

Meeting folder

SECRET

Prime Minister

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FROM: CHIEF SECRETARY

DATE: 15 February 1983



cc P. Grogan
DHSS

PRIME MINISTER

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You asked me recently whether we might give up our proposal to make an adjustment to this year's social security uprating on account of last year's overshoot and instead return to the historical method of uprating.

2. I have discussed this idea with the Chancellor. We have considerable reservations about it.

Dispute

3. First, reversion to the historical method is unlikely to be less controversial than making the adjustment, and could be more so. If the historic method produced an uprating equal to that which would have been produced by the forecast method less the adjustment, then it would appear that the Government, having calculated that it would fail to carry the adjustment, was just trying to achieve the same result by different means. What matters to the pensioner is the level of the uprating, not how it was calculated. By using a different method of calculation, the Government would appear devious as well as mean.

4. I deal with the possible outcomes for the uprating below. But it looks now as though the May inflation figure, on which a historical uprating would logically be based, could well be the lowest of the year. The Government would be accused of having chosen this month, of all possible months, as the basis for the uprating, purely in order to save what it would otherwise have saved by the adjustment. We would stir up an entirely new argument about the merits of the alternative uprating methods; and our change of tactics would be taken as an admission that inflation was on the way up again, not only through 1983 but afterwards.

5. We could only escape the accusation of meanness if it were clear that the uprating which would be produced by historical method were higher than that produced by the forecast method less the adjustment. But that of course would mean additional public expenditure.

6. In practice, there may not turn out to be much in it either way. On present prospects, the May inflation rate will be in the range $3\frac{1}{2}\%$ - 5% , with perhaps the most likely outcome giving an uprating of 4% - $4\frac{1}{2}\%$. The Budget forecast of inflation in the twelve months to November is likely to be in the range 5% - 7% , with 6% as the most likely figure, giving an uprating after the adjustment of 4% . There is a range of possible outcomes but a risk of additional expenditure. If the historical method uprating were 1% higher than the forecast method, it would mean additional public expenditure of about £100 million in 1983-84 and about £300 million in a full year.

Conflict with
Mr Fowler's
estimate

7. We shall not know which method would be more expensive until June, when the May inflation rate is known. But there is a real risk that sums of the order of £300 million in a full year could be at stake, and this uncertainty about public expenditure could be damaging at Budget time. Under the forecast method of course the uprating is fixed at Budget time on the basis of the Budget forecast, so that the effect on public expenditure is known.

8. We do not underestimate the difficulties of getting the adjustment. But they should be reduced by the benefit improvements which we have in mind. The Chancellor expects to announce a caring package in the Budget which will include several attractive, though inexpensive, measures to help the sick and disabled. There should also be a big increase in child benefit which will restore it to its real level when we entered office.

9. A last point is that a return to the historical basis would strengthen indexation by making the link between benefits and prices more certain and automatic. It would be difficult, if

not impossible, to avoid giving full price protection in the necessary legislation to all benefits, including those not covered by the present pledge of full price protection. Specific primary legislation would be needed in every year if we wished to increase benefits by less than the full amount of the historic inflation rate. Moreover, it would be much more difficult to carry through de-indexation in a new Parliament if we had just legislated to confirm indexation in the last year of the previous Parliament.

10. The balance of argument is clearly a matter of judgement. But we prefer to keep to the announced policy because the alternative could be equally or more controversial, would risk increasing public expenditure, and would strengthen indexation.

J. Gieve

J. Gieve LEON BRITTAN
15 February 1983

[Approved *[initials]* by Chief Secretary]