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cc Mr Wolfson
Mr Hoskyns
Mr Walters

Prime Minister
The Chancellor will have to consult other colleagues on this. But he wants your initial view first.
I imagine you will back the Chancellor (option A) (para 5) against Mr Jenkin's preference (Option B).

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

I prefer option A if we can get it through the House. MT.

SOCIAL SECURITY BENEFITS - LEGISLATION FOR THE 1 PER CENT REDUCTION

TL 16/1

As you know, in the course of the recent round of discussions about public expenditure, Cabinet noted that the Social Security upratings at November 1980 made in accordance with our Social Security Act 1980 were likely to exceed the amounts required to restore the value of benefits as at November 1979 (or to restore value less 5 per cent in the case of the abated benefits). Accordingly we agreed that the upratings at November 1981 should be held back to this extent, then estimated at about 1 per cent. The actual excess over what was intended is likely to be almost exactly 1 per cent which is the figure the Social Security Secretary and I propose. It is proposed that the necessary legislative provision should be sought in the Social Security Bill now in preparation, which will otherwise deal mainly with the Employers' Statutory Sick Pay scheme (ESSP). The Bill's Second Reading is expected in February. The purpose of this minute, which has been agreed with the Secretary of State for Social Services, is to let you have our views on the form of this legislation.

2. We are agreed that the legislation should provide for the upratings at November 1981 to be 1 per cent lower than they would otherwise have been in respect of both long-term and short-term benefits and, because the same legislation applies, public service pensions. We are also agreed that the legislation should make it clear that for November 1981 and future years

/the first announcement

the first announcement of the new benefits rates should be the definitive one. This is traditionally made at the time of the Budget. The current law requires a fresh view to be taken at the time the Uprating Order is laid, which may be as much as 4 months later. It is clearly undesirable to have to publish more forecasts of inflation than we have to, and equally undesirable to have the precise level of the uprating, and therefore its cash implications, in doubt for some months after the Budget. However the Secretary of State considers that we should include in the legislation a provision, in respect of long-term social security benefits (notably the state retirement pension but including invalidity benefit), imposing on the Government a duty, at any uprating, to correct any shortfall resulting from the RPI moving ahead faster than had been expected at Budget time. As a counterpart to this a power would be taken to recover any overshoot. This would still, of course, only represent a minimum position and we should always be able to do better in any year if we wished.

The Secretary of State argues for this provision on four grounds:-

(a) The Government is proposing to recover the 1980 overshoot. In equity, it should accept a statutory obligation to make good shortfall.

(b) The Government is making the chance of shortfall or overshoot more likely by making the Budget forecast the definitive one, and should therefore accept a statutory commitment on shortfall (matched by a new power on overshoot).

(c) The Government may want to recover overshoot in future years (my own proposals would require fresh legislation

/if we wanted to

if we wanted to do this after 1981); the corollary must be an obligation to make good shortfall.

I can see the political attractions in what the Secretary of State proposes. But you have given a pledge that for the life of this Parliament shortfall will be made good and in my view that is enough. To go further and put this on a statutory basis would represent a significant extension of statutory indexation, and might make it harder in the longer term to get away from the "cost plus" life generally. As such I am not happy with it even in this cause and I think it should be resisted. To my mind a simple recovery of the 1980 overshoot alone (coupled with making the Budget uprating definitive) is all we need. It would deal with this year. If we wanted to recover overshoot in 1982, we could legislate again (and we are always free, of course, to make up shortfall if we wish).

3. So far this has been about long-term social security benefits. Somewhat different considerations apply to short-term benefits (which in practice include short-term supplementary benefit where the main group of beneficiaries are the long-term unemployed) and public service pensions. No pledge on shortfall exists here. We both propose that at this stage anyway no change should be made. This means that there will be no obligation to make good shortfall, but equally no power to recover overshoot. In turn, this means that if we do what the Secretary of State wants on long-term benefits, there will be a difference between long-term benefits on the one hand and short-term benefits and public service pensions on the other; shortfall would have to be made good for the former but would not be mandatory for the latter, while overshoot could be recovered from the former but (without further primary legislation) not from the latter.

4. The Secretary of State recognises that this might be difficult to justify as it stood, but points out that we could certainly argue that it would not necessarily be the final

/position.

position. We might well wish to return to short-term benefits at the time they are brought into taxation. Similarly, public service pensions should be looked at in the light of Scott. Under my proposals there is no need to legislate now to alter the present position. But if we adopt the Secretary of State's proposal, the legislation would have specifically to exclude public service pensions from the protection proposed. This would be contentious, but in the Secretary of State's view could be defended as being subject to further consideration.

5. To summarise, the following broad possibilities exist:-

Option A — To legislate for clawback of 1 per cent in 1981 alone on all benefits, including short-term benefits and public service pensions (plus making the Budget uprating definitive) and do no more. This is what I recommend.

Option B — As Option A, but to provide that future shortfall must be made good and future overshoot may be recovered in the case of long-term benefits (including state pensions) but not in the case of short-term benefits or public service pensions, both of which will require further consideration in future in any case. This is the Secretary of State's proposals.

Option C — As Option B, but to extend the shortfall and overshoot provisions to:

(i) Short-term benefits, or
(ii) Public service pensions, or
(iii) Short-term benefits and public service pensions.

This is not recommended by either of us.

/Before we

6. Before we consider asking our colleagues for their views, we thought we should give you the opportunity to express an opinion, having regard to the fact that your pledge is involved.

7. I am copying this minute to the Secretary of State and, in view of the reference to public service pensions, to the Lord President.

G.H.

(G.H.)

16 January 1981

CO
PO
DAIS
A Duguid

10 DOWNING STREET

From the Private Secretary 19 January 1981

The Prime Minister has considered the Chancellor's minute of 16 January in which he set out three options in regard to the legislation needed for the 1 per cent reduction in social security benefits. The Chancellor asked the Prime Minister for her initial views before consulting colleagues more widely.

The Prime Minister has commented that she would prefer Option A if it can be carried through the House of Commons.

I am sending a copy of this letter to Don Brereton (Department of Health and Social Security) and Jim Buckley (Lord President's Office) and also to David Wright (Cabinet Office), together with a copy of the Chancellor's minute.

T. P. LANKESTER

John Wiggins, Esq.,
HM Treasury.

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