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Econ Pol. 1

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SECRET

PRIME MINISTER

Public Expenditure Programmes
(C(80) 62 and 64)

BACKGROUND

This meeting is the fourth of the current series to resolve the main public expenditure issues for next year and the following years of the PES period. It would be highly desirable for operational reasons if it could break the back of the remaining work. You are, of course, up to date on most of the outstanding points, and this brief does not attempt a fully detailed survey. I have however annexed some notes on points of detail where the earlier briefs need amendment or supplementation.

2. So far the Cabinet has reached agreement on:-

(i) the RSG percentage for next year;

(ii) the cash limits for next year other than for defence and a few 'technical' points outstanding from C(80) 65;

(iii) the further cuts on local authority current expenditure of 1 per cent across the board;

(iv) the 2 per cent cuts on cash limited programmes other than health (where equivalent sums will be raised through increased National Insurance contributions) and Defence;

(v) the additional provision to be made for special employment measures.

3. In addition E Committee (E(39th Meeting, Item 2) has reached agreement on the External Financing Limits to be applied to the nationalised industries in 1981-82. This will require a further provision of £157 million for that year (the Chief Secretary, Treasury, is still sorting out the details with sponsor Ministers).

4. The remaining issues are:-

(i) Social Security - uprating of benefits.

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(ii) Social Security - increased National Insurance contributions (not strictly a public expenditure issue but related to (ii).).

(iii) Defence - a 2 per cent volume cut of £188 million and any further specific cuts, together with the related issues of the reconciliation of next year's AFPRB award on pay with the cash limit factor and the accommodation, if any, to be made in the price factor to the differential increase in the cost of defence equipment.

(iv) Scotland - specific cuts on top of the formula percentage cuts.

(v) Wales - additional bids in 1982-83 and 1983-84 for industrial expenditure.

(vi) 1982-83 and 1983-84 generally. Some of the decisions here will be affected by what is decided on the points listed above but generally, and following particularly on their bilateral discussions with the Department of Education and Science, the Treasury now believe that the figures for these years are settled. The Chief Secretary, Treasury, is likely to offer to circulate to Cabinet a note summarising his understanding of the agreed figures for each year so that Cabinet may have the total picture.

5. As you know, the Chancellor of the Exchequer has to publish the Industry Act forecasts in the week beginning 24th November when he is also planning a more general statement on the outcome of the public expenditure discussions. If the Treasury are to complete their work on the Industry Act forecasts within this timescale they need to know tomorrow at least the broad decisions on the outstanding issues - in particular they need to know whether Social Security upratings are to be abated - although it is not essential for them to have final decisions on the details of exceptions if they cannot be resolved tomorrow.

HANDLING

6. You might open the discussion by inviting Cabinet to confirm that full agreement has now been reached on the 1 per cent cut on local authority current expenditure and, with exception of Defence, on the application of the 2 per cent volume cuts on cash limited programmes. Cabinet might also be asked to take note of the decisions by E which lead to further provision of £157 million for the nationalised industries; and that the Chief Secretary, Treasury is agreeing on the details with the sponsor Ministers.

7. I suggest that you then take the remaining issues in the order listed in paragraph 3 above (Social Security; Defence; Scotland; Wales). Before turning to them, you might give the Chancellor of the Exchequer an opportunity to make any general points and to explain to the Cabinet how he now sees the timetable, with reference both to the Industry Act forecasts and to any announcement on the public expenditure cuts in particular.

Social Security

8. The Chancellor proposes to hand out to the Cabinet the paper attached to his minute of 31st October to you, dealing mainly with the proposal to uprate benefits in November 1982 by 3 percentage points less than needed to give full price protection. A detailed note on this is at Annex A.

attached

9. He will also table a note on his proposal for legislation to reduce the Treasury supplement to the National Insurance Fund so as to reduce the PSBR by £500 million, with the difference in income to the Fund made up by raising the rate of employees' contributions payable from 1st April 1981 - see his letter of 10th November to the Secretary of State for Social Services and the Secretary of State's reply of 11th November. This is not a public expenditure question, although it needs to be considered alongside the proposal for abating the uprating i.e. Cabinet will need to take account of the politics of asking people to contribute more for less - to put it at its crudest. A more detailed note is at Annex B.

Defence

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

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

11. The issues for decision now are:-

(i) What should be the volume cut within this range.

(ii) What arrangements should be envisaged to reconcile any difference between the general 6 per cent cash limit for pay and whatever percentage pay increase the Cabinet agree next year in the light of the report of the Armed Forces Pay Review Body - recognising that the commitment to pay comparability for the Armed Forces stands.

(iii) What special arrangement, if any, should be envisaged to cope with the possibility that prices for Defence equipment will tend to increase faster than the general level of prices (for which the assumption in other programmes is, of course, 11 per cent)?

I believe that the Secretary of State for Defence (and the Chiefs of Staff) will attach most importance to the first of ~~these~~ the two cash limit conditions – the one on pay –; and my understanding is that the Treasury is inclined (at official level, at any rate,) to accept that, if the commitment to implement the Review Body's recommendations for Armed Forces' pay is accepted as binding, it is unrealistic to do otherwise than allow for that in an adjustment of the pay factor for the relevant cash limit. If this is conceded, it will be easier to resolve the point on the price factor: that could be left to be agreed bilaterally between the Chancellor or the Chief Secretary, Treasury and the Secretary of State for Defence.

11a. It may be tactically wise not to press these matters – including the volume cut – for decision today, so soon after the meeting with the Chiefs of Staff, but to give time for further discussions with the Defence Secretary, and come back to the matter in Cabinet on Wednesday 19 November.

Scotland

12. The Secretary of State for Scotland has accepted the formula cuts consequent on the equivalent percentage reductions now agreed by other Departments. His memorandum C(80) 62 however strongly disputes the Treasury's wish to have a further £90 million from Scotland to claw back part of the over generous provision for that country as opposed to England. This is discussed in more detail in the note at Annex C.

Wales

52. 37-34.

13. The Secretary of State for Wales has agreed to take his per centage cuts, but he wants an additional £20 million in 1982-83 and 1983-84 for factory building in areas affected by steel closures - see paragraph 29 of the Chief Secretary, Treasury's memorandum C(80) 64 and the note at Annex D to this brief.

1982-83 and 1983-84

14. If he does not volunteer it, you might invite the Chief Secretary, Treasury, to circulate a memorandum giving the detailed figures for each programme for each of 1981-82, 1982-83 and 1983-84. It should not be necessary for Cabinet to discuss the two later years either tomorrow or later. If there are any problems Ministers could be asked to sort them out with the Chief Secretary, Treasury, coming back to Cabinet for substantive discussion only in the last resort.

CONCLUSIONS

15. These will follow from detailed discussion of the remaining points at issue. You will also want to record specific endorsement of the 1 per cent local authority cuts and 2 per cent volume cuts on cash limited programmes.

RA

(Robert Armstrong)

12th November 1980

Public Expenditure: Social Security

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

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

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

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

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

HANDLING

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

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

8. The key question on C is whether it is politically on, given past pledges (including your own undertakings in your interview with Brian Walden on 6th January). It may also be necessary to look ahead to the Chancellor's parallel proposals to increase employees' National Insurance contributions. Notwithstanding the very real political difficulties there are powerful arguments in favour of this measure:-

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

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

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

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

10. The Cabinet may not be able to come to a final decision on whether any abatement of public sector pensions should apply solely to the public services only or to the nationalised industries as well until they have seen the Chief Secretary's promised minute and have a better feel of the complexities in the nationalised industry area. This decision has a relatively small effect on the overall arithmetic and could, if necessary, be left to 19th November.

CONCLUSIONS

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

(i) Endorse Proposals A and B.

(ii) Either endorse Proposal C and record agreement on the exceptions to be made (leaving details on the exceptions to be resolved bilaterally or at Cabinet on 19th November;

OR rule out Proposal C.

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

12th November 1980

Employees National Insurance Contributions

The Chancellor of the Exchequer and the Secretary of State for Social Services have agreed to two increases, each of 0.25 per cent, in employees' National Insurance contributions, namely:-

(i) in the context of the normal contribution review, to offset an estimated deficit in the Fund of £250 million;

(ii) following Cabinet's discussion on 4th November, in the NHS contribution as an alternative to the 2 per cent cut on health expenditure and to offset the £100 million income lost from charges which will not now be made.

2. They have not however agreed on the Chancellor's proposal that the Treasury Supplement to the Fund should be reduced so as to save £500 million on the PSBR with the Fund balance restored by a further 0.5 per cent increase in employees' contributions.

3. The Chancellor's arguments for this change are set out in paragraph 4 of his note. Even with the public expenditure cuts he is faced with the need to find further substantial contributions towards reducing the PSBR. This proposal would contribute £500 million and make his taxation options easier. The table annexed to his note sets out the effects on incomes of the proposed increase. Paragraph 8 of the note, and the footnotes to the table, argue that raising more from income tax (which effectively means reducing tax thresholds) would hit those on smaller incomes particularly hard; and that increases in indirect taxes would of course have an effect on the RPI.

4. The Secretary of State for Social Services' reservations are summarised in paragraph 5 of the note. He believes the increase would be seen as an improper use of the national insurance system for taxation purposes and would add to the difficulties of getting legislation through the House. He points out that the better-off would be at a relative advantage over those with lower earnings - the table shows that there is no increase in contributions for those with a gross income of more than £190 a week.

5. Legislation, with Royal Assent very early in the New Year, would be necessary to implement both the proposal on the NHS contribution and the reduction in the Treasury Supplement. A Bill has been drafted. Subject to policy approval by the Cabinet, proposals could be put to Legislation Committee at their next meeting on 19th November.

HANDLING

6. The Chancellor of the Exchequer and the Secretary of State for Social Services will each wish to put their case on the proposal in dispute. There seems no reason why Cabinet should call into question the agreement reached between the two Ministers on the normal increase in the contribution and on the increase in the NHS contribution, which follows Cabinet's earlier decision. On the proposal for a further 0.5 per cent increase they may be sympathetic to the points made by the Secretary of State for Social Services. On the other hand, as the Chancellor points out, there are no easy alternatives to this proposal. Even after the public expenditure cuts, tax increases are likely. For the reasons put forward by the Chancellor it seems better to find at least some of this money through national insurance contributions.

CONCLUSIONS

7. In the light of the discussion you will wish to record conclusions:-

(i) Taking note of the two agreed changes - i.e. the normal and the NHS increases (paragraph 2 of the Chancellor's note).

(ii) Either accepting the Chancellor's proposal for a reduction in the Treasury Supplement to the Fund together with a further 0.5 per cent increase in employees' contributions.

OR rejecting this proposal but accepting that in consequence more will have to be raised from taxation.

(iii) In the light of (i) and (ii) inviting the Chancellor of the Exchequer and the Secretary of State for Social Services to put proposals to the next meeting of the Legislation Committee on 19th November.

12th November 1980

£4.000m
£90m.

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Scotland

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

Unresolved cuts: £90 million each year.

The Secretary of State has accepted the formula cuts consequent on the equivalent percentage reductions now agreed by other Departments. He is however strongly against the further £90 million cut which the Chief Secretary proposes on the grounds that the Scottish share of public expenditure on comparable services is larger than justified by relative need.

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

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

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

3. Counter arguments:-

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

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

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

either insist on full £90 million

OR let the Scots off the £90 million

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

12th November 1980

Wales
(Section B vi. of C(80) 64)

The Secretary of State for Wales has agreed to take his percentage cuts. However, he wants an additional £20 million in each of 1982-83 and 1983-84 for factory building in areas affected by steel closures.

2. He will argue:-

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

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

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

3. The counter arguments are:-

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

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

4. The choice is -

either

(i) stick to the proposed cuts but leave Mr. Edwards free to switch his own resources into his industrial programme if he wishes;

or

(ii) modify the cuts by giving Mr. Edwards the £20 million more he wants for industrial support in 1982-83 and 1983-84.

12th November 1980