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MOST CONFIDENTIAL RECORD (MCR)

CC (80) 40th

CAB 128/69

MOST CONFIDENTIAL RECORD

CC(80) 40th Conclusions, Item 7

SOCIAL SECURITY EXPENDITURE

THE CHANCELLOR OF THE EXCHEQUER said that he had agreed with the Secretary of State for Social Services on savings from the proposed move to monthly payments of child benefit, following the study under Sir Derek Rayner, and to a 2 per cent cut on cash controlled expenditure, mainly affecting administration expenses. The outstanding issue for consideration was whether all benefits, including retirement pensions, should be up-rated in November 1981 by three percentage points less than would be necessary to give full price protection - that is, on present estimates, by 8 per cent rather than 11 per cent. Allowing for exceptions for war pensions and for mobility and attendance allowances this would lead to net savings of £159 million in 1981-82 and of about £470 million in each of the two following years. If the real value of benefits were to be reduced in this way, the Government would undoubtedly be accused of attacking the poor and of breaking pledges. Nevertheless, the social security programme represented 25 per cent of total public expenditure and, if the necessary overall savings were to be achieved, it could not be exempted. A down-rating of 3 per cent could be justified in three ways. Up to 1 per cent could be justified by reference to the expectation that earnings would fall behind prices over the next year or so. A further 1 per cent would offset the amount by which the 16½ per cent up-rating given in November 1980 was likely to be over-generous in relation to the actual rate of inflation for the year to November 1980. The remaining 1 per cent would prevent the Retail Price Index (RPI) effect of normal revalorisation of alcohol and tobacco duties in the next Budget working through into social security and other benefits. More generally the reduction could be defended as not being unfair, at a time when most sections of the community would be having to accept reduced living standards, against the background that the real value of retirement pensions had increased by 31 per cent since 1971 and that the elderly were also entitled to a range of other valuable benefits. In parallel with these proposals he recommended that index-linked public sector pensions should also be held back at the next up-rating by three percentage points.

THE SECRETARY OF STATE FOR SOCIAL SERVICES said that, while he understood the economic arguments in favour of the proposed abatement, it would be very difficult to secure the passing of the necessary legislation. The Government would be charged with breaking its commitment to maintain the value of retirement pensions. The Prime Minister, in a television broadcast on 6 January, had confirmed that the Government was pledged to the indexation of old age pensions for the lifetime of this Parliament. He had frequently confirmed this commitment himself. The exemption of retirement pensioners would reduce the prospective savings by about £75 million in 1981-82 and by £210 million in 1982-83. There would also be considerable political difficulties in applying the reduction to the other benefits most of which helped either the old, the disadvantaged or the unemployed, although there was not the same commitment in respect of those benefits.

In discussion it was the general view that the Government could not go back on its firm pledge to continue with indexation of retirement pensions. To do so would mean that this Government, and the Conservative Party, would be charged both now and for many years in the future with breaking faith with old people. It would moreover risk provoking social unrest at a time of deep disquiet, particularly outside the South East region, over rising unemployment. It could be argued that a 1 per cent abatement to offset the over-provision in the present increase of $16\frac{1}{2}$ per cent would not be inconsistent with the pledge. There was however no case for controversial legislation to secure this reduction alone.

In further discussion the following points were made:-

a. Although indexation of retirement benefits would continue, the Government were not similarly committed to the indexation of other social security benefits. The possibility of abating the November 1981 increase in some of these other benefits should therefore be examined further. It should however be recognised that there would be considerable difficulties in securing savings without penalising the old, the unemployed and the disadvantaged.

b. The Cabinet had previously decided that the health programmes should be exempted from the general 2 per cent cut applying to cash controlled programmes. If it were not possible to make any significant savings on social security programmes this decision should be re-opened. It might be possible to make savings to increase efficiency equivalent to, say, 1 per cent of the programme. There was also a case for considering suspension of the Christmas bonus payments to pensioners in 1981.

c. There was a case for taking alcohol, tobacco and energy costs out of the price index by reference to which the levels of benefits were determined. It had to be recognised, however, that all these items were prominent in the budgets of many old age pensioners.

d. As soon as the Government had reduced inflation to lower levels there would be a case for introducing legislation to remove the obligation to automatic indexation. Until this was done, the Government's hands were tied over a major area of expenditure and the benefits of North Sea oil would continue to be channelled into consumption rather than investment. This matter should be considered further in the light of the Scott report on pensions. A review of the commitment to index public sector pensions could best be included in this more general consideration of indexation.

e. Rather than make cuts on social security programmes it would be preferable to accept tax increases, and in particular to raise more from income tax by providing less than full indexation of thresholds; by raising more revenue from the North Sea; and perhaps by taxing the high profits which accrued to the banks from the present high level of interest rates. None of these courses was without difficulty. Raising income tax thresholds by less than full indexation would be to risk reaching the point of taxing benefits and of exacerbating the 'why work' problem. The present levels of tax on oil companies operations in the North Sea already involved very high marginal rates of tax and further increases risked deterring exploration and development. And additional taxation of bank profits would limit their ability to finance their current capital leasing activities which were an important source of finance for industry.

THE PRIME MINISTER, summing up this part of the discussion, said that the Cabinet agreed that the Government should not go back on its pledge to maintain full indexation of retirement pensions. They were not similarly pledged to indexation of other social security benefits, and the Chancellor of the Exchequer and the Secretary of State for Social Services should consider urgently the possibilities for, and arguments for and against, reductions of these benefits. They should also consider further the possibility of a reduction of the cash controlled health programme; even if it was not possible to achieve the 2 per cent which was being applied to programmes generally, it might be possible to achieve a reduction of, say, 1 per cent. When the Government had received the report of Sir Bernard Scott's enquiry into public sector pensions, the Cabinet would consider further the case for legislation to reduce or remove the elements of indexation built in to present financial arrangements, including the indexation of public sector pensions.

Cabinet Office

14 November 1980