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CABINET

PUBLIC EXPENDITURE

Memorandum by the Chancellor of the Exchequer and the
Chief Secretary, Treasury

1. In the light of our discussion on 24 January (CC(80) 3rd Conclusions, Minute 7), we have held further meetings with the Ministers concerned. The outcome of those discussions and our recommendations are described in the following paragraphs. The revised list of proposed reductions on the programmes we agreed in the autumn is at Annex A.

SOCIAL SECURITY

2. Further discussion with the Secretary of State for Social Services has led to revised proposals being agreed as set out in Annex C. These agreed savings are not, however, sufficient from this very large programme and we must seek more.

3. The Chief Secretary, Treasury, and I accept that we cannot secure any savings from less than full-price protection of retirement pensions - the bulk of the programme.

4. The Secretary of State for Social Services proposes to give a £1 per week increase in child benefit (from £4 to £5) next November. The Chief Secretary, Treasury, and I are not able to agree to this; we need a further saving totalling at least £200 million per annum from this programme for 1981-82 and later years. Annex C shows two ways of achieving this. The first, which we prefer, is our earlier proposal that child benefit should be increased by 50p with a new premium of £1 given for the fourth and later children, and that in the interests of work incentives supplementary benefit children's scale rates should be held back so as not to narrow the differential between in-work and out-of-work income. The second would be to give a 75p increase in child benefit, with no premium, and with this to suspend the Christmas bonus and freeze the earnings rule for pensioners. The savings from these alternatives, compared with the Secretary of State for Social Services' proposal, would be:

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	£ million			
	1980-81	1981-82	1982-83	1983-84
The first alternative (50p child benefit etc)	95	235	240	250
The second alternative (75p child benefit, suspend Christmas bonus etc)	145	215	215	215

Some combination of these, or other variants, would be acceptable, provided it yielded at least £200 million per annum in 1981-82 and later.

HOUSING

5. The Secretary of State for the Environment has agreed to the following reductions:

	1980-81	1981-82	1982-83	1983-84
	270	489	605	695

He wants to be free to settle the composition of his programme for the three later years nearer the time. For illustration, one combination of measures to achieve his proposals might involve rent increases of 60p a week next October and £2.50 a week each year from 1981-82; and council housebuilding approvals of 35,000 in 1980 and 30,000 a year thereafter. We would not propose going further on rents, but in view of the severe difficulties on other programmes we suggest further cuts on capital, as follows:

	£ million			
<u>New housebuilding</u>	37	69	57	67
Reduce to 30,000 approvals in 1980 instead of 1981; curtail land acquisition, reduce unit costs				
<u>Council house improvements/other investment</u>	30	45	35	35
Reduce in 1980-81 to 95% of 1978-79 level and to 85% from 1981-82 onwards				
<u>Private sector housing</u>	55	60	65	65
10% cut in present spending on renovation grants, abolish insulation grants, cut mortgage lending to 1977-78 level				
	<u>122</u>	<u>174</u>	<u>157</u>	<u>167</u>

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DEPARTMENT OF THE ENVIRONMENT - OTHER

6. In addition to savings already agreed in his other programmes, the Secretary of State for the Environment has offered further savings of 1 per cent cumulatively in current expenditure on local environmental services, by reductions in manpower; these are included in the figures in Annex A.

EDUCATION

7. In addition to the savings already offered, the Secretary of State for Education and Science has agreed to make further savings of £20 million a year from 1981-82, which he expects to achieve mainly by reducing the provision for local authority higher education. This will involve a reduction of about 10,000 (or 5 per cent) in student numbers in polytechnics and colleges. We have also asked the Secretary of State for Education and Science to consider a further cumulative 1 per cent reduction in the provision for non-teaching staff in the education services which would yield savings rising to £34 million in 1983-84 (see Annex A).

HEALTH

8. Our proposals involve raising the prescription charge to £1 in December 1980 and replacing the present exemptions - which cause two-thirds of all prescriptions to be issued free - by a 50 per cent charge except for those on supplementary benefit and family income supplement. This proposal yields £20 million in 1980-81 and about £120 million in subsequent years. If the prescription is not raised from 70p to £1 in December, but is raised in the following April to an amount necessary to maintain its real value, and exemptions are revised as proposed, the yield would be £10 million in 1980-81 and about £80 million a year in later years.

TRANSPORT

9. The Minister of Transport has offered to increase his savings in 1981-82 from £35 million to £40 million, as for the two later years. (He is also about to propose the sale to the private sector of a stake in the British Transport Docks Board, which would raise between £35 million and £60 million in 1981-82, provided that legislative authority can be obtained in time; this should reduce the Public Sector Borrowing Requirement, and would contribute to the sale of assets programme, but cannot be treated as a contribution to the present reductions in public expenditure.)

AID

10. The Foreign and Commonwealth Secretary has agreed to further reductions in the overseas aid programme beyond those reported in our previous paper (C(80) 3) as follows:

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£ million

1980-81	1981-82	1982-83	1983-84
2	5	10	10

EMPLOYMENT

11. The Secretary of State for Employment accepted annual savings of £30-£35 million before we discussed the extension of special employment measures. We have now agreed that we cannot afford to continue the Small Firms Employment Subsidy, but that the Temporary Short-Time Working Scheme and the Job Release Scheme should continue for a further year (the latter in a substantially reduced form). This will abate the savings by about £20 million in both 1980-81 and 1981-82.

DEFENCE

12. In the light of our Manifesto commitments, and the North Atlantic Treaty Organisation (NATO) 3 per cent target, we have not hitherto sought major reductions on defence, but the Secretary of State for Defence has now accepted cuts of £62 million in 1980-81 and £10 million in 1981-82. The application to defence of the same cash limits regime as for other programmes is likely to cause a further volume reduction in the defence programme next year, but - in line with the Manifesto commitment on Armed Forces pay - we accept that the cash limits should be increased as necessary to accommodate any extra costs (above the provision included at the outset) arising from the implementation of decisions on the forthcoming Armed Forces Pay Review Board report. They will also be subject to review during the year in the light of developments in the international situation and NATO's response to them. The reduced 1980-81 figure (£8 billion) will represent an increase of some 3.6 per cent on the latest 1979-80 forecast outturn. The reduced 1981-82 total (£8,240 million) will represent a 3 per cent increase, and to allow for further 3 per cent increases and the possibility of some expenditure on Polaris replacement, we are content that the comparable figures for total defence expenditure in the last two years of the Public Expenditure Survey period should be £8,487 million and £8,742 million respectively.

FOREIGN AND COMMONWEALTH OFFICE

13. The Foreign and Commonwealth Secretary has agreed to a reduction in the Government's grant to the core budget of the British Council in future years by £3.9 million, gross of the costs of redundancy payments. The net amount will depend on the timing of implementation of the reduction, which has still to be decided.

CASH LIMITS

14. The cash limits agreed by the Cabinet in December are likely to cut the volume of expenditure further in 1980-81. We cannot assess the extent of this reduction until we have a new forecast of inflation, and the Cabinet should have a further discussion of this aspect then.

AGGREGATE EXPENDITURE

15. We attach at Annex B a table of provisional totals of expenditure on the assumption that the proposals in this paper are accepted. They incorporate additional savings found by the Home Secretary since our last meeting and some net additions to the Welsh programmes (see Annex A).

CONTINGENCY RESERVE

16. It is assumed in Annex B that savings from uprating child benefit by less than proposed by the Secretary of State for Social Services would be reflected by a corresponding reduction in the Contingency Reserve and thus in total expenditure. In view of the uncertain prospects in the nationalised industry sector, however, it would be premature to take a final decision now on the Contingency Reserve which needs to be provided for 1980-81 and later years. We will bring forward a recommendation on this with the draft White Paper when the prospects will be clearer.

CONCLUSION

17. We invite the Cabinet:

- i. To decide the outstanding issues on social security (paragraphs 3 and 4), housing (paragraph 5) and education (paragraph 7).
- ii. To endorse the other proposals for reductions in Annex A.
- iii. To note that a White Paper incorporating these proposals will now be prepared for publication in March.

G H
J B

Treasury Chambers

29 January 1980

<u>Proposed changes</u>	<u>80-81</u>	<u>81-82</u>	<u>82-83</u>	<u>83-84</u>	<u>Main measures involved</u>
Social security					
Agreed	-100	-275	-330	-380	See paragraphs 2-4.
Further reductions proposed by Treasury Ministers	-95	-235	-240	-250	
Housing					
Agreed	-270	-489	-605	-695	See paragraph 5.
Further reductions proposed by Treasury Ministers	-122	-174	-157	-167	
DOE - Other	-	-40	-62	-74	See paragraph 6.
Education					
Agreed	-16	-62	-75	-84	Uprate student grants by less than increase in prices, reduce provision for under-fives and halve assisted places scheme; reduce local authority higher education.
Further reductions proposed by Treasury Ministers	-	-13	-24	-34	Cumulative 1% reduction in non-teaching staff employed by local authorities (see paragraph 7).
Health	-20	-120	-125	-80	See paragraph 8. £50m allowed in 1983-84 for demographic growth.
Transport	-	-40	-40	-40	Road construction and local authority expenditure on road maintenance and administration and concessionary fares; savings in 1981-82 increased since 24 January.
Overseas aid	-2	-24	-38	-38	See paragraph 10.
Employment	-17	-9	-27	-23	Mainly savings on Manpower Services Commission expenditure eg training (subject to consultation with MSC), partially offset by special employment measures (see paragraph 11).
Defence	-62	-10	+37	+92	See paragraph 12.

/continued ..

<u>Proposed changes</u>	<u>80-81</u>	<u>81-82</u>	<u>82-83</u>	<u>83-84</u>	<u>Main measures involved</u>
FCO - Other	-	-1½	-1½	-1	Further/reductions in grant to British Council dependent on considerations in paragraph 13.
Home Office	-	-18	-25	-29	Mainly economies in fire service; savings increased since 24 January.
Energy	-15	-10½	-7½	-6½	Mainly estimating changes in Redundant Mineworkers' Payments Scheme.
Lord Chancellor's Dept.	-7½	-4	-2	-2	Legal aid fund and capital.
Export credit and home shipbuilding	-8	-37	-84	-126	Withdrawal of refinance from April under fixed-rate lending scheme.
Consequentials - Scotland, Wales, N. Ireland	-91½	-206½	-239½	-258½	
Wales	+11½	+10	-	-	Steel closure remedial measures, net of savings on other Welsh programmes.
TOTAL	-814	-1758	-2045	-2196	

Further/reductions in grant to British Council dependent on considerations in paragraph 12

Proposed changes
 ECO - Other
 80-81 81-82 82-83 83-84
 - -1 -1 -1

Public expenditure 1974-75 to 1983-84

	Outturn						Plans			
	74-75	75-76	76-77	77-78	78-79	79-80	80-81	81-82	82-83	83-84
Outturn (actual or projected), before further cuts*	71626	71887	70069	65852	69600	69800	69950	70050	69000	69000
Cuts proposed (Annex A)	-	-	-	-	-	-	-814	-1758	-2045	-2196
Outturn resulting [‡]	71626	71887	70069	65852	69600	69800	69150	68300	66950	66800
Percentage change on previous year	[+8.5] ^x	+0.4	-2.5	-6.0	+5.7	+0.3	-0.6	-1.2	-2.0	-0.2

* Total as defined in line 13 of table 1 of Cmnd 7746. Subject to further revision, especially in 1979-80. Includes (in the years 1980-81 to 1983-84) approximate adjustments for revised assumptions about unemployment, inflation etc (mainly affecting social security).

‡ Rounded to nearest £50 million in the years 1980-81 to 1983-84.

x Approximate; excludes nationalised industries' short-term borrowing and capital value of leased assets.

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SOCIAL SECURITYThe Proposals

The agreed proposals are shown in Table 1 attached. They mainly differ from those considered by Cabinet last week in that :-

- a. ERS is now proposed to be abolished from 1 January 1982 instead of 1 January 1981. This preserves entitlement arising from contributions already paid.
- b. The entitlement formula is nevertheless to be amended from 1 January 1981 until abolition by reducing the return on earnings between £30 and £135 from 15 per cent to 10 per cent.
- c. Certain short term benefits and invalidity benefits are to be uprated by 5 per cent, rather than 10 per cent, less than prices.
- d. Linking rules - spells of unemployment and sickness should be linked only if they fall within 6 weeks of each other rather than present 13.
- e. The proposal to abolish death grant is dropped.

2. Additional proposals are shown in Table 2 attached. These are two variants but combinations are possible.

Views of the Secretary of State and the Chancellor on additional proposals

3. The Secretary of State considers child benefit, which needs to go up by more than £1 in November just to keep pace with prices since April 1979, should be raised across the board from £4 to £5. The importance of child benefit to the incentives equation is that social security benefits are reduced £ for £ while the worker has the benefit in addition to wages. There are also now no child tax allowances and child benefit is the only significant means by which help may be given to the family man above the poverty line.

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There is evidence that a lot of the pressure for higher wages comes from men with family responsibilities. If personal tax allowances are price protected and child benefit not, the family man with children is singled out for unfavorable treatment.

4. Even if less than full price protection were given to child benefit the Secretary of State does not consider that there should be any cut in the basic subsistence level for children on short term supplementary benefit. He points out that of the $\frac{1}{2}$ million children involved, 300,000 are in one-parent families, families of the sick, for whom the incentives argument is not relevant; the cut would therefore be small in relation to the total "why work" problem anyway, and the political difficulties of selecting the children's rates for cuts are obvious. Moreover he thinks that such cuts would run entirely counter to the Government's declared policy being implemented in the Social Security Bill now before Parliament to switch supplementary benefit resources towards families with children on supplementary benefit because they of all groups find it most difficult to manage.

5. The Secretary of State does not therefore consider either of the variants proposed is acceptable, but would be prepared to legislate to suspend the Christmas Bonus despite the difficulties in doing so.

6. The Chancellor's view as to child benefit is that an increase of as much as £1 is not justifiable in current circumstances. Price protection is not required either by statute or by custom, and it is most undesirable to extend indexation. The benefit itself goes indiscriminately to all with children, whether they are rich or poor; the arguments about poverty and incentives apply to only a minority of recipients and would be met in part by the proposed premium for the 4th and subsequent child. So far as supplementary benefit goes, the Chancellor thinks that as a consequence of less than full price protection of child benefit children's scale rates must be held back in the interests of work incentives, in the same way that broadly similar steps have already been agreed in respect of child dependency allowances payable with sickness and unemployment benefit. He notes that supplementary benefit levels are otherwise virtually untouched.

SOCIAL SECURITY

Savings £ million 1979 Survey Prices

Agreed proposals

	<u>1980-81</u>	<u>1981-82</u>	<u>1982-83</u>	<u>1983-84</u>
<u>A. Earnings Related Supplement</u>				
Abolish as from 1 January 1982 (thus respecting current contribution entitlement).	-	30	130	130
<u>B. Alter entitlement formula (see text) until abolished</u>	10	50		
<u>C. Short Term Benefits and Invalidity Benefit</u>				
Increase adult rates of unemployment, sickness, injury benefit, maternity allowance and invalidity benefit and allowances by 5 percentage points less than required to give full price protection (probably giving an increase of about 10 percentage points in cash terms.)	35	105	90	90
<u>D. Up-rating Date</u>				
Put back one further week	40	40	40	40
<u>E. Linking Rules</u>				
Alter to 6 weeks basis (see text)	5	20	5	5
<u>F. Short Term Supplementary Benefits</u>				
Uprate by <u>lower</u> of earnings and prices (assume to be 1 per cent).	5	10	10	10
<u>G. Unemployment Benefit</u>				
Withhold for those with substantial occupation pensions	5	20	20	20
<u>H. Earnings Rule</u>				
Defer start on abolition to 1983-84.	-	-	35	85
	100	275	330	380

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ADDITIONAL PROPOSALS

	Savings £ million 1979 Survey			
	1980-81	1981-82	1982-83	1983-84
<u>VARIANT I</u>				
I. 50p increase in child benefit	90	230	235	245
J. Premium of £1 for fourth and subsequent child	(5)	(20)	(20)	(20)
K. Restrict increase in supplementary benefit child rates	10	25	25	25
	95	235	240	250

VARIANT II

L. 75p increase in child benefit	50	120	125	130
M. Suspend £10 Christmas Bonus	90	85	80	75
N. Freeze pensioners earnings rule (at present £52) instead of increasing in line with earnings	5	10	10	10
	145	215	215	215

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