

SUBJECT

cc Master



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cc: HMT
Chy Sec's Office
CO (Gregson
ARTA

10 DOWNING STREET

From the Private Secretary

21 February 1983

Dear David

UP-RATING OF PENSIONS AND OTHER BENEFITS

The Prime Minister held a discussion this afternoon of the matters set out in your Secretary of State's minute of 11 February, and the Chief Secretary's minute of 15 February. In addition to your Secretary of State, the Home Secretary, Chancellor of the Exchequer, Chancellor of the Duchy of Lancaster, the Chief Secretary, and Mr. Gregson, Cabinet Office, were also present.

The Prime Minister explained the background to the discussion. She saw considerable attraction in the longer-run in moving from the forecast to the historic method of up-rating. Such a move would enable the Government to by-pass continuing political difficulty in years to come stemming from over-shoots and under-shoots. She would prefer the historic method to be based, if possible, on the June RPI figure which would become available in July; but she recognised that this would depend upon how quickly the pension, and so on, books could be produced.

The Chancellor said that it would be most important for his Budget arithmetic to secure the savings which were shown in the Public Expenditure White Paper on account of recovery of last year's over-shoot. Your Secretary of State's proposal was designed to be neutral on this point, on the basis that the November RPI figure, whatever it was, minus the 2 per cent adjustment was likely to be roughly equal to the May RPI figure, whatever that proved to be. From the pensioners' point of view, therefore, the cash increase would be the same whatever method of up-rating was chosen.

In discussion it was argued that a return to the historic method would make the handling of the social security up-rating much easier in political terms not only this year but in the future. Only twice since the forecast method had been adopted had forecasts proved correct. The Opposition would have difficulty in attacking the Government for making this move, given the circumstances in which the Labour Government moved from the historical to the forecast method. The attraction of making the change now

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was that it would be a very expensive change to make when inflation was falling; the present situation, in which the change could be made without cost to Government or pensioner, would not easily recur. Furthermore, a move to the historic method on the basis proposed might well seem to the Government supporters to produce a deal generous to the pensioners in relation to what the Public Expenditure White Paper had led them to expect. Against this it was argued that a move to the historic method involved a greater risk of a more expensive uprating than otherwise would occur. The cost of every additional one per centage point would be £100 million in the first year and £300 million in a full year. It would not be possible to choose this course in preference to various improvements in other social security benefits, since some of these improvements were in any event inescapable: restoration of the 5 per cent abatement of unemployment benefit now seemed unavoidable; nor did it seem likely that the increase in child benefit could be kept down to 3 per cent. In addition to these financial arguments, a political case could also be made: since the Government would not be giving up the savings it had scored for recovery of over-shoot, its critics would direct all their fire against the move to the historic method. They would charge the Government with being devious as well as mean. Finally, the change would be taken as a signal that the Government believed inflation would rise rapidly.

Summing up the discussion, the Prime Minister said that it was agreed that the Government should seize this opportunity of returning to the historic method of uprating, which was methodologically far more satisfactory. She would wish to consider further how public service pensioners should be treated, but her initial conclusion was that they, too, should be switched to the historic method. She would raise the matter orally at Cabinet on 3 March. Knowledge of the decision should be restricted to as few people as possible: the Prime Minister asked your Secretary of State to consider whether the timetable made it necessary for legislation to be prepared in the meantime.

I am sending copies of this letter to John Kerr (HM Treasury), John Gieve (Chief Secretary's Office) and Peter Gregson (Cabinet Office). I should be grateful if you and they would ensure that it is neither copied nor circulated outside your Private Offices; and that it is seen by only those specifically authorised by your Ministers to do so.

Yours sincerely,

Michael Scholar

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