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E(80) 2nd Meeting

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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

MINUTES of a Meeting held at
10 Downing Street on
WEDNESDAY 23 JANUARY 1980 at 11.00 am

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon Lord Carrington
Secretary of State for Foreign and Commonwealth Affairs
(Item 1)

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer

The Rt Hon James Prior MP
Secretary of State for Employment

The Rt Hon Peter Walker MP
Minister of Agriculture, Fisheries and Food

The Rt Hon Michael Heseltine MP
Secretary of State for the Environment

The Rt Hon David Howell MP
Secretary of State for Energy

The Rt Hon John Biffen MP
Chief Secretary, Treasury

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon Patrick Jenkin MP
Secretary of State for Social Services (Item 1)

Viscount Trenchard
Minister of State
Department of Industry

Mr Paul Channon MP
Minister of State
Civil Service Department

Mr Hugh Rossi MP
Minister of State
Northern Ireland Office
(Item 1)

Sir Kenneth Berrill
Central Policy Review Staff

SECRETARIAT

Sir Robert Armstrong
Mr P Le Cheminant
Mr P Mountfield

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1	BRINGING SHORT TERM BENEFITS INTO TAX
2	INFLATION-PROOFED OCCUPATIONAL PENSIONS

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1. BRINGING SHORT-TERM BENEFITS INTO TAX

The Committee considered papers E(80) 3 by the Chancellor of the Exchequer and E(80) 2 by the Minister of State, Civil Service Department

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2. INFLATION-PROOFED OCCUPATIONAL PENSIONS

The Committee considered a paper by the Chancellor of the Exchequer

Their discussion and conclusions reached for the both of these items are recorded separately.

Cabinet Office

23 January 1980

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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

LIMITED CIRCULATION ANNEX
E(80) 2ND MEETING MINUTES
WEDNESDAY 23 JANUARY 1980 AT 11.00 AM

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1. BRINGING SHORT TERM BENEFITS INTO TAX

The Committee considered a memorandum by the Chancellor of the Exchequer (E(80) 3) on the taxation of short term benefits, covering a note by the Inland Revenue dealing with the coverage of, and various possible methods of implementing the proposals; together with a note by the Minister of State, Civil Service Department (E(80) 2) on the manpower implications of these proposals.

THE CHANCELLOR OF THE EXCHEQUER said that both main political parties agreed that short term social security benefits were a form of income which in principle should be taxed. The Government had already agreed to transfer the main burden of sickness benefit from the State to the employer, and benefits paid by the employer would automatically be subject to tax. There might be a residual problem if certain small employers were exempted from these measures. The other main group of short term benefits were those paid to the unemployed. These included unemployment benefit itself, the earnings-related supplement, and some supplementary benefits. There were two main methods of taxing these benefits: by deducting tax from the payments as they were made (Method A), or by calculating the tax liability at the end of the period of unemployment (Method B). After discussion with the Secretary of State for Employment and the Secretary of State for Social Services, he had concluded that the second was the more defensible method. But it could not be introduced until 1982. Interim measures might be possible, for example by making a flat-rate deduction from benefit in lieu of tax, but this was not a satisfactory long-term solution. The original estimates of staff costs had been pared down, but it was likely that at least 2,000 additional staff would be needed, in the three Departments concerned, to operate Method B properly.

In discussion, the following points were made -

a. The Cabinet would be considering the next day proposals for a series of reductions in public expenditure, which would have direct implications for the current proposals.

b. There was general agreement that the aim should be to bring unemployment benefit (up to the standard rate), the earnings related supplement and supplementary benefit paid to the unemployed, within the tax net. The additional supplementary benefit allowances for children would not be taxed.

c. Similarly, it was generally agreed that the subsequent method of taxation (Method B) was both the right and the administratively less burdensome method.

d. It was highly desirable that these benefits should be taxed, if possible, from 1981 rather than from 1982. The original proposals should be re-examined to see whether this was feasible, and whether interim mechanisation would help.

e. Because mechanisation of benefit-payment in Northern Ireland was not scheduled for completion until 1984, taxation of benfits would have to be undertaken manually until then, and some additional staff would be needed for this purpose. It would nonetheless be preferable to introduce the taxation of benefits in Northern Ireland at the same date as in Great Britain, even at the cost of some additional staff, provided that there was a net saving overall.

f. If the staff savings already agreed were not to evaporate, Ministers would need to be ready, when they decided to undertake some major new task, to give up other operations in order to keep down the numbers of additional staff required. Ideally there should be no net additional staff needed. The staffing estimates for these proposals had already considerably reduced, but there was probably scope for further reduction, or for offsets in other parts of the Departments concerned. The Department of Health and Social Security could meet the additional staff requirement within its existing ceilings. These estimates should be reviewed again in the light of the possibility of a 1981 start-up.

THE PRIME MINISTER, summing up the discussion, said that the Committee approved the Chancellor of the Exchequer's main proposals on the coverage of the scheme, and endorsed his preference for Method B. They were not satisfied on the proposed date of implementation of the new arrangements which they would much prefer to come into force in 1981; nor did they accept the additional staff requirement could not be further reduced or offset by savings in staff elsewhere in the Departments concerned. They would prefer to see the scheme introduced in Northern Ireland at the same date as in Great Britain. They would want to return to these matters at an early meeting.

The Committee -

1. Approved the proposal in E(80) 3 for the taxation of certain specified short term benefits to the unemployed by the 'subsequent' method (Method B).

2. Invited the Chancellor of the Exchequer, in consultation with the Secretaries of State for Employment and for Social Services, to consider further whether it would be possible to introduce this scheme from the beginning of the financial year 1981-82.

3. Invited the Chancellor of the Exchequer, in consultation with the Secretaries of State for Employment and for Social Services, and with the Minister of State, Civil Service Department, in the light of any revised estimate of the earliest possible starting date, to consider the staff numbers which would be needed, and the scope for offsetting savings.

4. Invited the Minister of State, Northern Ireland Office, in consultation with the other Ministers concerned, to consider what would be the staff costs of introducing the scheme in Northern Ireland from the same date as in Great Britain, whether the scheme would despite those costs yield net gains in revenue during the years before payment of benefits in Northern Ireland was mechanised, and to report to the Committee accordingly on the feasibility and financial implications of bringing the scheme into operation for the whole of the United Kingdom from a single date.

5. Agreed to resume their discussion in the light of these enquiries at an early meeting.

2. INFLATION-PROOFED OCCUPATIONAL PENSIONS
Previous Reference: E(80) 1st Meeting, Item 5

THE COMMITTEE considered a memorandum by the Chancellor of the Exchequer (E(80) 4) proposing the establishment of a small outside committee to advise the Government on the value to be placed upon inflation-proofed occupational pensions.

THE CHANCELLOR OF THE EXCHEQUER said that it would be very difficult for the Government to attack the principle of inflation-proofing public sector pensions, although it was not finally committed to preserve full inflation-proofing at all costs. Yet the cost of these pensions was now very high and was likely to rise in the future. It was necessary to do something to offset this. A more attractive course might therefore be to increase the contribution made by existing employees, or where appropriate to increase the abatement for pensions made in determining their pay. Since the Committee's discussion at their previous meeting, he had refined his proposals for a small outside advisory committee, and in his paper had suggested terms of reference and membership. Ideally, he would have liked a report from this advisory committee in time for it to be used during the present round of public sector pay negotiations, but it seemed unlikely that such a complicated topic could be dealt with so quickly.

The following points were made in discussion -

a. There was arguably no point in or need for such an inquiry. No insurance company would be prepared to quote for an inflation-proofed pension at anything but an astronomical present cost. This demonstrated that the value of such rights was virtually priceless. The right course was to grasp the nettle of indexation, and to abolish index-linking altogether. Against this, it was argued that there were already over 5 million employees in the public sector entitled to index-linked pensions. Many of them were on comparatively low earnings, and the real value of their pensions would be quite small. It would be very difficult for the Government to remove existing rights, many of which were statutory.

b. The real difficulty in putting a value on the right to an inflation-proofed pension lay, not in forecasting the future course of inflation - which was to a degree offset by the effect of inflation on staff contributions - but in predicting the earning power of the assets of pension funds, on which actuarial calculation in this field critically depended. Any published report from an advisory committee which cast doubt on the assumptions currently used by actuaries and pension funds generally could have very far-reaching consequences. It might, for exampl cast doubt on the viability of existing pension funds in the public and private sectors and on the contributions made to them - of which an average perhaps two-thirds come from the employer. The Government needed a much wider appreciation of the factor involved if the risks of change were to be properly evaluated.

THE PRIME MINISTER, summing up the discussion, said that the Chancellor's proposals needed to be re-examined in a wider context before decisions could be reached. It would clearly be impossible to complete such an examination in t to affect this years pay negotiations with the non-industrial Civil Service.

The Committee -

Invited the Chancellor of the Exchequer to arrange for the Treasury, in consultation with the Central Policy Review Staff, to consider the wide financial implications of his proposals, including their implications for **existing** pension funds, in the light of the points made in discussion, and to report back to the Committee in due course.

Cabinet Office
23 January 1980