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CABINET

CONCLUSIONS of a Meeting of the Cabinet held at 10 Downing Street on

TUESDAY 1 NOVEMBER 1988 at 9.30 am

P R E S E N T

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon Sir Geoffrey Howe QC MP
Secretary of State for Foreign and Commonwealth Affairs

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer

The Rt Hon Lord Mackay of Clashfern
Lord Chancellor

The Rt Hon Douglas Hurd MP
Secretary of State for the Home Department

The Rt Hon Peter Walker MP
Secretary of State for Wales

The Rt Hon George Younger MP
Secretary of State for Defence

The Rt Hon Norman Fowler MP
Secretary of State for Employment

The Rt Hon Tom King MP
Secretary of State for Northern Ireland

The Rt Hon Nicholas Ridley MP
Secretary of State for the Environment

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry

The Rt Hon Kenneth Baker MP
Secretary of State for Education and Science

The Rt Hon Kenneth Clarke QC MP
Secretary of State for Health

The Rt Hon John MacGregor MP
Minister of Agriculture, Fisheries and Food

The Rt Hon Paul Channon MP
Secretary of State for Transport

The Rt Hon John Moore MP
Secretary of State for Social Security

The Rt Hon John Wakeham MP
Lord President of the Council

The Rt Hon The Lord Belstead
Lord Privy Seal

The Rt Hon Cecil Parkinson MP
Secretary of State for Energy

The Rt Hon John Major MP
Chief Secretary, Treasury

The Rt Hon Antony Newton MP
Chancellor of the Duchy of Lancaster

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THE FOLLOWING WERE ALSO PRESENT

The Rt Hon David Waddington QC MP
Parliamentary Secretary, Treasury

The Rt Hon Peter Brooke MP
Paymaster General

SECRETARIAT

Sir Robin Butler
Mr R T J Wilson (Items 2 and 3)
Mr A J Langdon (Item 1)
Mr G Monger (Items 2 and 3)
Mr S S Mundy (Item 1)

C O N T E N T S

RLIAMENTARY
FAIRS

1. The Cabinet were informed of the business which was expected to be taken in the House of Commons in the following week.

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THE SECRETARY OF STATE FOR HEALTH said that the House of Commons would later that day consider amendments by the House of Lords which sought to strike out from the Health and Medicines Bill the provisions to enable charges to be imposed for dental examinations and sight tests for those who could afford to pay. Under the Government's proposals about one-third of the population would be exempt from the charges. This would be a very difficult occasion since several dozen Government backbenchers had gone on record as opposing such charges. He had made strenuous efforts to persuade them that people who stood to be charged would not be deterred by the modest fees of £3.15 for dental examinations and about £10 for sight tests and that anyway many opticians would choose to absorb all or part of the cost of sight tests in order to attract custom. However, many of the Government supporters opposed to charges were not susceptible to reasoned argument on the issue. The savings of £134 million which would be generated by the introduction of charges were required to finance some extremely worthwhile improvements in primary health care services. If the Government should lose the vote, however, he would wish to reflect on the best response: an immediate announcement either of offsetting increases in other charges or of reductions in allocations to the health authorities would cause further difficulties with the Government's supporters.

In discussion, the following main points were made:

a. The proposed charges would be required only from those who could afford them. All previous evidence suggested that, apart perhaps from some minor short-term effects, the imposition of charges of the modest levels proposed would not deter people generally from obtaining the medical care which they needed. Maintaining free examinations simply in order to protect the irresponsible minority was redolent of the dependency culture.

b. It would be essential to make clear in advance of the Vote that, should the House of Commons refuse to agree to the introduction of charges, there could be no question of allocating any further resources to the National Health Service (NHS) on top of those already provided for in the proposed Autumn Statement. The impact of the Autumn Statement would be seriously damaged if it were thought that additional funding might be made available to the NHS because backbenchers on the Government's side had not supported the Government.

THE PRIME MINISTER, summing up the discussion, said that the maintenance of the Government's strategy on public expenditure was of paramount importance. The introduction of charges for dental examinations and sight tests was part of a carefully considered package under which the money generated from charges would be used for highly desirable improvements in the primary health care services. In his opening speech in the debate, the Health Secretary should leave the House of Commons in no doubt that, if the Government were defeated, there could be no question of increasing the very generous settlement to the NHS in the proposed Autumn Statement, and that the money which would have flowed from the charges would accordingly be lost to the NHS. If the Government were then to lose the vote, the Secretary of State, in accepting the decision of the House, could refer back to that clear statement: he would then need to consider how to re-order priorities in NHS programmes.

The Cabinet -

Took note, with approval, of the Prime Minister's summing up of the discussion, and invited the Secretary of State for Health to proceed accordingly.

1988 PUBLIC EXPENDITURE SURVEY

2. The Cabinet considered a memorandum by the Chief Secretary, Treasury (C(88) 13) on the 1988 Public Expenditure Survey.

THE CHIEF SECRETARY, TREASURY said that at their meeting in July, Cabinet had set the objectives of keeping as close as possible to the existing planning totals, and of ensuring that public spending as a proportion of national income continued to fall over the three Survey years. At the start of the Survey total additions sought to programmes, including those which had already been agreed, had been £8.7, £13.2 and £18.7 billion in the three Survey years. These additions were very large but in the Survey discussions it had been possible, with the cooperation of colleagues, to reduce them substantially, while still reflecting the Government's priorities. The final outcome, subject to the agreement of Cabinet, was for additions to programmes of £3.5, £6.8 and £11.3 billion. The prospective outturn of the planning total in 1988-89 was put at £153.6 billion, £3.3 billion below the plan.

As to individual programmes, he had agreed an increase in provision for health of about £1 1/4 billion in 1989-90 and £1 1/2 billion in the following year. The health programme would also benefit from new cost improvement programmes, land sales and a reduction in employers' superannuation contributions. The result would be to increase resources for the National Health Service (NHS) in England alone by £1 3/4 billion and over £2 billion respectively in the two years. These were the largest increases ever made for the NHS. The Home Office would receive increases of £246 million, £354 million and £324 million in the three Survey years, mainly for prison building and prison manpower. For housing, receipts from council house and other sales would yield some £4 billion over the three years, and there would be additions to gross capital spending on housing of about £450 million a year. There would be a step change in expenditure by the Department of Transport on the national roads programme, rising to an increase of £406 million in the Department's programme in 1991-92. For the Department of Education and Science he had agreed an addition of some 16 per cent in the Science Budget between 1988-89 and 1989-90, reflecting the Government's view of priorities for science and technology. Ministry of Defence expenditure would increase by £160 million, £610 million and £1024 million in the three years, and would also benefit from substantial efficiency savings.

These were substantial additions and had been possible within a satisfactory overall settlement only because colleagues had helped by reducing other bids and because of the savings resulting from the Government's policies. For example, the fall in unemployment had produced considerable savings in the social security and employment programmes; the right to buy policy had produced very large receipts; the trading results of the nationalised industries had improved; and savings had been obtained on the Common Agricultural Policy. The reduction of debt was also bringing substantial savings in debt interest. But notwithstanding these benefits, difficult policy decisions had still been necessary on almost all programmes.

The discussions on running costs had been difficult, and there would be a higher increase in 1989-90 than in previous years. But the settlements were within the agreed objective of keeping the running costs share of the planning total roughly constant. He was grateful to most colleagues for agreeing three year cash settlements on running costs.

THE CHANCELLOR OF THE EXCHEQUER, after laying before the Cabinet the press notices which it was proposed that the Treasury should publish that afternoon, said that the outcome of the Chief Secretary's discussion was an increase in programme spending of £3.5 billion in 1989-90 and £6.8 billion in 1990-91, compared with uncommitted reserves in those years of £7 billion and £10.5 billion. Reserves should be at least equal to those fixed after last year's Survey, at £3.5 billion, £7 billion and £10.5 billion in the three years. This meant that there need be no increase in the reserve, or the planning total, in 1989-90, and an increase of £3.3 billion in 1990-91. The planning totals would be £167.1 billion, £179.4 billion and £191.6 billion in the three years. The increase in programme expenditure, at over 3 per cent a year in real terms during the Survey period, was at the limit of what could be afforded. Nevertheless, the outcome was generally satisfactory. In particular, the Government's success in avoiding an increase in the planning total in 1989-90 would be welcomed by the markets, who were not expecting so good a result.

The Cabinet's objective of ensuring that public spending continued to fall over the three Survey years as a proportion of national income had proved to be demanding. This was because the ratio in the current year, at 39 3/4 per cent, had proved to be the lowest for twenty years, partly because spending was turning out below plans and partly because growth in the economy had been higher than expected. The outcome was however a declining path for the ratio, which would fall to 39 1/4 per cent, 39 per cent and 38 3/4 per cent in the three Survey years.

The outcome on General Government Expenditure had also been helped by an expected decline in debt interest. Debt repayment in 1988-89 would be about £10 billion, and the Government would be in surplus even disregarding privatisation receipts. There would clearly have to be another substantial repayment next year.

The Autumn Statement would also as usual contain the decisions on National Insurance Contributions for next year, which he had agreed with the Secretary of State for Social Security. The only new element in the decisions this year was that the Treasury Supplement, which had been 18 per cent when the Government took office and now stood at 5 per cent, would be abolished.

THE CHANCELLOR OF THE EXCHEQUER said that the Autumn Statement would also contain his economic forecasts. Demand in the current year had grown faster than expected. It would however be useful to emphasise in public discussion that investment was growing twice as fast as consumption, as it had done during the last five years. Indeed it had grown faster throughout the Government's period of office. This was the reverse of what had happened under the preceding Government. Inflation, as measured by the Retail Price Index (RPI) was now expected to reach 6 1/4 per cent in the fourth quarter of the current year as against the 4 per cent earlier forecast. Over half the deterioration was due to increases in mortgage repayments. The current account deficit for the year was now forecast at £13 billion.

As to next year, he expected growth to fall back to 3 per cent. Inflation would edge up in the first half of the year but decline again to 5 per cent in the fourth quarter. The main impact on the current account of the measures recently taken would not be felt until 1990, and he forecast a deficit of £11 billion next year. The world outlook was reasonably good, with a slight fall in growth and a slight upturn in inflation expected next year, but neither on such a scale as to cause alarm. The main preoccupation of the international markets in the short term would be with the result and aftermath of the United States Election and there might be some turbulence until they gained confidence in the new Administration.

Altogether there was a good prospect that the United Kingdom economy would achieve a 'soft landing'. But it was essential to retain international confidence, especially to finance our trade deficit. This required continued pursuit of sound policies, and especially control of public expenditure. The Autumn Statement would be a contribution to this.

In discussion the following main points were made:

a. The Chief Secretary was to be congratulated on an outcome to the Survey which was satisfactory both economically and politically and combined a satisfactory settlement on overall expenditure with a recognition of the Government's priorities.

b. The very substantial receipts from the right to buy policy had made a major contribution to the satisfactory outcome of the Survey. But the stock of cheap housing for renting was being reduced by the sale of council houses, and a serious shortage could develop. This could become a significant problem in the medium term.

c. The inclusion of mortgage interest payments in the RPI raised difficult questions. It could be argued that increases in such payments had a major effect on the ordinary householder, who would therefore expect them to be in the Index. Also the RPI would benefit from a future fall in mortgage interest, unwinding the effect of the recent rise. On the other hand, it was clear that the inclusion of mortgage interest payments in the RPI made it an incorrect measure of inflation and was not the practice adopted in most other countries. It also led to the perverse result that measures, like the rise in interest rates, which were aimed at reducing inflation had as their first effect an increase in the published Index. It would be difficult to make any change in the RPI without the agreement of the RPI Advisory Committee. It would probably be necessary at some time to raise again with the Committee the inclusion of mortgage interest payments. This could best be done when their exclusion would make no difference to the Index. Meanwhile the Secretary of State for Employment had agreed that when the RPI was published he would also state, for information, what the figure would be if mortgage interest payments had not been included. There was also a question whether the present composition of the Advisory Committee was appropriate.

d. The reduction below 40 per cent of the ratio of public expenditure to Gross Domestic Product was a major achievement and there was a case for drawing special attention to it in public discussion. But the level of the ratio depended on what happened to economic growth. If that declined, the ratio would probably rise and it was essential to avoid any sense that discipline could be relaxed. On balance it seemed unwise to give undue prominence to the fall in the ratio.

e. The high level of increase in earnings was one of the least satisfactory features of the economy at present. It was true that unit labour costs had, because of high productivity, increased only modestly in recent years. But the record of our competitors was better, with many enjoying a fall in unit labour costs. It was important that increases in the pay round just starting should not be excessive, and a number of difficult negotiations were in prospect in the public sector.

THE PRIME MINISTER, summing up the discussion, said that the Cabinet congratulated the Chief Secretary on the outcome of the Survey. They endorsed the agreements he had reached on individual programmes, and his conclusions on running costs, and noted the estimated outturn on public expenditure for 1988-89. They also agreed with the recommendations made by the Chancellor of the Exchequer as to the content of the Autumn Statement, and noted that he would deliver an oral statement in Parliament that afternoon, with publication of the full printed version on 8 November. She would arrange for the press to be told that the Cabinet had today successfully concluded its work on the 1988 Public Expenditure Survey, and that the Chancellor proposed to make his Autumn Statement to the House that afteroon, setting out the outcome of the Survey and the prospects for the economy.

The Cabinet -

1. Endorsed the recommendations in the memorandum by the Chief Secretary.

2. Took note that the Chancellor of the Exchequer would make his Autumn Statement later that day.

TOP-UP LOANS FOR STUDENTS

3. The Cabinet considered a memorandum by the Secretary of State for Education and Science (C(88) 14), to which was attached a draft White Paper on top-up loans for students.

THE SECRETARY OF STATE FOR EDUCATION AND SCIENCE said that the draft White Paper proposed that from October 1990 all full-time home students in higher education, other than postgraduates, would be eligible for top-up loans. At the same time they would lose their entitlement to social security benefits. All other students now entitled to claim benefit would also be disentitled from that date. Three Access Funds would be established, along the lines described in the draft White Paper and administered by the education institutions to provide students with assistance on a discretionary basis. The White Paper illustrated a figure of £420 for the size of a full year loan, for students not at home and not in London, on the inception of the scheme. The proposal was that thereafter any uprating of students' total resources in grant and loan would be applied to the loan facility only, until it equalled the grant and parental contribution taken together. It was important that the scheme should be administered by the financial institutions. They were being difficult in negotiation but if the Cabinet approved his proposals he proposed before the White Paper was published to see the Governor of the Bank of England and the Chairmen of the Committee of London and Scottish Banks and of the Building Societies Association and press them to co-operate.

THE SECRETARY OF STATE FOR EDUCATION AND SCIENCE said that opinion in the educational world was now ready to accept the proposals he was putting forward. It would be a great prize for the Government to secure them. The withdrawal of students from the social security system, which Beveridge had never intended to cover them, would be especially welcome. He believed that the proposals could be presented positively to students, parents, universities and the public at large and he hoped that colleagues would endorse them and agree to early publication of the White Paper.

In discussion the following main points were made:

a. In presentation, it would be wrong to put the main emphasis on the eventual savings, important through these were. The point to stress was the educational advantages and the change in culture which the scheme would bring about, by giving students more responsibility and freedom of choice. The statistic in the White Paper that 77 per cent of students now drew social security benefits was striking. The generosity of treatment of students in the United Kingdom, in comparison with other countries, should also be stressed.

b. Repayments would be comparatively low, even in the early years of a student's working life when his income would probably be modest and he would be acquiring new responsibilities. Nevertheless, there would inevitably be hard cases and there must be some means of adjusting repayments to students' resources. There were objections to operating through the tax system. Probably the best solution would be to provide that where earnings were low - for example, less than 85 per cent of national average income - repayments would be deferred, and the period of the loan extended. After consultation an incentive to early repayment could also be considered.

c. It was undesirable to extend the loan facility to post-graduates. They could be in their late twenties or even early thirties. Their needs could be dealt with through their Access Fund, for which funding was being proposed at a generous level.

d. Present plans were that the necessary legislation would be announced in the Queen's Speech at the start of the 1989-90 Session, and carried in time for the scheme to start in autumn 1990. The White Paper must however be so drafted that it did not anticipate the Queen's Speech.

e. Some of the drafting of the White Paper contained infelicities and needed to be tightened up.

THE PRIME MINISTER, summing up the discussion, said that the Cabinet endorsed the proposals in C(88) 14, and noted that the Secretary of State planned to publish the White Paper in the week of 7 November, on a day to be settled in detailed discussion. Any further detailed drafting amendments should be conveyed to the Secretary of State urgently.

The Cabinet -

Took note with approval of the Prime Minister's summing up of their discussion and invited the Secretary of State for Education and Science to proceed accordingly.

Cabinet Office

1 November 1988