prices partly reflects the increase in the proportion of better paid people and people with dependants becoming unemployed as unemployment rises.

2.20 Table 2.1 quantifies each of the main costs incurred in 1979/80, when the average unemployment level was 1.335 million. Total sums paid out to the unemployed are based on accounting records, and revenues forgone have been estimated using a weighted sum of the losses associated with particular categories of unemployed persons.

Table 2.1
Financial costs of unemployment

		£ million (1979/80 prices)	
(a)	flat rate unemployment benefit	570	
(b)	earnings related supplement	90	
(c)	supplementary allowances	725	
(d)	rent and rate rebates (supplementary allowances recipients only)	45	
(e)	SUB-TOTAL: TRANSFER PAYMENTS [(a) to (d)]		1430
(f)	income tax	1,330	
(g)	national insurance contributions	920	
(h)	indirect tax	275	
(i)	SUB-TOTAL: REVENUES FORGONE [(f) to (h)]		2525
	NET FINANCIAL COST [(e) plus (i)]		3955

2.21 The estimated net financial cost in 1979/80 of unemployment of 1.335 million is nearly £4,000 million, or some two-fifths of the 1979/80 Public Sector Borrowing Requirement (PSBR). These costs could not be fully eliminated, but reducing unemployment to the assumed minimum sustainable registered unemployment level of 700,000 would almost halve these financial costs down to £2,075 million. (This makes no allowances for changes in national insurance contribution rates at lower unemployment levels). Taking these estimates as a broad indication of the costs associated with further rises in unemployment would imply that each additional 100,000 registered unemployed would cost about £300 million per annum at 1979–80 prices in transfer payments and revenues forgone. Unemployment at 2 million costs about £3,850 million per annum above the "minimum sustainable" cost of £2,075 million or £5,925 million in all. At 2½ million unemployed the total costs would be £7,405 million.

...rced up

well into the next century. The Kingdom's proven reserves were likely to be far higher than present estimates would suggest —around 170bn. Its published reserves (which compare with world-wide reserves of some 650bn barrels) were based on the amount of oil located by exploration and production wells, he said.

The estimates took no account of the extent of reservoirs indicated by seismic exploration work. "If we applied the same method of evaluation as Mexico you would be amazed. You would have to fasten your seat belt," he said.

The Kingdom was discovering oil at about the same rate as its production—around 8.5m barrels a day.

Sheikh Yamani also dismissed industry reports that Saudi Arabia was considering building up a strategic petroleum reserve similar to the reserve stocks being put in place by the U.S. Saudi Arabia was evaluating the development of storage facilities to alleviate any transportation bottlenecks at loading terminals, he said.

It was unlikely that this storage would handle more than a week's supply of exported crude oil or four weeks' supply of refined products—normal development for an exporting country.

...ocrats hit ...ves to right

making regional nationalism an overriding issue in the French-speaking South.

Under Belgium's complex proportional representation system the final results apportioned on a provincial basis, will not be known until later today.

All the big Belgian political families — the Christian Democrats, Socialists and Liberals — were this morning heading for roughly equal representation in parliament, with about 60 seats each. This could make the task of forming a government even more difficult than usual.

While a combination of any two of the three main parties would give them a majority, a coalition of the Flemish-

...at BP accept 8.1% rise

By Philip Bassett, Labour Staff

TANKER DRIVERS at BP have voted decisively to accept the company's 8.1 per cent pay offer in a move which throws into confusion the prospect of what would effectively be an all-out national drivers' strike from next Monday.

Full results of voting by the company's 2,000 manual distribution workers — the first of the 20,000 in the major companies to vote — will not be disclosed until BP shop stewards meet negotiators from the Transport and General Workers' Union in London today.

However, unofficial shop stewards calculations over the weekend estimate that the vote to accept the offer, depot by depot, has gone about 18—6 in favour.

Neither the company nor senior TGWU officials were able to confirm the decision last night. The drivers and distribution workers in BP are considered to be traditionally more moderate than those employed by other major oil companies.

The BP vote will cause division in the drivers' ranks. It will throw the strike called for by the TGWU from next Monday by drivers in all the companies into considerable doubt, since negotiations, including acceptances of offers, tend to follow each other in the industry.

However, some shop stewards are convinced that more militant regions, particularly London, may well take action despite such votes as the BP decision.

They feel this could create further confusion. Since the strike has official TGWU support, the union might well bring considerable pressure to bear on any drivers who had voted to accept the deal to strike.

The firmness of the union's resolve over the dispute, following the collapse last week of the BL pay strike, was emphasised yesterday by Mr Alex Kitson, the TGWU acting general secretary. He was reported in a newspaper interview as saying that he wanted to bring out the tanker drivers to try to force an economic U-turn, or even a General Election, on the Government.

The Government has pre-

Continued on Back Page
Pay talks this week, Page 6

...person costs £4,380 a year

BY MAX WILKINSON, ECONOMICS CORRESPONDENT

EVERY EXTRA unemployed person costs the Exchequer £4,380 a year, an increase of 46 per cent compared with the cost two years ago, says the latest official estimate.

It shows that unemployment costs have risen at one and a half times the rate of inflation for the period, and suggests that on the basis of present tax and national insurance rates total cost of unemployment this year will be £12.45bn.

The figure, from the Manpower Services Commission, includes direct cost of benefits and lost tax which would have been paid by the unemployed had they stayed in jobs.

8 per cent of men and 47 per cent of women earn less than the latest estimate of what it would cost the State to keep them on the dole.

The main reason for the steep increase in the costs of unemployment is that a large proportion of skilled and better paid workers have been thrown on to the dole in the last two years.

Consequently, direct cost of earnings-related benefits has gone up, and so has loss from the taxes and national insurance contributions which the Exchequer has foregone.

In 1979-80 the MSC put the total cost to the Exchequer of

MSC ESTIMATE OF COSTS OF UNEMPLOYMENT 1981/82
(Assuming average 2.84m unemployed)

	£bn
Unemployment benefit	2.004
Supplementary benefit	2.000
Loss of income tax	4.257
Loss of NI contributions	3.280
Loss of indirect taxes including VAT	0.906
TOTAL	12.447

The new estimate will be important ammunition for those economists and Conservative Party dissidents who have been urging the Government to start a programme of reflation. For it indicates that every new job created would result in an average saving of £4,380 a year for the Exchequer, much more than was previously thought.

This saving could be set against cost to the taxpayer of any job-creating programme.

The calculation applies, however, only to jobs created in the private sector. For new jobs in the public sector, the saving would be somewhat less.

The new estimate has taken many officials in Whitehall by surprise because it is much higher than the most recent calculation of the Treasury in February, which put the cost of additional unemployment last year at £3,400 per person.

Both estimates are made on a similar basis, but on slightly different assumptions. Last night the Treasury said it was not ready to release its own estimate for unemployment costs this year.

It seems likely that when it does so, a sharp increase will be shown over its previous figure, for 1980-81.

The MSC's estimate, which puts total cost of keeping an extra person unemployed at £84 a week, is about 70 per cent of the average wage of men in manual work. According to the Government's most recent earnings survey, about

each additional 100,000 registered unemployed at £300m. The latest estimate of £438m per 100,000 this year, given in a Department of Employment written Parliamentary answer is a 46 per cent increase. In the same period the retail price index has gone up by only 30 per cent.

The Treasury's estimate that the cost of an extra 100,000 unemployed was £340m last year leaves out loss of indirect taxes such as Value-added Tax as a result of the fact that people on the dole have less spending power than if they had remained in work.

This loss of indirect taxes amounts to about £320 a year per person this year, according to the MSC's estimate.

The Treasury says it would be theoretically incorrect to calculate total cost of unemployment by multiplying the cost to the Treasury for each extra unemployed person by the total number on the dole.

If all the present unemployed were back at work, the whole economy would be transformed so that tax rates and insurance contribution rates would probably be different, it adds.

However, the MSC has in fact made a rough estimate of the total cost, assuming present tax and contribution rates.

This comes to a total of £12.45bn on the basis that the average number of registered unemployed this year will be 2.84m.

Clare plan for recovery, Page

DEPARTMENT OF EMPLOYMENT

WRITTEN REPLY

MONDAY 19 OCTOBER 1981
WEDNESDAY 28 OCTOBER 1981

319 SIR DAVID PRICE (Eastleigh): To ask the Secretary of State for Employment, if he will bring up to date the figures quoted by the MSC in their report entitled "Review of Service for the Unemployed" that each additional 100,000 registered unemployed cost about £300 million per annum at 1979-80 prices in transfer payments and revenues foregone.

MR MICHAEL ALISON REPLIED:

Pursuant to his reply /Official Report 22 October 1981 Vol 10 Col 147/ gave the following information:

The Manpower Services Commission estimate that each additional 100,000 registered unemployed cost £438 million per annum, at 1981-82 prices, in transfer payments and revenues foregone.

Background Notes

1. The Exchequer cost figure given in this draft reply is based on two main assumptions:

(a) In the period 1981/82 the average level of registered unemployment (including school leavers and temporarily stopped workers) will average 2.84 million.

(b) In this period the minimum sustainable level of unemployment will be 0.7 million.

2. The Exchequer costs of 2.84 million persons registered as unemployed in 1981/82 are estimate to be as follows:

A TRANSFER PAYMENTS:

1. Unemployment benefit (including ERS)		£2,004 mill
2. Supplementary benefit		£2,000 mill
	SUB-TOTAL	£4,004 mill

B REVENUE FOREGONE:

3. Income tax		£4,257 mill
4. National Insurance contributions		£3,280 mill
5. Indirect taxes		£ 906 mill
	SUB-TOTAL	£8,443 mill
	GRAND TOTAL	£12,447 mill

3. The total cost to the Exchequer of 2.84 million registered unemployed persons in 1981/82 is therefore estimated to be £12,447 mill. Lowering this level of unemployment to the minimum sustainable level of 0.7 million would reduce total Exchequer costs to about £3,068 million pa. This implies that each additional 100,000 registered unemployed would cost about £438 million per annum in transfer payments and revenue foregone.

4. Data on the level of transfer payments relating to 2.84 million unemployed have been obtained from DHSS. The associated level of revenues foregone has been estimated on the basis of the following assumptions:

(a) Persons entering unemployment earn 80% of national average gross weekly earnings for all workers. In July 1981 this national average is estimated to have been £108 (ie on the basis of the April 1981 New Earnings Survey, updated by the Department of Employment's index of average earnings).

(b) The average rate at which income tax would have been payable is assumed to be 25%

(c) 70% of the newly unemployed wouldhave been contracted into the State pension scheme for National Insurance purposes. 30% would have been contracted out of the scheme.

(d) Indirect taxes would have been payable at the rate of 20% of net disposable income. 25% of the newly unemployed are assumed to avoid any reduction in their disposable income by dissaving and/or borrowing. The marginal propensity to consume is assumed to be 0.9.

(e) 75% of persons entering unemployment register as unemployed.

5. Independent estimates of the Exchequer cost of unemployment have been made, and are being refined, both by the Department of Employment and H.M. Treasury. Although the approach used by MSC and these Departments in estimating the Exchequer cost of unemployment is broadly similar, Departmental estimates vary due to differences in the detailed assumptions adopted and in the coverage of Exchequer costs estimated.

6. MSC current estimates of the Exchequer cost of unemployment are 46% above those shown in the "Review of Services to the Unemployed". This exceeds the 30% rise in the Department of Employment's index of retail prices in the period July 1979 to July 1981 due to changes in assumptions which have now been made on the basis of more recent data. These changes in part reflect the tendency for the characteristics of the unemployed to more closely match those of the working population as a whole as unemployment rises to relatively high levels.

CONFIDENTIAL

cc. A. Duguid
A. Walters
J. Vereker.

DEPARTMENT OF EDUCATION AND SCIENCE

ELIZABETH HOUSE, YORK ROAD, LONDON SE1 7PH

TELEPHONE 01-928 9222

FROM THE SECRETARY OF STATE

Prime Minister

This is relevant to tomorrow's RSG Cabinet discussion.

The Rt Hon Leon Brittan QC MP
Chief Secretary to the Treasury
Parliament Street
London
SW1

11 November 1981 MLS 11/11

Dear Leon,

PUBLIC EXPENDITURE

Following our discussion on Monday evening I have been able to consider further the balance of Vote and local authority expenditure within my programme and I am glad to let you know that, subject to what I say below, I can accept one of the propositions which you put to me.

see para 3 of C(81)54

The factor, that is the need for realism, which led to your own proposal for a reserve of £500m in 1982-83 and to Michael Heseltine's proposal for an addition for England of some £350 in respect of spending by local authorities in 1982-83 applies equally of course to education which therefore needs a substantial share of any extra resources. However the proposals for the rest of my programme will exacerbate real difficulties for the universities and will raise serious political opposition for the Government in relation to support both for the universities and science. My most pressing requirement is for the additional £8½m for Vote expenditure (ie the outstanding £7½m for science about which I wrote to Willie Whitelaw on 4 November together with about £1m for the universities and the MRC as a consequential of the recommendation from E(PSP) about NHS pay - assuming this is agreed by Cabinet). The £7½m is especially important because, although allocated to the Research Councils, about half of it will be spent in support of research in the universities.

On the assumption that there is support for the additional local authority expenditure and, in the interests of reducing public expenditure as well as of securing a better balance for my programme, I am prepared to accept £155m (instead of £255m) as education's share of the addition proposed by Michael - hence foregoing £100m and reducing the total addition to around £250m. If that total is agreed, I should expect that, for later years, education's share would be increased by the same amount (£155m) compared with the figures in the annex to C(81)51. If a higher total is agreed, I should of course expect an appropriate increase in the share for education in 1982-83 and later years.

I thus accept your offer and, on this basis, you agreed to support in MISC 62 my bid for the additional £8½m in my Vote expenditure for 1982-83 and later years. This is without prejudice to any proposals I may need to put forward later on university costs in the light of their redundancy needs.

CONFIDENTIAL

Since this is all relevant to tomorrow's discussion, I am sending copies of this letter to the Prime Minister, Willie Whitelaw, Michael Heseltine and Robert Armstrong.

Yours ever,

Keith

Mr Whitmore

Thanks. MCS 20/11

Public Exp

10 DOWNING STREET

Mr Ingham

This is a good paper by Mr Ingham. You may want to glance at it. He is due to discuss it with Mr Pym next Thursday.

MR. WHITMORE

You should see the attached paper which is for discussion later this week with Francis Pym. It represents the views of my colleagues, Messrs. Gaffin, Vereker and Ms. Drummond, and Heads of Information in Treasury, DoE, DHSS, D/Employment, D/Energy and D/Industry.

B. INGHAM
10 November, 1981

PUBLIC EXPENDITURE - PRESENTATION

This paper sets out, for purposes of discussion by the Lord President with members of the MIO Economic Group, the presentational problems arising over the period to the Christmas Recess, primarily from the annual public expenditure review, and how the end of November package of economic announcements should be harnessed to restore confidence in the strategy.

BACKGROUND

The Government is widely seen to be split over priorities - i.e. whether the top priority should be the containment of inflation or whether there should be a somewhat looser approach to the Medium Term Financial Strategy (MTFS) with the objective, if possible, of easing unemployment - if necessary, at the expense of the control of inflation. This clash is conveniently (but superficially) presented by the media as the familiar struggle between "wets" and "drys". The public's perception is nonetheless reasonably accurate - not surprisingly since Ministers have assiduously fed the media with blow-by-blow accounts of the public expenditure debate.

In practice, the argument is much more complex. The Cabinet is not disposed to abandon the MTFS, difficult though it may be to adhere strictly to it. It recognises that there is limited room for manoeuvre. In an ideal world it would like to reduce unemployment and continue to bring down inflation. But since the world is not ideal, there is a painful conflict between heart and brain. This is all the more painful because it is recognised that the reflation required substantially to lower unemployment exceeds all reasonable prospect and would, if undertaken, give a powerful new boost to inflation.

Unfortunately, heart has ruled the brain again this year and the public has not merely been given a yardstick by which the

/success

success or failure of the wets and drys will be measured (an MTFS overshoot of £7 billion); it has been conditioned to expect dastardly cuts in services of one kind or another - e.g. education, social security - regardless of the fact that the Government will be spending at least £3.5 billion more than it planned under MTFS.

In short, the Government has got itself into the worst of all possible worlds:

- it is in public conflict within itself;

- while it is most certainly going to spend a lot more than it planned, it is publicly perceived to be slashing expenditure yet again;

- when all is settled, its expenditure will be seen to be way over target and so doubt will be cast upon the integrity of its strategy, with possible consequentials for the exchange and interest rates; and

- unless there is a fundamental break with the past, onefaction or the other will claim a victory and perpetuate the split.

This is no way to run a railway.

In such circumstances (which are regrettably familiar to Chief Information Officers),an inordinate load is placed on presentation. Where do we go from here?

OUTLOOK

There is little prospect that the Government will take greater care of itself. The rot of competitive leaking has gone

/too

too far this time round. It has therefore to be recognised at the outset that whatever Information Officers do - and however brilliantly they do it - they are rowing against a tide which, unless controlled, could destroy the Government.

In short, if the Government itself won't look after its own interests, there is not a lot the Government Information Service can do to help it.

DOING OUR BEST

Having said that, we now need to consider how best the Government can bring together the strands of the public expenditure review and most positively and convincingly present it to the country to the common good. There are a number of elements:

- the overall figures, with the public now partially conditioned to expect an additional expenditure of at least £3.5 billion (£113.5 billion) over and above the figure implied by the MTFS but knowing that savings of £3.5 billion have to be found if the £7 billion overrun of bids is to be eliminated;

- the Departmental consequences - and especially those (e.g. social security, educational grants, local authority RSG) which directly affect the individual's pocket; this includes nationalised industry EFLs and RSG;

- the fiscal consequences, taking account of the trend of revenue;

- reconciliation of the outcome with forecasts - e.g. Industry Act, Government Actuary - of unemployment, inflation and pay increases;

- the powerful influence, for good or ill, of pay bargaining in both the public and private sectors.

/In

In the perfect world, the Government would take due time in secret to resolve all these issues and then present them in a single announcement, backed up by individual Departmental exposition of how they fit into the composite whole.

Given that the world is imperfect - and knowing that the Cabinet's discussions will be retailed to the media - there is still a powerful case for bringing the maximum number of decisions together in one statement as soon as possible after those decisions have been taken.

It seems unlikely that any such statement could include the RSG decision. That is a pity because it would be better to get as much as possible out of the way at once. But on that principle we ought to try to bring together the overall decisions on public expenditure, backed up by Departmental expositions, with the Industry Act and Government Actuary reports in one single statement to Parliament which emphasises the crucial nature of pay bargaining NOT primarily to the Government but to the livelihoods of those directly concerned and the unemployed.

Our overall purpose should be to present a coherent picture of the Government's economic policy, and especially its approach to public expenditure in 1982-83 and beyond, explaining:

- what the prospects are and why there are grounds for confidence;

- how the public expenditure decisions will affect particular sections of the community;

- how we are prudently adapting our strategy to difficult circumstances without throwing it overboard;

- how this adaptation is possible and how it can be reconciled with the Government's overall objectives of containing inflation and providing secure jobs based on a competitive economy;

/the

- the choices that have been faced and why they have been selected or rejected; and

- the crucial nature of the pay element to the country's performance and prospects (with an explanation of how the earnings increase forecast of 7.5% is compatible with a 4% pay factor).

CONCLUSION

Such an approach would give the Government the best chance of coming out of a bad (and eroding) situation with most credit. It would require Ministers to gear themselves and their Departments up well in advance of final decisions. It also implies a common will and purpose to act as a determined Government.

B. INGHAM

9 November, 1981

CONFIDENTIAL

cc JV AD AW. Econ Pol ②

Prime Minister

A further reason for the caution you have expressed

MLS 9/11

DEPARTMENT OF EDUCATION AND SCIENCE

ELIZABETH HOUSE, YORK ROAD, LONDON, SE1 7PH

TELEPHONE 01-928 9222

FROM THE PARLIAMENTARY UNDER-SECRETARY OF STATE

The Rt Hon Sir Geoffrey Howe MBE MP
Chancellor of the Exchequer
Parliament Street
London SW1P 3EB

9 November 1981

MS

Dear Geoffrey,

NHS PAY AND THE UNIVERSITIES attached AND RESEARCH COUNCILS

In your minute of 30 October you reported to the Prime Minister E(PSP)'s endorsement in principle of a proposal to put extra cash at the disposal of the NHS to permit the April 1982 pay settlements for doctors and dentists and certain other NHS employees to go beyond the 4% pay factor.

If this is confirmed in Cabinet, there will be direct financial consequences for the universities and the Medical Research Council and the like in respect of those of their staff (for example, the clinical medical teachers) whose pay increases are directly governed by those in the NHS. May I take it that you will agree whatever addition is needed in my Votes to meet whatever Cabinet decides for the NHS? You will know from the proceedings in MISC 62 that there is no possibility of finding the additional sums, even though they be only of the order of £1m - £2m, from the provision now remaining for the universities and the Research Councils.

I am sending copies of this to the Prime Minister, to other members of Cabinet, to Sir Robert Armstrong and to Mr Ibbs.

Yours,

Keith

CONFIDENTIAL

WR

Prime Minister 3

I really don't mind it will be possible for you to meet the Chairmen, and you had already agreed that Mr Channon should see them on your behalf. A letter to Lord Goodman is attached.

WR 9/11

PRIME MINISTER

1. You spoke to me recently about the letter which you had received from the Chairmen of the four major national performing arts companies.

2. I recently received a deputation from the directors. They are obviously very concerned about the future, given what they already know about the arts budget from the Public Expenditure White Paper. MISC 62 have now agreed that the cut in the arts programme is to be less severe than was originally proposed, and there will be no need for drastic reductions. But even so cash grants will fall short of what is needed to keep pace with costs and there may be as much as a further 3 or 4 per cent squeeze on these companies in real terms. This will very difficult but probably just about manageable. The same is true for all the arts bodies, from the British Museum downwards. But I am afraid that the present arts budget makes that inevitable.

3. The Chairmen would of course very much like to see you. But if this is not possible I will certainly do so, and send you a report.

4. My Private Secretary is sending a draft reply to the letter.

P.C.

PAUL CHANNON

9 November 1981

MS

PRIME MINISTER

Public Expenditure: MISC 62

I have been taking some informal soundings from contacts in the Treasury about how the public expenditure exercise is going.

I understand that both the Chief Secretary's bilaterals and the MISC 62 exercise are usefully narrowing down the area of controversy and generating some worthwhile savings. But there are some very large upward pressures: I gather that local authority current expenditure is likely to be £½ billion higher than the Chief Secretary's paper took account of, because the 1981/82 out-turn is beginning to look worse than expected. An extra £½ billion on housing is also a prospect, given that colleagues are doubting that the rent increases envisaged by the Chief Secretary are practicable. You are aware of the difficulties with defence. On the health and social services side, too, there are great difficulties, centring on the political difficulty of abating the uprating of the non-pledged benefits.

All this is likely to mean that that the base line will be £1 billion or so higher than the £113.5 billion in the Treasury's papers.

This is all informal at the moment. If you wish to keep up to date with the progress of the review more formally the Duty Clerk has a folder of MISC 62 papers and minutes. But I am not troubling you with this mass of paper, since the important issues will be put to you when the Home Secretary minutes you on the upshot of his discussions next week.

MCS

6 November,1981

bc Vereker
Duguid
Hoskyns

cc HO SO D/N
LCO WO D/M
FCO WPSO
DES Ind. PGO
LPO D/Trade CO
NIO D/Trans CPRS
MOD DHSS
MAFF CSO
DOE CDL

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CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary

6 November 1981

Dear John,

National Health Service Pay

The Prime Minister has noted the Chancellor's minute of 30 October on pay and cash planning in the National Health Service.

She has commented that the question whether the special treatment proposed for certain staff groups in the NHS should be given and whether extra provision should be found for this purpose must depend on the progress of the public expenditure exercise. This, as the Chancellor's minute makes clear, will be for Cabinet to decide when they consider the report of MISC 62.

I am copying this letter to the Private Secretaries to the other Members of the Cabinet, to David Wright (Cabinet Office) and to Gerry Spence (CPRS).

Yours sincerely,

Michael Scholar

John Kerr, Esq.,
HM Treasury.

CONFIDENTIAL

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SECRET

FILE

VLS

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10 DOWNING STREET

BC. J. Vercker

From the Private Secretary

4 November 1981

Economic Assumptions

The Prime Minister was grateful for the Chancellor's minute of 27 October, about the economic assumptions to be given to the Government Actuary for his report on the National Insurance Fund; and about the forecast required by the Industry Act.

The Prime Minister is content with the Chancellor's proposals on unemployment earnings and inflation as set out in paragraphs 3-6 of his minute. On the earnings figure, she has commented that she hopes that the figure of 7½ per cent, which is on the face of it uncomfortably high in relation to the 4 per cent planning factor for public service pay, will be justified by reference to what she understands is the implied settlements figure of 5-5½ per cent. She hopes that the Chancellor will take every opportunity to make it clear that the 7½ per cent and the 4 per cent figures are not directly comparable one with another.

I am sending copies of this letter to Don Brereton (Department of Health and Social Security) and to David Wright (Cabinet Office).

M. C. SCHOLAR

John Kerr, Esq.,
H.M. Treasury.

SP

SECRET

PRIME MINISTER

Meeting with the Chancellor, 1730, Wednesday 4 November

I understand that the Chancellor is planning to raise four points with you:-

1) Presentation of Government Policy
He is concerned that the Government's message is not getting across and discussing with Treasury officials ways of improving our presentation. I expect that he will wish to tell you what he hopes to achieve.

2) Public Expenditure Leaks
The Chancellor suspects that some of the leaks from the 20 October public expenditure Cabinet arose through our press section. He is particularly concerned about the briefing he believes was given to the press at that time about the public expenditure totals, at a time when we certainly should not have been talking figures to the press.

3) MISC 62
He will probably wish to up-date you on progress in the Home Secretary's Public Expenditure Group. There is in particular - as was only to be expected - difficulty about defence expenditure.

4) Economic Assumptions
The Chancellor will almost certainly wish to discuss his note on the economic assumptions he is to publish under the Industry Act, and as required by the Government Actuary, for the National Insurance Fund (minute to you of 27 October attached). In short, the Chancellor wanted to publish an earnings figure of 7½ per cent. You have suggested publishing a number of different figures - say 5½, 6½ and 7½ per cent. The Treasury's letter to you of 2 October explains that there is no escape for using a single figure for earnings, since this is operationally required by the Government Actuary. The Chancellor will say that last year we published an assumption of 10½ per cent at a time

/when

when we had announced a 6 per cent pay factor, so what he is proposing is in line with last year. He will also argue strongly that publishing a forecast below 7½ per cent would severely damage the Government's credibility.

MLS

4 November 1981

Lee AD
JV

DEPARTMENT OF EDUCATION AND SCIENCE
ELIZABETH HOUSE YORK ROAD LONDON SE1 7PH
TELEPHONE 01-928 9222

FROM THE SECRETARY OF STATE

The Rt Hon William Whitelaw CH MC MP
Secretary of State
Home Office
50 Queen Anne's Gate
LONDON
SW1H 9AT

4 November 1981

Dear Willie.

You asked me to let you know very quickly whether I could accept MISC 62's recommendations on my programme following our meeting yesterday.

You endorsed the agreement which Leon Brittan and I had reached on a reduction in student grants and an increase in the parental contribution and undertook to support them in Cabinet.

On universities, you agreed to recommend acceptance of three quarters of my bid in each year ie £30m, £38m and £47m as additions to the provision proposed by Leon in Table 19.2 of MISC 62(81)10. This was in recognition of the need to assist the orderly restructuring of the universities which I described in paragraph 3 of my paper MISC 62(81)9. It will however still leave the universities in a very difficult position; and I shall need to look carefully at the balance of provision for higher education as a whole within whatever totals for Vote and other education expenditure respectively are finally determined.

On science, you proposed not only to reject my additional bid of £10m a year which is necessary to sustain the policies set out in Cmnd 8175 but also to support Leon's cut of £15m a year. In the circumstances I do not press my additional bid; and I intend to use the limited discretion given to me by MISC 62 in order to meet about half of the proposed cut of £15m from the small miscellaneous savings elsewhere in my programme mentioned in paragraph 6 of my paper, difficult though this will be. But to find the rest of the £15m from science would be equivalent to a cut of about 3½ per cent in real terms, more than is proposed for most cash limited expenditure. It would further damage the universities-by the reduction that the Research Councils would tend to make in their contribution to university funds - and mobilise the influential scientific world against us.

It would require us to abandon the claim in Cmnd 8175, to which I referred yesterday, that "the Government wish to give protection to the support of basic science, an activity which underpins further development and is a particular strength of the United Kingdom". The Prime Minister stressed the importance of scientific research in her speech to the Parliamentary and Scientific Committee on February 25. I enclose an extract from her speech.

I hope therefore that MISC 62 will agree that the cut of £15m a year in the Science Budget should not be made. On the understanding that I will find instead the miscellaneous savings of half this size to which I have referred, I must ask that the other half should be restored. If not, will you please record my disagreement in your report to Cabinet so that this limited but disproportionately important matter can be resolved there?

Because of her interest in this matter, I am sending copies of this letter to the Prime Minister, as well as to Patrick Jenkin, George Younger, Leon Brittan, Michael Jopling and Sir Robert Armstrong.

Yours ever.

Keith.

EXTRACT FROM PRIME MINISTER'S SPEECH TO PARLIAMENTARY AND SCIENTIFIC COMMITTEE, 25 FEBRUARY 1981.

Everything that I have said so far has been addressed to the problem of the successful application of our research efforts. Our future - and the future prospect for science too - will depend above all on our economic well-being, and we must ease the path for the innovators and the wealth creators in our society. The Government will play its part, and I know that this Committee and all its constituent organisations will do so too. There is much to be done if British industry is to gain the benefits which can be achieved from the discoveries and inventions of British scientists and engineers.

But I also want to see our excellent fundamental research, for which the universities of this country have long been justly famous, flourish. No matter how difficult the universities find their adjustment to the straitened circumstances of the 1980s they must remember that one of their prime roles is to preserve the national capability for fundamental research across all the major disciplines. That is why we have kept up spending on the Science Vote, which supports research through the Research Councils and the universities.

We have a great deal to be proud about in our record of scientific achievement, and we should not be too gloomy about our prospects. I have been delighted to be able to visit laboratories from time to time in the last two years. You can be sure that I shall maintain my own interest in the course of fundamental science in Britain - although I can't promise that my visit to a laboratory will be followed every time by the award of a Nobel Prize, as happened in Cambridge last year.

Prime Minister

(1)

CONFIDENTIAL

cc Mr Hoskyns

Do you really want to concede special treatment to this group at the start of the pay round and at a cost of £118m? Suggest as a minimum I write as at X.

MES 4/11

MR SCHOLAR

National Health Service Pay

In his minute of 30 October, the Chancellor records that the Ministerial sub-committee on public services pay endorsed in principle extra provision for NHS pay, as proposed by Mr. Fowler, and proposed that Cabinet should decide on the amount of the extra provision, following further discussion in MISC 62.

The Prime Minister should be aware that there is no case in terms of the criteria the Government is applying to public services pay generally for special treatment for the NHS. DHSS have been given ample opportunity in both the official and Ministerial discussions to justify extra provision on grounds of recruitment and retention factors, but they have always come down to basing their case on what the NHS expect, in comparison with other groups. As I have said before, all public service groups are potentially special cases: the uniformed services with their indexation, the Civil Service with its arbitration, and so on. It would be a poor start to the public service pay round to make an exception of the NHS.

X Accordingly I suggest that the Prime Minister should note rather than agree the conclusion of the Ministerial sub-committee, and should indicate that whether or not extra provision is found for the NHS must depend on the progress of the public expenditure exercise: as the Chancellor points out, Mr. Fowler is seeking an extra £100m(in fact, the figure is £118m. if you include superannuation and national insurance).

JV.

3 November 1981

CONFIDENTIAL

cc A Walters
J Vereker

JV
AD
AW.

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

2 November 1981

Michael Scholar, Esq.,
No.10 Downing Street

Dear Michael,

ECONOMIC ASSUMPTIONS

We spoke this morning about the Chancellor's minute of 27 October to the Prime Minister about the economic assumptions to be given under the Industry Act and to the Government Actuary, and in particular the figure of 7½ per cent for the increase in earnings between 1981-82 and 1982-83. You told me that the Prime Minister was unhappy with this figure - not least because it might be seen as rather far from the 4 per cent figure being used in connection with cash planning in the public sector - and that she had asked whether it might not be better to proceed on the basis of using three figures - 5½ per cent, 6½ per cent and 7½ per cent.

I have taken advice, and am assured that there really is no escape from using a single figure for earnings. This is because the earnings assumption is required not for the Industry Act forecast but for the Government Actuary's report made in connection with changes in National Insurance Contributions to take effect from next April. The Actuary has to produce one set of figures, and for this purpose one earnings assumption has to be made. It is true, of course, that the Actuary also provides a ready reckoner showing by how much the surplus on the Fund would be higher or lower if earnings were higher or lower than assumed, but there has to be one principal number used for the purpose of the work.

As to comparisons with the 4 per cent figure, it is perhaps important to note that the figures are on slightly different bases. The 4 per cent pay factor is in respect of the total pay bill in the current pay round, i.e. a compound of settlements, earnings, and numbers employed. The 7½ per cent proposed by the Chancellor was for earnings for the financial year 1982-83. Earnings figures tend to be higher than settlement figures because of "drift" and higher overtime as the economy picks up. We estimate that these two factors might account for 2-2½ per cent of the 7½, leaving an implied settlements figure - if one ignores numbers employed - of 5-5½ per cent, or not so far from the 4 per cent.

/It is

It is relevant that we last year provided the Government Actuary with an assumption of 10½ per cent for earnings, at a time when we had announced a 6 per cent pay factor.

It is also relevant that an assumption of settlements of 5-5½ per cent, or an earnings increase of 7½ per cent, is itself already on the low side by comparison with outside forecasts of earnings growth (at present 9-10 per cent for calendar 1982); with an expected RPI increase, both in the Industry Act forecast and many outside forecasts, of around 10 per cent; and particularly if fiscal measures are announced or presaged in November - eg on employees' National Insurance contributions and possibly on personal direct taxation - which point to a further reduction in real incomes. For these reasons, I suspect that the Chancellor's point about the need to consider credibility would apply rather forcibly to going below 7½ per cent in the Government Actuary's report. On the other hand, I am sure that the Chancellor would be more than ready to look for ways - whether in the Government Actuary's report or elsewhere - of making it clear that the 7½ per cent and the 4 per cent are not directly comparable one with another.

Yours ever,

John Kerr.

J.O. KERR

cc. A. Walters
A. Duguid.
J. Vereker.

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

PRIME MINISTER

PAY AND CASH PLANNING IN THE NATIONAL HEALTH SERVICE

You will recall that, when on 15 September the Cabinet discussed the pay and price cash factors for public expenditure in 1982/83, the previous Secretary of State for Social Services submitted a paper (C(81)(44))arguing in general terms the need for an element of special treatment for a limited number of staff groups in the NHS; and that Cabinet (CC(81)31st Conclusions, Item 4) agreed to defer consideration of this and of any other similar proposals until the current round of public expenditure discussions. The Chief Secretary's paper on public expenditure (C(81)51) suggested that the implications for pay policy should be considered by the Ministerial Sub-Committee on Public Service Pay, before Cabinet took a view on whether to allow extra, and if so at what stage. He provisionally allowed £100 million in the totals.

2. At its meeting on 27 October the Ministerial Sub-Committee on Public Service Pay reviewed the detailed proposals (E(PSP)(81)25) which the Secretary of State for Social Services is now making on NHS pay. He proposed that three groups (nurses, doctors and dentists, and professions supplementary to medicine) should have an extra provision of something over 2 per cent, and that two groups (ambulancemen and hospital pharmacists) should have an extra 1 per cent. These groups amount to about 60 per cent of total NHS staff. This would cost £118 million next year.

3. The Sub-Committee looked at these proposals from the point of view of policy on public service pay. We recognised that since nurses form just less than half of total NHS manpower, it

would be impracticable to seek to provide for an element of special treatment for them within a 4 per cent cash limit pay factor for the NHS generally, without either unacceptable cuts in service levels or the need for unrealistically low pay settlements for other NHS groups. Similarly, in the case of the doctors and dentists, colleagues agreed that the Review Body system is likely to continue to be acceptable to the professions only if we are prepared to make available some money in excess of the general NHS cash limit pay factor for these groups this year. Unless we provide for extra pay increases for these two groups in particular, we are likely to provoke a damaging confrontation in which it would be hard for the Government to win public support.

4. The Secretary of State's proposals are not without difficulty. The decision to provide for extra pay increases for certain key groups will have to be presented to the relevant Whitley Councils as firm Ministerial decisions, to avoid any possibility that part of the extra money might be diverted to other groups. This is bound to give rise to complaints not only from other groups in the NHS but also from other groups of employees in the public services. We shall need to lay as much stress as possible on recruitment and other operational considerations. The timing of any announcement will also be important, particularly because of its potential impact on the course of the pay negotiations with the local authority manual workers and the non-industrial Civil Service. The latest that any announcement could be made is mid-February, but the Secretary of State for Social Services will be keeping in close touch about this with the other Ministers concerned.

5. The Sub-Committee decided that, despite the wider repercussions for public service pay, it should endorse in principle extra provision for certain NHS groups on the lines proposed by the Secretary of State for Social Services. It would be for Cabinet to decide on the amount of any extra provision, and on

the groups to which it should be directed as part of our overall decisions on public expenditure. I presume that you will wish MISC 62 to cover this as part of their report on health and other programmes.

6. I am sending a copy of this minute to the other Members of the Cabinet, to Sir Robert Armstrong and to Mr. Ibbs.

(G.H.)

30 October 1981

Econ
P51

Ref. A05853

PRIME MINISTER

Regional Development Grants

(E(81) 101 and 107)

BACKGROUND

In E(81) 101 the Secretary of State for Industry proposes reductions in public expenditure on Regional Development Grant (RDG); these savings would be less than those recommended by the Chief Secretary in C(81) 51. In E(81) 107, the Secretary of State for Scotland argues for letting the present arrangements stand. Discussion of these papers by E Committee has been planned for some time and it would not be feasible to divert them to the Home Secretary's MISC 62 Group, since three of the four members of MISC 62 have very firm but very different views on the solution.

2. The decisions fall into three main groups: whether RDGs should be paid for the Sullom Voe and Flotta oil pipeline terminals; the rates of RDG; and the period of deferment of payment of grants. The figures are summarised in Annex 2 of the Secretary of State for Industry's paper E(81) 101.

Sullom Voe and Flotta

3. The Secretary of State for Industry and the Chief Secretary recommend savings of £122 million in 1982-83 and of £9 million in 1983-84 by denying RDGs to the oil companies who have built these two terminals. The Secretary of State points out that the payments would be a poor use of public money, since the prospect of them did not influence the choice of location and the number of jobs provided is only 800 or 900; and that the oil companies are already able to reduce their tax payments by the full cost of the assets and maybe by more. Although the oil companies are expecting the payments under present procedures, the Attorney General, and the Lord Advocate, have advised that the Secretary of State could properly exercise his discretion to refuse them payments and that it is unlikely that his decision could be challenged successfully in the courts.

4. The Secretary of State for Scotland agrees that payment in these cases would be an ineffective use of public money and that there should be no risk of successful legal challenge (the doubts to which he refers in his paragraph 2 have now been cleared up following further discussions with the Lord Advocate). He has, however, grave misgivings on the grounds that refusal would be a breach of good faith on the part of the Government which could be damaging to the confidence of the oil companies investing in the North Sea.

Rates of Grant

5. The present rates of RDG are 22 per cent in the Special Development Areas (SDAs) and 15 per cent in the Development Areas (DAs). The Secretary of State for Industry proposes that these rates should be cut by 2 per cent and the Chief Secretary, Treasury, proposed, in C(81) 51, that the cuts should be of 3 per cent for the SDAs and 4 per cent for the DAs. The prospective public expenditure savings from these alternatives are:-

	£ million		
	1982-83	1983-84	1984-85
Industry	20	53	51
Treasury	36	90	90

The Secretary of State for Industry judges that his option is the most that could be done consistently with the statement made by his predecessor in July 1979 after the Government's review of regional policy, and repeated since, that:-

> "Our objective is to maintain reasonable stability in the framework of regional investment incentives and to avoid abrupt changes".

6. The Secretaries of State for Scotland and for Wales will both argue strongly against making any reductions, on the grounds that it is mistaken to reduce incentives during a recession and that reductions could cause some companies, including overseas companies, to decide against going ahead with projects. The counter-argument is that it is questionable whether a small cut would really tip the balance. A company receiving tax allowances and RDGs in an SDA would at present only have to find 48 per cent of the capital costs of a new investment and it seems doubtful whether such projects would be withdrawn if, in future, they had to find 2 or 3 per cent more. It may also be argued that

some tapering of the RDG percentage now is in line with the thinking of some Ministers that in due course the whole RDG system should be fundamentally changed; the CPRS are preparing a paper on this for the Chancellor of the Exchequer's MISC 14 Group.

7. In political terms, however, industry is looking for more help from Government, not less - particularly at a time when they are beginning to be conscious of the need to invest against the prospects of economic recovery. It would be easier to justify the proposed reduction to industry, if it could be presented as part of a package which also included more cost-effective, and perhaps more selective, measures to encourage industrial investment, not necessarily on a regional basis.

8. The Secretary of State for Industry recommends against withdrawing RDGs from capital intensive industries (other than future oil terminal projects) since this could lose major inward investments, and the Chief Secretary is not proposing this. The Secretary of State for Scotland would be prepared to accept such cuts, as the less of two evils, only as an alternative to the Chief Secretary's proposed deeper cuts in RDG percentages.

Period of Deferment of Grant Payment

9. Under present procedures, once an application has been approved payment is deferred from that date for four months. The Secretary of State for Industry recommends that, to make the proposed reduction in the RDG percentage more palatable, this deferment should be reduced to two months. If this were approved, the other savings would then be reduced by £70 million in 1982-83 and by £4 million and £11 million in the two following years. This would halve the total potential saving in the key year 1982-83. Not surprisingly the Chief Secretary is opposed to it, and the Secretary of State for Scotland does not regard it as a consolation he would want to accept in return for concessions on the other points.

Summary of Expenditure Implications

10. The Chief Secretary is looking for the following savings:

	£ million 1982-83	1983-84
Sullom Voe/Flotta	122	9
Reduction in RDG rates by 3 per cent in SDAs and 4 per cent in DAs	36	90
	158	99

The Secretary of State for Scotland is opposed to both these proposals. The Secretary of State for Industry would be prepared to offer Sullom Voe/Flotta and a 2 per cent reduction in RDG rates (saving £20 million in 1982-83 and £53 million in 1983-84) but offset by reduction in deferment of payment (increase £70 million in 1982-83 and £4 million in 1983-84) so that the net savings would be only £72 million in 1982-83 and £58 million in 1983-84.

??

11. If the overriding priority is to get as near as possible to the Chancellor's proposed public expenditure totals for 1982-83 and 1983-84, it is difficult to see how they can avoid going for the Sullom Voe/Flotta proposal and some reduction in RDG rates (e.g. perhaps the 2 per cent reduction favoured by the Secretary of State for Industry), and dropping the deferment reduction proposal. This would give savings of £142 million in 1982-83 (as against the £158 million sought) and £62 million in 1983-84 (as against the £99 million sought). But there are formidable objections: of breach of faith on Sullom Voe and Flotta, and of appearing to run counter to the need to encourage industrial investment in the case of the grant percentages.

HANDLING

12. After the Secretary of State for Industry has introduced his proposals, you might suggest that the Committee deals with them in turn, with the Chief Secretary, Treasury, and the Secretaries of State for Scotland and for Wales commenting on each. The Secretary of State for Energy should be invited to advise on the reactions of the oil companies to the proposals on Sullom Voe and Flotta.

CONCLUSIONS

13. You will wish to reach conclusions on the following issues:

(i) Should RDGs for Sullom Voe and Flotta be refused?

(ii) Should the rates of RDGs be reduced and, if so, should it be by 2 per cent as proposed by the Secretary of State for Industry, or, as proposed by the Chief Secretary, Treasury, by 3 per cent in the SDAs and by 4 per cent in the DAs?

(iii) Should RDGs continue to be paid for capital intensive projects other than oil terminals?

(iv) Should payment of RDGs continue to be deferred for four months, or should the deferment be reduced to two months as proposed by the Secretary of State for Industry?

RWA

ROBERT ARMSTRONG

30th October, 1981

SECRET

Prime Minister

2AA.

MR SCHOLAR

cc Mr. Walters
Mr. Ingham
Mr. Hoskyns

Economic Assumptions

You will have seen the exchange of notes between Alan Walters and me about the Chancellor's note of 27 October to the Prime Minister which contains proposals for the economic assumptions which have to be published towards the end of November. I have also discussed the presentation of these figures with Bernard Ingham.

We see no reason to disagree on economic grounds with the Chancellor's proposals for assumptions of 2.9 million (narrow definition) for the average level of unemployment in 1982-83, for 10 per cent as the increase in RPI between November 1981 and and November 1982, and for 7½ per cent as the similar figure for earnings.

But these figures, and notably the earnings figure, will give rise to adverse public comment. On the unemployment and RPI figures, it will look as though we are now admitting both that unemployment is going to go on increasing and that inflation will not get into single figures in 1982: we shall have to work hard to persuade people of the possibility that unemployment will peak during 1982 and fall significantly below 2.9 million by the end of the year, and that 10 per cent is only the mid-point of a range of possibilities for inflation, which could of course be lower, particularly if pay rises are moderate. The earnings figure is particularly awkward, because it is bound to be set against the 4 per cent planning factor for public service pay, and union negotiators speaking on behalf of public service groups will lose no time in pointing out that it looks as though the Government are intending to discriminate against them to the tune of 3½ per cent. There is not much of an answer to this: wage drift ought not to come into it, since the 4 per cent is a pay bill figure, and we shall have to rest on the argument that, as the economy peaks up, we expect both increased overtime working and genuine increases in productivity.

/The Chancellor

SECRET

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The Chancellor says that in arriving at these figures he has balanced the need to influence expectations against the need for credibility. He is thus implying that the average earnings figure is already on the low side of what the Treasury actually expect. Given that he has therefore already accepted the principle that the published assumption does not have to be the centre of the Treasury's range of estimates, I think there is a strong case for suggesting that the paramount need to influence the pay round in the right direction points to a lower figure, perhaps of the order of 6½ per cent. Otherwise, the Treasury is going to be hard put to come up with arguments to justify adherence to the 4 per cent pay factor.

J.

29 October 1981

SECRET

CONFIDENTIAL

Prime Minister

2

MLS 30/10

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SWIP 3AG

Rt Hon John Biffen MP
Secretary of State
Department of Trade
1 Victoria Street
London SW1H OET

29 October 1981

Dear John,

BRITISH AIRWAYS : EXTERNAL FINANCING LIMIT 1981-82

Thank you for your letter of 20 October, proposing a £53 million increase in British Airways' 1981-82 EFL in respect of severance payments for redundant workers.

In the circumstances you describe and on the basis of the provisos you make about the handling of this increase, I am content that you should go ahead with Sir John King as you propose, leaving an announcement till later. This delayed procedure is a departure from our normal practice, but I think it can be justified in the circumstances; in any case it involves no impropriety. I note that you are thinking in terms of an announcement in January, and would hope it could be no later than that.

The sum will need to be found from the Contingency Reserve and the eventual announcement should make that clear. I also attach importance to your undertaking to announce that the borrowing is to be repaid in full during 1982-83; thereafter BA's short-term borrowing facility should revert to its normal level. And I certainly trust and assume that the Chairman will take every possible measure to keep within his enlarged 1981-82 EFL of £154 million.

I am sending copies of this letter to the Prime Minister and to other recipients of yours.

Yours

Leon

LEON BRITTAN

Prime Minister

SECRET

cc Mr. Hoskyns
Mr. Ingham
Mr. Scholar
Mr. Duguid

2 A

MR. VEREKER

ECONOMIC ASSUMPTIONS FOR THE INDUSTRY ACT
AND THE GOVERNMENT ACTUARY

I find it difficult to disagree with the figures which the Chancellor has used in his minute of 27 October.

If anything, I suspect the price assumption of 10% between November 1981 and November 1982 is likely to be interpreted as a little veering towards wishful thinking. But I, for one, would not regard it as very unlikely. I doubt very much whether we would have any effect at all on pay bargaining if we said that the price increase was going to be 9% for that period. Negotiators would simply take it with a larger pinch of salt and put their own estimates in to their game of bluff.

I think that the aspect to stress on the earnings assumption of 7½% is that it is predicated on a very considerable increase in productivity. This is not merely due to additional hours, through overtime working as the Chancellor says, but due to genuine increases in output per man hour worked. The increased value of the product should at least in part go towards rewarding the labour involved. Again, however, I wouldn't want to dispute his basic figure of 5% on basic rates and a drift of 2½%.

Your problem is to make this consistent with the public sector 4% cash limits on pay. I suppose part of this can be rationalised by saying that there is "wage drift" in the public sector due to the quasi automatic promotion up the pay scale. Public servants ascend the pay scale more or less automatically, while in private industry the ascension is associated with increased productivity and is usually dubbed "wage drift". But I guess there are a lot of other excuses, such as catching up, etc which you have in your locker.

The other point that concerns me about the Chancellor's memo, is that he discusses the distribution of the national insurance contribution burden between employees and employers. He in fact talks about sparing employers as far as possible from increases in

/their burden

SECRET

their burden leaving the weight of the increase (NIC) to rest on employees. This proposition seems to me to violate one of the fundamental propositions of price theory. Under competitive conditions, it does not matter whether you put a tax on the buyer or on the seller. The same tax will give exactly the same results. The burden of a given tax is determined by the extent to which the purchasers, in this case the employer, can escape it (our old friend the elasticity of demand for labour) and the degree to which labour (the suppliers) will respond. But the whole point is that, under competitive conditions, the issue of who pays a subsidy, whether employer or employee, is trivial and of no consequence. To give you the flavour of this argument, consider the tax on beer. At the moment the brewers pay this. But supposing we said the brewers could supply the beer tax free and we'd simply collect the tax in the pub. Administrative difficulties aside, this would have no effect on the distribution of burdens.

There are, of course, more problems when we consider markedly non-competitive markets. The issue becomes very complex. (I examined these problems in my book, with Esra Bennathan, on Port Pricing.) But there is certainly no presumption that the burden of a tax is borne by the group who actually pays it. Broadly speaking, my research suggested that the results of the competitive model were not dramatically reversed by any of the "non competitive" aspects of a more general model.

What a boring memo this is! But there is a point of substance in it.

AW

28 October 1981 ALAN WALTERS

010

cc A Duguid
J Vereker

I share John Vereker's worries. Can we not publish 2 or 3 forecasts putting in different figures i.e. for earnings 7½ not 5½.

(1) 1c

SECRET

Prime Minister

These assumptions are to be published on a date to be fixed before the end of November. Their effect on the current pay round is likely to be adverse and I suggest that we ask that consideration be given to timing ? – insofar as this is practical – given the impact on current pay negotiations (mineworkers, waterworkers).

John Vereker suggests a lower figure – 6½% for earnings. But this will be inconsistent with the rest of the forecast and will strain credibility. See also Alan Walters' note. Content to agree with Chancellor's conclusion?

MLS 30/10

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

PRIME MINISTER

ECONOMIC ASSUMPTIONS

As you know, towards the end of next month we have to publish (i) the forecast required by the Industry Act (IAF) and (ii) the report by the Government Actuary (GA) on the National Insurance Fund. So once again we have to decide on the economic assumptions that we give the GA; they will, of course, be published in his report.

2. The assumptions to be provided are those in relation to unemployment in 1982-83, earnings for 1982-83, and the inflation between the fourth Quarter of 1981 and the fourth Quarter of 1982. The purpose of this minute is to let you know what I propose to have published, in the light of the latest forecasts available to me, and the need to produce figures which are both credible and - in the case of prices and earnings - helpful in their influence on expectations.

3. On unemployment I propose that we should publish, as an average level for 1982-83, a figure of 2.9 million on the narrow definition - that is, excluding school leavers, adult students and the temporarily stopped. These groups are forecast at 225,000, making a total of 3.1 million on a wide definition. These figures are for Great Britain; the United Kingdom figure (i.e. including Northern Ireland) is about 100,000 more than this, but this figure does not have to be given.

4. Obviously, we should prefer to avoid publishing, as a Government forecast, a figure of over 3 million. But in fact it is relatively conservative - and might, by now, be so regarded.

SECRET

On the narrow definition unemployment now stands at 2.63 million seasonally adjusted. The increase over the last few months has averaged 50,000 per month. At this rate the figure is likely to rise to 2.9 million as 1982-83 begins, so to use this figure as the average for the year implies a considerable slowing down in the rate of increase. I do not think we could sensibly or justifiably publish a lower figure.

5. For prices, I propose a figure of 10 per cent as the increase in the RPI between November 1981 and November 1982. This is at the bottom end of the range of figures given by our present forecast. But I think it is justifiable to go for this lower number. On the other hand I do not think it would be feasible to go for a number as low as 9 per cent and still retain credibility, having regard to the fact that the year-on-year figure is currently 11.4 per cent, and the figure for November (published in December) will probably get to 12 per cent or more having regard to increases such as the rise in mortgage interest which are in the pipeline. 10 per cent is consistent with our view that there has been a pause in the deceleration of inflation, but that we should be able to get to single figures by early 1983. It is also consistent with the 9 per cent factor being used for non-pay elements in public expenditure plans.

6. For earnings I propose a figure of 7½ per cent. This will be consistent with settlements of about 5 per cent on average, coupled with drift and increased overtime working to be expected in line with our projections of improvement in output. Taken with the prices figure it implies a fall in real earnings of about 2½ per cent over the year. The figure for earnings gives a good deal of weight to our expectations of a substantially lower level of wage settlement.

7. In arriving at these figures I have - as explained above - tried to balance the need to influence expectations so far as we can against the need for credibility. I believe that the balance

is right, and accordingly propose to arrange for these figures to be published in the GA's report and/or IAF as appropriate.

8. Looking ahead, we shall as usual shortly have to take decisions about any changes in National Insurance Contributions, and also on allied matters including the National Insurance Surcharge, which would take effect from next April. There is a complex network of issues here which I shall be discussing in the near future with the Secretary of State for Social Services. It is too early to say what we shall propose. But I should let you know that I think our general approach should be governed by two considerations; first, to spare employers as far as possible from increases in their burden, leaving the weight of the increases to rest on employees; and second, to maximise the help we can get for the 1982-83 PSBR through the NIC machinery, so as to increase our flexibility of manoeuvre in the next Budget. This is, of course, broadly the approach we took last year. I should add that my preliminary examination shows that, on most of the options we might adopt, primary legislation would be necessary before the end of January, and this is a factor which we shall have to take into account.

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

GH.

(G.H.)

27 October 1981

SECRET

1B

cc:- Mr Hoskyns
Mr Ingham
Mr Scholar

p.a.

MR WALTERS

ECONOMIC ASSUMPTIONS FOR THE INDUSTRY ACT AND THE GOVERNMENT ACTUARY

I attach a copy of the Chancellor's minute of 27 October to the Prime Minister proposing the assumptions the Treasury should give, for the purpose of the Industry Act and the Government Actuary, in respect of unemployment, prices and earnings.

I am sure you will wish to comment on the substance of the figures: the Chancellor's basic approach, to compromise between the need to influence expectations and the need for credibility , seems to me to be right. But I think we should also warn the Prime Minister about the likely public impact the figures, particularly the prices and earnings figures, will have - and the consequences of that for pay bargaining. Michael Scholar has asked me to show a copy of the minute to Bernard Ingham, who will also wish to comment.

My own view is that an announcement that we no longer expect single figure inflation by the end of 1983 is bound to have an adverse effect on pay expectations, but is sufficiently well trailed in the forecasts which have recently been published for it not to cause a major stir. But a 7½% forecast for earnings is likely to be rather widely misinterpreted, since it will be set against the 4% cash limit planning assumption, and will, therefore, make it even less likely than it already is that the public services will be prepared to settle at 4%.

/Do

SECRET

Do you see any justification for proposing a lower figure; if not, Bernard and I will have to turn our attention to ways of making it seem consistent with the sort of pay settlements we are looking for in the public sector.

E.M.M. VEREKER

27 October, 1981

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CONFIDENTIAL

✓ P.?

Treasury Chambers, Parliament Street, SW1P 3AG

M Scholar Esq
10 Downing Street
London SW1

27 October 1981

Dear Michael,

PUBLIC EXPENDITURE COMPARISONS

I understand that the Prime Minister asked the Chief Secretary last night for a note on the statement in yesterday's Times that Treasury Ministers' proposals for 1982-83 would lead to little change in expenditure in real terms compared with the likely outturn of this year.

You will see from the enclosed note that the proposals would lead to some reduction compared with this year's outturn. The extent of the reduction depends on the method of comparison.

The Chief Secretary would, however, advise the Prime Minister not to comment on this. The Chief Secretary specifically refused to answer questions about the scale of the bids and of Treasury Ministers' proposals when he was being interviewed last Wednesday. Although Sarah Hogg came very close to giving the full set of figures in the Sunday Times, it still seems desirable to avoid getting drawn into confirming or denying particular figures which may appear in the press. It would be very difficult to make any comment on this assertion about the comparison in real terms without getting drawn into such confirmations or denials.

The Chief Secretary also thought that you might like to have available the attached brief on public expenditure which has been prepared for the Chancellor before tomorrow's debate.

Yours sincerely

T F MATHEWS
Private Secretary

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PUBLIC EXPENDITURE IN "REAL TERMS"

Note by the Treasury

There has been press speculation about whether the public expenditure figures proposed by Treasury Ministers involve an increase in "real terms" compared with spending this year. (Riddell, F.T. 22 October "an increase". F. Williams, Times, 25 October "roughly the same".)

2. The switch to cash planning means that there is no unequivocal answer. The proposals, and eventual decisions, will relate to cash. At least for the controlled programmes, it is the decisions on cash which will limit expenditure whatever may happen to prices. If prices increase more than expected, departments will only be able to finance a lower scale of activity than they had expected. Conversely, if prices increase less than expected, departments will be able to obtain more than they expected for their money. Any comparison in real terms therefore requires a view on future prices.

3. This difficulty of comparison is compounded by the existence of two possible measures of change in "real terms". The first measure is the constant price or "volume" basis, used in public expenditure surveys up to this year. The other is the "cost terms" basis which is usually adopted when public expenditure is set against revenue or GDP, as in the MTFS. The difference between the two is that the "cost terms" series is adjusted to allow for changes in relative prices: for example it shows up the very rapid increase in public service pay, compared with the increase in prices generally, in 1979 and 1980, and then the fall in pay this year and the intended fall next year.

4. Subject to that, the Treasury Ministers' proposals for the <u>plans</u> for next year, if adopted and achieved, would almost certainly lead to expenditure in real terms which is below the likely <u>outturn</u> for 1981-82, on any basis.

"Volume"

5. We have deliberately not kept comprehensive figures for volume in this year's public expenditure exercise. To have done so would have encouraged

departments to cling on to volume planning rather than switch to cash planning. However, it is possible to build up a very approximate picture as follows:

(1)	The last White Paper showed a fall in volume between 1981-82 plus and 1982-83 plans	- 1.7%
(2)	Outturn in 1981-82 is expected to exceed these plans (cash) by, say + 2½%	
	Of this volume element is, say,	+ 2%
(3)	Treasury proposals involve increase in cash for 1982-83 compared with White Paper revalued of	+ 3.3%
(4)	But changed inflation prospects imply a squeeze of, say,	- 0.5%

So proposals for 1982-83 represent change in volume from expected outturn for 1981-82 of (-1.7% -2% +3.3% -0.5%) = (say) - 1%.

Cost terms

6. In the case of a comparison in cost terms, the decline is sharper, because of the expected fall in the relative prices paid by the public sector, largely due to the 4% cash factor for pay:

(£ billion cost terms 1980-81 prices)

	1979-80	1980-81	1981-82	1982-83
March White Paper			94.1	90.6
Outturn / Expected Outturn	91.0	94.2	96.6	
"All bids"				96.5
Treasury Proposal				93.5

The Treasury Ministers' proposals would thus lead to a fall in cost terms of a little over 3%. Accepting all the bids would hold expenditure in cost terms in line with this year's outturn.

27 October 1981

PUBLIC EXPENDITURE

(a) This year (1981-82)

Too early to predict outturn.

Clearly overspend by local authorities on current expenditure - Heseltine action on revised budgets this year.

But PSBR appears to be on track for £10½ billion Budget forecast.

[Note : White Paper cash figure £104 billion.
Budget added £0.3 billion - fuel prices, miners.]

(b) Next Year (1982-83) and beyond

Not in business of confirming or denying press speculation about numbers.

Nor in commenting on press reports, beyond saying that few bear much resemblance to meetings which I have attended. But obviously makes better copy to over dramatise a discussion into a confrontation.

The Government now considering expenditure, as part of normal annual cycle changes to last year's plans.

Changes in circumstances make increases in some expenditure programmes appropriate - eg the employment measures announced in July, nationalised industry EFLs.

The question is therefore how much increase over White Paper is appropriate.

- Within this some programmes may be less, others more.

- No cut in total. And hardly a cut to say we cannot afford some additional proposal put forward in hope, rather than out of necessity.

Whatever we decide on expenditure will affect my views on tax in Budget. Expenditure will be responsibly financed, and not allowed to jeopardise our objective for inflation.

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MJ

cc Mr. Scholar

MR. INGHAM

I ought to alert you to the fact that we shall have a similar problem this autumn as we did last year about the pay and price assumptions to be made by the Government Actuary.

The Treasury have warned me that both assumptions are likely to be higher than the assumptions being made for cash limits; and since the price assumption becomes public knowledge at the time of the Industry Act forecast, there will be some presentational difficulties. We will not know how to play this until we see the figures; I am sure Michael Scholar will keep us au fait.

J. M. M. VEREKER

26 October 1981

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PART 15 ends:-

20-10-87

PART 16 begins:-

26-10-87