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Ref: A03594

SECRET

PRIME MINISTER

Public Expenditure
(C(80) 72)

BACKGROUND

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

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

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

HANDLING

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

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

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

Defence

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

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

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

Social Security

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Health

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

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

Scotland

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

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

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

1982-83 and 1983-84

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

The Chancellor's Statement and the wider Economic Strategy

10.20.30

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

D.J. Wright

(Robert Armstrong)

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

18th November 1980