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Mr. ...

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PRIME MINISTER

PUBLIC EXPENDITURE - MAJOR REDUCTIONS

Before our talk tomorrow morning, you may wish to have this note on the proposed reductions in public expenditure needed to achieve the target (£1 billion in 1980-81, £2 billion in 1981-82 and later years) which I hope Cabinet will endorse on Thursday. To secure these savings, as I said in my paper, we need fundamental new decisions on major programmes. In particular we need to agree that earlier commitments to protect certain programmes (defence, social security) can no longer be sustained. I attach a table showing the cuts I propose, and my comments on the main programmes are as follows:-

(i) Defence

I have sent you a separate minute on the possibilities here, suggesting a meeting with Francis Pym to take this forward. We should recognise that defence will also be required to take a sizeable share of the squeeze likely to result in 1980-81 from the 14 per cent level of cash limits proposed in my other Cabinet paper.

(ii) Social Security

This is where the most important and difficult decisions are needed. On child benefit, I think we must go for something less than full uprating next year, despite the impact on incentives; we could meet this by some re-shaping, and holding back short-term benefits will help - so I have assumed half the increase that would correspond to full uprating. Less than full price



uprating of short-term benefits (unemployment, sickness and short-term supplementary benefits) could be achieved through an amendment to the Social Security Bill to break the link with prices; the figures assume £2 a week less on most benefits (2 per cent less on supplementary benefits), but more could be saved if we decided to give little or no cash increase next year. The other main saving, from abolition of earnings-related supplement, has already been discussed more than once; in my view it is time to take this step. Clearly I should wish Patrick Jenkin to join me in considering the best shape for the whole of this package.

(iii) Environment

Michael Heseltine's programmes must be the next largest source of savings. We should assume some further decline in housebuilding by local authorities and housing associations, and some cut-back in improvement; also on current subsidies we should aim to bring rents up to 10 per cent of earnings by 1983-84, and reduce the rate of option mortgage subsidy to 25 per cent. There is some doubt whether the present assumed savings from council house sales will materialise, but in my view we should start by seeking the gross savings shown.

(iv) Health

Given our commitment to maintain existing (volume) plans for gross NHS spending, we have to look to charges. The least unattractive proposal which we can suggest is a £2 charge for each visit to a GP (on the same lines as charged for dental services now, and with the same wide exemptions as for prescription charges); this would need to be negotiated with the BMA, and would need primary legislation, but it would yield £140 million a year. The small balance would come less painfully



from annual increases in prescription charges in line with prices after next year.

(v) Education

We have had earlier arguments with Mark Carlisle about the contribution from his programme, and I do not think it can be exempted from this round. The figures shown could be achieved by charging for under-fives, increasing the parental contribution to student grants, and postponing the assisted places scheme - but he may himself have better suggestions.

(vi) Public service superannuation

If we are not going to break the link with prices for state pensioners, it is questionable whether we ought to seek to do so for the wide range of public service pensioners (civil service, armed forces, NHS staff, police, teachers, judges, MPs, etc.). It would be a complex legislative operation, and not all the saving shown would count as public expenditure. I think we both agree that it would be better to save on this front by ensuring that the value of index-linked pensions is more fully taken into account in public service pay comparisons.

(vii) Other programmes (overseas aid, employment, transport, fire, personal social services - and Scottish, Welsh, Northern Irish consequential). The cuts in all these programmes, though smaller, will all be painful, going beyond what we have already decided, but we need to find savings wherever possible.

(viii) Taxation

The links between cuts in public expenditure, and reductions in tax allowances, are close in some areas -



e.g. age allowance with state pensions, mortgage interest relief with council rents, VAT on children's clothes with child benefit. I hope we can make some PSBR savings in these areas, but they need to be considered in the Budget context and put into effect in the Finance Bill. They do not help to meet the criticism that we have not done enough to restrain public spending. The same applies to increases in NI contributions; the main need here is to prevent benefit savings feeding through into lower contributions, by reducing the Exchequer contribution (as assumed in the table).

2. I hope you will agree that Cabinet on Thursday should identify the first five programmes above as the main targets for reductions in spending, with whatever help we can get from the other areas mentioned. The total figures shown barely reach our target for 1981-82, and fall short in 1980-81; but they include nothing for defence (or EEC), and in 1980-81 we are likely to get some further volume reduction assuming that we hold to the cash limits proposed, plus perhaps a bit from the contingency reserve (depending partly on the child benefit decision). We have to recognise that we are unlikely to get all the savings shown, but in the light of last Friday's discussion (which has led me to drop de-indexation of long-term benefits, and hospital charges) I do not see much chance of adding to the list.

3. I hope we may have a chance, before Cabinet, to discuss the best procedure - as between colleagues - for carrying forward this whole exercise. I would propose to start by letting each spending Minister know individually what contribution we want from him.

(G.H.)

12 December 1979

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	Major Reductions				£m 1979 Survey prices
	<u>80-81</u>	<u>81-82</u>	<u>82-83</u>	<u>83-84</u>	<u>Comment</u>
Defence					Under separate discussion
Social security					
Child benefit	100	300	300	300) Assumes (a) savings carried
Short-term benefits (de-indexing - say)	70	230	230	230) forward into later years
Abolish ERS	100	260	260	260) (b) NI Fund savings reduce
Up-rating date (put back 3 weeks)	30	50	50	50) Exchequer contribution, not employer or employee contributions.
Environment					
Housing	300	500	500	600) Cuts in housebuilding, improvements and insulation
Other (incl. PSA)	-	40	50	50) schemes, and (from 1981-82) higher rents, cut in option mortgage subsidy.
Health	-	150	155	160	£2 charge for visits to GP, and index prescription charges.
Education	-	75	115	125	
Public service pensions	20	40	40	40	Break index link and uprate 2% less than prices.
Overseas aid	-	50	50	50	
Employment	35	30	30	30	MSC savings (including ITBs)
Transport	20	50	50	50	Further cuts in roads prog.
Home Office	-	15	20	30	Reduce fire cover.
Personal social services	-	20	40	60	Remove proposed 2% growth.
Consequentials (Scotland, Wales, NI)	65	190	205	230	
Total	740	2000	2095	2265	