párt .A.

SECRET

(... under cover and
...TRY of movement)

Begins: ~~3/1/80~~ 23/7/79.
Ends: 10/7/80

PO -CH /GH/0045

PART A

Chancellor's (Howe) Papers:

PUBLIC EXPENDITURE AND
FINANCE 1980

Disposal Directions: 25 Years.

D Andersen
25/7/95.

PO -CH /GH/0045
PART A

27

M C

cc: Chief Secretary
Sir Douglas Wass
Sir Anthony Rawlinson
Mr. Hansford
Mr. Kerr

CHANCELLOR

POSSIBLE REDUCTIONS IN THE DEFENCE PROGRAMME

You asked me to explore with Mr. Whitmore how the Treasury might best carry forward the Prime Minister's wish that we should look for specific options. Mr. Whitmore firmly ruled out of court the possibility of quoting the letter from Janes Fighting Ships, both on the grounds that it would sow confusion and dissension, and that it was idiosyncratic in any case. He, like Mr. Hansford and me, does not in any case think this is a profitable way to get reductions out of Mr. Pym. Nor does he think the Prime Minister is seriously pressing for a Treasury initiative of this sort rather than the more traditional global approach to defence expenditure. He is not inclined to launch such an exercise himself from No.10.

2. I have one modest suggestion, which is to take up Clive Priestley's offer of a private discussion with Rayner on defence matters. But the most sensible course in any case would probably be to catch the Prime Minister at an appropriate moment, explaining the advantages of going for defence budget totals, rather than attempting to second-guess the MOD.

MAH

(M.A. HALL)
25th January, 1980

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greater capacity for sustained analysis and this should operate under the second Treasury Minister in the Cabinet, who would, under the Chan cellor's direction, have responsibility for the public sector divisions of the Treasury, and who would also be responsible for the C.S.D.

all ?

52. The Treasury should be geared to look more closely at the actual impact of specific tax changes on the individual, on social groups, on firms and whole industries, and should study also the integration of taxation and social policies. The Inland Revenue and Customs departments should be brought into much closer contact with Treasury thinking under the supervision of a senior Treasury minister.

EE

BUDGETARY SECRECY

53. We felt that the doctrine of budgetary secrecy was an outmoded concept, certainly so far as the Cabinet was concerned, and that there is a good deal to be gained from having the chance to cross check its forecasts and assumptions in a more general and open process. The numinous value attached to budget day itself seems no longer relevant when economic policy making is a continuous process.

✓✓

54. We recommend therefore that the Budget, fiscal, monetary and economic policy generally should be brought into open Cabinet discussion.

A.B:
I think it's already arranged that and Bridgeman/Middleton and Sud/will follow each of the 3 areas identified below by A.R?

AP

CHANCELLOR

c Financial Secretary
Sir Douglas Wass
Mr Bridgeman
Mr Middleton

FOLLOW UP OF MONETARY SEMINAR

As there was so much valuable material in the Treasury papers for the seminar with the PM the other day which we did not get time to discuss, it seems to me it might be a good idea to arrange for a brief follow up meeting before everybody goes on holiday. There are quite a number of loose ends which it might be important to tie down at this stage rather than to wait for September or October. One such is the Bank of England's sudden revelations about its proposals for changing its treatment of reserve assets. Another is its proposals for future work on the monetary base. Last, but not least, there is the vexed issue of submission to the Prime Minister on the virtues and vices of "borrowing long" - a subject on which a little further internal work would, I suspect, be of interest to yourself as well.

AR

ADAM RIDLEY
23 July 1979

2

R PM

FINANCIAL SECRETARY TO THE TREASURY

CHANCELLOR OF THE EXCHEQUER

Chief Secretary
Mr Ridley

COUNCIL RENTS: "OPPOSITION" CUTS

You asked me to check Michael Heseltine's allegation that the Opposition cuts "were based on an arithmetical mistake. They assumed that any given rent increase would yield subsidy savings about 50% higher than the true average".

2. It is not clear from this whether he means the rebated or un-rebated rent, which is one possible cause of confusion. Another possible cause is that figures in Opposition were for the subsidy savings, net of increased expenditure on rent rebates; additional expenditure on supplementary benefits was taken care of separately, under the social security programme.

2. The Opposition bilateral with Michael Heseltine was held at the beginning of April of this year. We assumed then that cuts of £285m a year in housing subsidy would be equivalent to an increase of about £1 pw in the rebated rent. The information that we had to go on at the time was only for England (rather than GB), and this was that a fall in subsidy of this magnitude required an increase of £1.14 pw in rebated rents. We assumed that including Scotland and Wales, with their lower rents, would bring the rent increase to £1 rather than £1.14 pw. Since then Treasury officials have told me that a £1 pw rent increase in GB gives only a £150m fall in subsidy, net of rebate.

4. I think that the problem arose partly because we made a mistaken assumption in Opposition about the difference between England and Great Britain; and there seems to be some further difference between the Written Answer we had in Opposition and the information now available to us, which officials have not yet managed to explain.

GC.

GEORGE CARDONA
17 October 1979

3

C

CHANCELLOR

c Chief Secretary
Financial Secretary
Sir Anthony Rawlinson
Mr P G Davies

BALANCE IN BROADCASTING

Listening to this morning's Today programme, I was once again struck by the manner in which the case against economies in public expenditure was being presented without any spokesman for the other side. It was, on this occasion, perhaps more a Department of Environment matter than a Treasury one. There was a long piece about Lambeth Council, which is refusing to implement the economies in expenditure required by Mr Heseltine. Nonetheless, I wonder whether it might not be as good a peg as any other on which to hang some kind of enquiry to the BBC about what procedures they are following in order to preserve reasonable balance between the pros and cons of such matters.

AR

ADAM RIDLEY
18 October 1979

In general, I strongly agree.
Take up with P.M.G.?

F/E17 C 4

CHANCELLOR

c Chief Secretary
Financial Secretary
Sir L Airey
Mr Littler
Mr Monck
Mr Unwin
Mr P G Davies
Mr Cropper
Mr Cardona

Entirely agree - see draft w.p.

SIR K JOSEPH'S LETTER - CASH LIMITS AND ALL THAT

1. I have been talking to Mr Littler about the backwash from the Joseph letter. Since the cash limits for the NIs and the RSG will have to be promulgated in public in about a month, the issues involved will be brought to the surface again whether we like it or not. The arguments involved are both complex and important. Might it not therefore make a good subject for a speech from you at about the same time? One could cover, inter alia, the problems of defining "non-intervention" in NIs, what the "banker's role" towards them involves (pace Sam Brittan) , the question of incomes policy etc.

2. Someone has to raise the debate to a higher level, and you are the obvious person to do it!

AR

ADAM RIDLEY
19 October 1979

5

cc: Chief Secretary
Financial Secretary
Sir Anthony Rawlinson
Mr. P.G. Davies

MR. RIDLEY

BALANCE IN BROADCASTING

The Chancellor has seen your minute of 18th October. He has commented that in general he strongly agrees. He wonders whether this might not be a point to take up with the Paymaster General. Perhaps you would like to advise, consulting others as necessary.

MAH

(M.A. HALL)
22nd October, 1979

27/10/89.

Discussed with A.R.
– he will decide.

Chancellor.

KJ Letters.

We ought if possible to have a brief word about this over the w/end. Jim Prior would like to show it to Andrew Knight with whom he lunched solo today, & has already written a letter of thanks implying "en parenthèse" that he will be arranging to do so shortly. On the other hand officials here doubt whether it would be wise to do so – & you might well too, I imagine.* I have an alternative in mind, as I have been separately onto S. Hogg about the latest Econ's article on cuts & could easily use that as a briefing session on the KJ letter if that was desired. Unfortunately it is not easy to get Jim out of his commitment at this stage, & thus to get him to buy any other alternative. If we can't speak (I shall try to call you), guidance is needed

* I suspect that the precedent would be seized, and quickly acted on!

early on Monday so that DE private office can be ~~posted~~ told what can or can not be done.

Supplementary benefits. URGENT.

I have discovered that the Chief Sec'y is proposing to "give in" to Patrick Jenkin & concede, without a further fight, that there should be statutory provision henceforward. This is, in all honesty an odd decision, & an unnecessary one, since

(a) it could & should be fought to Cabinet;

(b) there is no great public reason why one need change the treatment one way or the other.

I have intimated to the Chief Sec'y's pte office that I felt you would have views, & would wish to be consulted before he goes ahead.

Mr Kemp's submission, copied to you, 5 Oct 79 "Statutory provisions for Supplementary benefit uprating." sets out the issues clearly, I believe.

M 27/10.

(AB)

c - for prayers

Mr. Ridley

Discussed, I believe.

CHANCELLOR

cc Minister of State (L)
Minister of State (C)
Chief Secretary
Financial Secretary
Mr Cardona
Mr Cropper

23/11

PEWP-2

I spoke this afternoon to Messrs Cassell and Sedgwick, and explored with them some of the issues which arise if it is in the end decided to proceed with a fairly conventional White Paper. Since time is so short, it might be a good idea if we could spend five minutes at your meeting on Friday morning to see whether you and other Ministers and Advisers have any strong views about how the general economic introduction [Part I] to the White Paper should be written. The general trend has been for the introduction to be very short and bare. I would advise, apart from anything else, that we should include two paragraphs and two tables on the tendency to over promise and under achieve which has persisted since the first PEWP, and can enlarge on this idea at the meeting if you want me to. If you agree with this idea it might, I suppose, be useful to warn those attending.

Subject to further discussion

TO Mr Battishill. Yes. V. helpful!

AR 26/11

AR

ADAM RIDLEY
21 November 1979

The PM should
(1) See the transcript of my programme with B.W.
(2) know that B.W. – in lengthy discussion with me – expressed his strong personal view that an "unwillingness" to go further in tackling the question of T.U. power was an major area of weakness (in his view) (which the PM + I do not share!)

3/1 ~~MHall~~ 8

Chi

PRIME MINISTER

cc. Mr. Whitmore
Mr. Sanders
Mr. Gaffin

"Weekend World"

I have had a further check with London Weekend about the format of the programme for Sunday and they have confirmed that they wish to concentrate on the economy to the exclusion of such subjects as Afghanistan, Iran, etc.

2. We are preparing briefing for your weekend box to meet the needs of the outline programme set out below. The overall objective is to elicit your approach to "the rescue of the British economy".

3. You will be questioned by Brian Walden for a total of 49 minutes divided almost equally around a natural break around 12.30 p.m. The interview, to be conducted in the White Room, will start at 12 noon.

4. The programme will fall essentially into four parts:

- the trade union problem, occupying some 20 minutes;
- the steel strike in particular (5 minutes);
- the tax, public expenditure, PSBR equation (10 minutes); and
- overall strategy, raising the question whether the Government will have time to show results.

5. I set out below more detailed guidance on the approach of the editor, David Cox, to each of the four sections.

Trade Unions

6. The programme will argue that the trade unions remain a problem, as evidenced by the reluctance of the steel unions to accept what their employers can afford. But what can the Government do about it? Is the Employment Bill a solution? Some people, the programme will point out, would say that the Bill is not designed to help the BSC in their present struggle

/with

with the unions and certainly will not make picketing of docks, etc. illegal. What then is the Government going to do to redeem the Prime Minister's pledge at Paddington in December 1978 to tilt the balance away from the trade unions towards the employers? In this context the programme will wish to pursue the question of trade union immunities under the law, especially following the Lords Express v. MacShane judgment and will raise the question of a referendum if there is a repetition of the 1974 challenge to Government, bearing in mind your promise of a referendum in those circumstances on "Weekend World" in September 1977. It is also likely that Mr. Walden will pursue the possibility of social security benefits being withdrawn from strikers' families by way of follow up to the "Time Out" leak.

Steel

7. The plan is to use the general discussion of the trade union problem as a lead into the specific problem of steel from two points of view:

- free collective bargaining; and
- the potential problem of sympathetic action, secondary picketing, etc.

8. This bit, lasting for no more than five minutes, will come immediately before the commercial break. It will be the major newspoint of the interview and one which offers you immediate opportunities. But, given the limited time to be devoted to it, it will be essential to be very crisp and pointed.

Economic Section

9. In this section immediately after the commercial break the programme will seek to probe the Government's economic policy. It seems likely that Brian Walden will introduce the passage by summarising the present economic situation covering tax, public spending, PSBR and interest and mortgage rates as well as inflation. (Interestingly, unemployment was

/not

not mentioned during my briefing by David Cox).

10. It is clear that the programme has picked up your statement in the Barbara Walters interview in Washington that "a lot of people in England say I have not cut public spending enough and I think that is right". Taking their cue also from accounts of your meeting with the 1922 Committee just before the Christmas Recess, they will ask:

- If public expenditure has not been cut enough, what further cuts have you in mind and where are they likely to occur?

- What will be the consequence for taxes if you find it difficult to cut public expenditure?

- Again picking up leaks, what are the prospects for de-indexing social security benefits?

Overall Strategy

11. Here the programme has picked up the idea that you feel you need three Parliaments effectively to implement your strategy. But basically it will question whether a policy designed to restore incentives and to widen differentials between "rich" and "poor" (while nonetheless improving the position of the "poor" in absolute terms) can possibly have a chance of succeeding because of the constitutional constraint of an election after five years. In short, given the egalitarian nature of British society, will the electorate tolerate a policy which, whatever longer term benefits it brings in absolute terms, has the effect of making for a more inegalitarian country?

Conclusions

12. I would be grateful for guidance overnight on any particular briefing requirements in the light of the above.

/You

You may find useful the attached specimen questions which I have prepared covering the four sections of the programme.

Bryan

B. INGHAM

3 January, 1980

ANNEX 1

TRADE UNIONS

What is the nature of the trade union problem? Is it simply an imbalance of rights and responsibilities? Or is it not at least as much a question of attitudes and capacity to deliver?

How can you change attitudes if they are the real problem?

How can you right the balance if that is the real problem? And will the Employment Bill achieve a better balance? Or is it too modest in all respects - closed shop, picketing, ballots?

Is not the fundamental problem the question of immunities? Do you plan to do more than try to limit the spread of immunity? If not, why should trade unions be singularly privileged in the extent to which they are made immune to actions for breach of contract?

Why do you suppose you will fare any better in tackling the trade union carthorse than your predecessors? And is it worth the candle anyway? - which, of course, turns on the extent to which trade unions are seen as an economic and social liability in Britain today.

How far are you prepared to go in pressing home trade union reform? Do you see your present legislation as merely a start of a continuous process?

And are you prepared to risk further disaffection on top of cash limits, the Employment Bill, rising unemployment and the shake out by tackling the "Why Work?" syndrome through less attractive social security benefits?

STEEL

Here questions will turn to some extent on events between now and Sunday. The important points to get over are:

- massive injections of public money;
- huge losses over the last five years;
- half productivity of European competitors in spite of injection of capital;
- consequent losses of markets to extent that competitors now supply one-fifth of UK market;
- no substitute for a competitive, dynamic and profitable industry providing genuine jobs;
- even so, major opportunities, as evidenced by low productivity figures, for higher earnings through more efficient production.

Possible questions:

We have returned to free collective bargaining, as promised. By how free is it in view of cash limits? And if it is free, can you complain if trade unions seek at least to cover inflation?

Will you stay out of the dispute? Indeed, how can you, if the UK economy is grinding to a halt? What contingency plans have you made?

Does not success in the steel dispute rest on the efficiency of picketing of British Steel plants and ports? What can you do to prevent the unions" strangling the economy?

Are you prepared to legislate, use troops, etc. if necessary?

ECONOMICS

What was your economic legacy as a Government? Is it worse or better than you expected?

What have you been able to accomplish over your first eight months? And where have you been frustrated?

Are further public expenditure cuts the key to your success in 80/81? Without them - and where will they fall? - can we expect increases rather than further reductions in tax in April?

But are we not really trading tax cuts for higher unemployment?

What makes you think that monetary policy will squeeze out inflation? Is it really as simple as that?

Is your policy not really a rather desperate gamble involving three elements - your nerve; trade union tolerance; and the limited time afforded by the democratic process?

We have seen something similar before - the Heath Government? Why should the British public think it will be different this time round? Can you guarantee they will not witness yet another U-turn?

OVERALL STRATEGY

Do you accept that your policy will make British society less equal? Is that its objective? And do you think such an objective is acceptable?

Would it be more acceptable if you would guarantee a better standard of living in absolute terms for the poorest over a reasonable period of time?

If Britain is not irrevocably wedded to the idea of a more egalitarian society, is your problem not then one of time - of securing results and the promise of more to come sufficiently early enough for your mandate to be renewed?

Can any Government realistically plan for a 15 year term of office? Or are you saying that only a Government which adopts that time horison has any chance of halting and reversing the UK's economic decline?

What, if any, straws do you see in the wind which suggest that after eight months you might be making headway?

How do you see the future unfolding? Are you not asking the British people to take a terrible beating? Or do you believe that they are ready for really drastic surgery - that, notwithstanding the reflex actions of trade unions, there is a basic and deep rooted yearning in Britain to snap out of it and that we are prepared to take our medicine?

pwp

CONFIDENTIAL

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Shown 6.i a.m

CHANCELLOR

cc: Sir Anthony Rawlinson
Mr Bailey
Mr Kemp
Mr Ridley
Mr Hall

4/1

LINE FOR PRIME MINISTER TO TAKE IN WEEKEND WORLD INTERVIEW: 6TH JANUARY

After discussion today with officials, you decided that the Prime Minister should be recommended to take the following line in Sunday's Broadcast if pressed on the question of bringing the recipients of short-term social security benefits into tax and/or of raising these benefits and pensions in November by less than that suggested by the increase in the RPI:-

(i) Recipients of short-term benefits were not currently subject to taxation;

(ii) The Government regarded it as quite legitimate to look at bringing short-term benefits into tax;

(iii) If pressed on the question of whether the Government would continue to protect fully pensions and/or short-term benefits:
the Government had done so in the past, and would endeavour to do so in the future, though this must depend on the success of the Government's policies and the strength of the economy.

2. I communicated this to Mr. Sanders at No.10 who said he would bring it to the Prime Minister's attention. He said that if the Prime Minister were to adopt and be forced to deploy this line it would almost certainly be interpreted as representing a movement from the current position, as expressed in the

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Social Security Bill. He recognised that though such a change might in the event be required if the social security programme were to yield the savings assumed in the current Public Expenditure exercise, the Prime Minister might well judge it inappropriate to hint at any movement in the Government's position at the present juncture.

3. You may judge it appropriate to speak directly to the PM before Sunday.

R.I.T.

R. I. TOLKIEN
4th January 1980

C 18

COVERING SECRET

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Mr Ridley
Mr Cropper

PUBLIC EXPENDITURE REVIEWS: POST-MORTEM

I attach a brief post-mortem of last year's public expenditure reviews, in the hope that it will stimulate discussion.

I hope so
— & comment;
&, either on this
or independently (see †)
Look fwd. to
officials' reactions.

Wd this flexibility
form part of our papers
for S'dale?

GC

GEORGE CARDONA
4 January 1980

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PUBLIC EXPENDITURE REVIEWS

This note aims to make a quick preliminary assessment of the way in which the four public expenditure reviews have been conducted. A further post-mortem will doubtless come from officials. T

2. The four reviews are:

i. The Treasury's own review of expenditure plans for the White Paper on Public Expenditure.

ii. The Lord President's review of Civil Service staff costs.

iii. Sir Leo Pliatzky's review of Quangos.

iv. Sir Derek Rayner's review of efficiency.

There are also other reviews which could be considered relevant, such as Michael Heseltine's review of Local Authority Statutory Duties.

3. In practice only the Treasury and CSD reviews are really important. Sir Leo Pliatzky's review of Quangos cannot, and is not expected to, yield large savings. It is in safe and experienced hands and I think can do nothing but good. Sir Derek Rayner's review can yield very significant savings, and is also in very good hands: the only problem is that we have only one Derek Rayner.

4. The multiplicity of centralised reviews does not in itself appear to have caused the problems that might have been expected. (Sir Leo Pliatzky did mention to me that wherever he went in Whitehall looking for quangos he was told he would have to await the outcome of some other review, but the problem is caused by reviews started by an individual department in order to stave off cuts.)

The Treasury's Review

5. The biggest single criticism of our review must be that we did

not cut enough. This problem is now being taken care of, largely thanks to the effect of a 17% MLR on spending colleagues' attitudes.

6. The next criticism is that at the beginning of a Government's life, starting with a uniform percentage cut across departments means accepting the previous Government's priorities between expenditure programmes. (It is true that departments were asked for the higher of the percentage reductions or the cuts agreed in Opposition - but the latter were not big enough.) In fact this problem was by no means as serious as it might have been, because defence and police were exempt and in the end the peculiarities of each individual programme meant that percentage cuts of different sizes had to be made in each programme.

7. But meanwhile a certain amount of damage had been done, largely because cuts of $17\frac{1}{2}$% in social security were considered unattainable. The "options" put forward were duly leaked to the Guardian, which newspaper presented cuts in the nominal value of benefits as an option seriously under consideration by a hard-hearted Tory Government.

8. The "options" put forward by departments were not really options: they were the only way put forward for reaching the quantitative targets. And several departments were almost certainly playing the game of putting forward options which were so awful that they would be rejected. In fact, because the options were not genuine options but simply the bare minimum necessary to achieve our totals, we accepted virtually all of them. This meant that there was no collective consideration of options, and also that some options put forward by departments on the assumption that they would not be accepted were indeed chosen.

9. The recommendation implicit in the above analysis is that most departments should be asked for options for cuts a good deal larger than will probably be required, together with some indication of the ranking the department would give such options. (This method should not be adopted with very sensitive programmes such as Health and Social Secutiry, or if it is adopted then extraordinary security measures should be taken). This recommendation is not intended to

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deal with the problem of bargaining over the amount of any particular department's reduction: thus even if one has agreed that a certain department should cut by 10%, one would still expect options adding up to 20% so that a genuine choice could be made.

10. The problem that arises if bilateral bargaining with spending departments fails to yield the overall total cuts agreed by Cabinet could be dealt with by distributing the shortfall in a uniform percentage way across all departments (perhaps including defence?).

11. Another criticism must be that a large proportion of the cuts were at the margin of existing programmes: very few functions were cut out completely. To a certain extent this is of course either inevitable or desirable. But to call for options adding up to a considerably larger total than is actually required should persuade departments to put forward options involving cutting out some function completely.

12. A different problem, already touched on, is that of leaks. They make rational choice extremely difficult. One can only comment that this is a wider problem to which more thought should be given.

13. A related problem that has emerged is one to which I have already drawn attention, in the special case of the BBC External Services. It is re-appearing in the case of the British Council. I still maintain that in order to mount their very successful campaign against the Government, the External Services breached the confidentiality of the expenditure review: and that the right response to such behaviour may be to treat expenditure decisions more like a Budget, ie to make people face a fait accompli.

Lord President's Review

14. Some of the criticisms of the public expenditure review also apply to the Lord President's Review of Civil Service staff costs.

15. The principal problem has been that across-the-board percentage cuts are sometimes inappropriate, for example as applied to our own revenue-raising departments - though if we can establish the link

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between the fall in revenue as a resultof manpower cuts and a further reduction in expenditure, then the Lord President's exercise may prove to have been very useful indeed.

16. The size of the percentage cuts called for (10-15-20%) did succeed in bringing out a wide range of options (as argued for in paragraph 9 above). But because these cuts would have struck only at the Civil Service itself, the threat perceived by the Civil Service and its unions in the first few months of Government certainly did nothing to help relations between Government and Civil Service. There is evidence - admittedly anecdotal - that sections of the Civil Service were persuaded by the Soames exercise that "this Government hates civil servants", as one of them said to me.

17. One obvious failure of the Soames exercise is that the Ministry of Defence, the biggest and fattest target in Central Government, have wriggled out with the feeble excuse that they are undertaking an internal review. One will believe their manpower reductions when one sees them.

18. The cuts eventually achieved by Soames are probably satisfactory, and it is not really a criticism of them to say that they have gone for the wrong target. But in a sense they have. The Civil Service employs less than 750,000 people, and this number was falling even before Soames. The Service is managed by some very intelligent people at the top, and is more efficient than the rest of the public sector. Local authorities employ more than 2,000,000 people, and the trend is upward. Central Government has virtually no control over local manpower and (with a few notable exceptions like Leeds under Irwin Bellow) most local authorities are painfully inefficient and wasteful, and sometimes corrupt as well. This is where a Soames is really needed; but instead we have cut back on the part of Government that is already most efficient and that has been subject to cutbacks in the past, because that is where Ministers have direct control. The only solution I can see that is even remotely politically acceptable is to transfer services one at a time from local to central Government, and reduce the RSG by a corresponding amount.

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Conclusions

19. i. In future public expenditure reviews, we should ask departments for genuine options, for a total of cuts greater than we actually require;

ii. something must be done about leaks;

iii. we should consider ways of dealing with parts of the public sector (such as the BBC) who are in a position to lobby hard against cuts in their budget;

iv. we should consider what can be done about waste and overmanning in local authorities.

GEORGE CARDONA
4 January 1980

CONFIDENTIAL

3

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cc Chief Secretary
Financial Secretary
Minister of State (Commons)
Minister of State (Lords)
Sir Douglas Wass
Sir Kenneth Couzens
Sir Anthony Rawlinson
Mr Burns
Mr Ryrie
Mr Bailey
Mr Littler
Mr Bridgeman
Mr Cassell
Mr Middleton
Mr Unwin
Mr Riley
Mr Folger
Mr Ridley
Mr Cardona

CHANCELLOR

DRAFT PAPER FOR CABINET ON 24TH JANUARY

1. I would like to support the Chief Secretary's plea for a clearer emphasis on the importance of narrowing the PSBR en route towards lower interest rates via less "crowding out" in capital markets.

2. Interest rates are at the centre of a complex web of cause and effect. Particularly relevant to this particular analysis are the facts that:-

i. high interest rates can act to stifle demand for credit and thereby control money supply

ii. high interest rates can be caused by excessive PSBR and consequent crowding out.

3. It does not follow that one welcomes a high PSBR as a means of establishing the high interest rates needed to control money supply. If the two factors are compounded in the same direction you just end up with grotesque interest rates such as we have today and a stagnant economy.

4. The important thing to emphasise is that high interest rates and a lower PSBR are straight alternatives as policy weapons, as well as being themselves linked in a cause and effect relationship. From the point of view of the country's economic future all the emphasis ought to be being placed on the lower PSBR; that is surely the message to Cabinet.

PETER CROPPER

15th January 1980

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E.16

CHANCELLOR   mp

cc Financial Secretary
Minister of State (C)
Sir Kenneth Couzens
Mr Cropper

EUROBOND TAXES

I attach a copy of a letter I have just received on this subject from John Sparrow. I must confess that it seems to me to make good sense. As I gather from Mr Tolkien that the MS(C) is contemplating the draft text of a Press Release on this very subject, I am copying it to him too. There must be a lot of city interest in the line the Revenue take and the likelihood of some adverse criticism if we get in wrong in their eyes. I should add that I was quite heavily questioned about this issue by a number of people when talking to the WIB gathering of city worthies last Tuesday - something I foolishly forgot to report at the time.

2. Copies are also going to the FS/T and Sir Kenneth Couzens because they may be interested in the Exchange control arguments.

Should certainly be considered carefully before action

AR

ADAM RIDLEY
18th January 1980

cc. Mr Tolkien
Mr Cropper

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23 GREAT WINCHESTER STREET
LONDON EC2P 2AX
01-588 4545

From: JOHN SPARROW

18th January, 1980

Dear Adam,

I understand that Somerset House expect to make a statement next week on the rumoured possibility that Eurobonds issued by U.K. companies should only pay interest subject to deduction of tax.

Once such a statement has been made it might be difficult to resile from it. I think that it is worth pointing out that anyone who wishes to defraud the Inland Revenue will still be able to do so by buying bonds issued by overseas companies; that British companies, in order to remain in a market with peculiar preferences, will have to (and will be able to) borrow through subsidiaries domiciled abroad; and that the proposal is not really consistent with the thinking behind the abolition of exchange control.

It seems to me, and to a lot of other people in the City, that what is being suggested as the likely attitude of the Inland Revenue is unlikely to achieve any real purpose, but will merely complicate and make more expensive what ought to be a simple and relatively cheap method of raising finance. I take it that there is no disagreement on the fundamental point, that it is in certain circumstances positively desirable for U.K. companies to borrow abroad. If that is so, it would be a pity to throw the baby out without doing anything effective to get rid of the bathwater.

Yours sincerely,

Jn.

Adam Ridley, Esq.,
H.M. Treasury,
Parliament Street,
London,
SW1P 3AG.

M C27

cc: Chief Secretary
Sir Douglas Wass
Sir Anthony Rawlinson
Mr. Hansford
Mr. Kerr

CHANCELLOR

POSSIBLE REDUCTIONS IN THE DEFENCE PROGRAMME

You asked me to explore with Mr. Whitmore how the Treasury might best carry forward the Prime Minister's wish that we should look for specific options. Mr. Whitmore firmly ruled out of court the possibility of quoting the letter from Janes Fighting Ships, both on the grounds that it would sow confusion and dissension, and that it was idiosyncratic in any case. He, like Mr. Hansford and me, does not in any case think this is a profitable way to get reductions out of Mr. Pym. Nor does he think the Prime Minister is seriously pressing for a Treasury initiative of this sort rather than the more traditional global approach to defence expenditure. He is not inclined to launch such an exercise himself from No.10.

2. I have one modest suggestion, which is to take up Clive Priestley's offer of a private discussion with Rayner on defence matters. But the most sensible course in any case would probably be to catch the Prime Minister at an appropriate moment, explaining the advantages of going for defence budget totals, rather than attempting to second-guess the MOD.

MAH

(M.A. HALL)
25th January, 1980

CHANCELLOR OF THE EXCHEQUER

PA

Phoned IR 5/1

They are phoning back with answer whether they have got the papers.

PPS P1

28

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

28 January 1980

PRIVATE SECRETARY TO THE CHANCELLOR

PS1 REPORT ON THE ECONOMIC PROBLEMS OF COUNTRY HOUSES

... We attach a draft letter to Sir Charles Carter's letter of 16 January, which contained an advance copy of the tax recommendations to be included in the forthcoming report (written by John Butler, an Economist).

As Sir Charles' letter says, the advisory committee concerned with the report contained officials as well as representatives of the various heritage pressure groups, and Mrs Jennifer Jenkins of the HBC. The Revenue contribution, however, was limited to giving technical advice, and the outcome is a report which substantially reflects the views of the lobby.

Sir Charles is not at this stage asking for a meeting either with the Chancellor or with the Minister of State (Lords); accordingly the draft reply below is simply a grateful acknowledgement of the advance warning.

Sue Tyrrell
Private Secretary
Inland Revenue

---

cc Chief Secretary
Financial Secretary
Minister of State (Commons)
Minister of State (Lords)
Sir Douglas Wass
Mr Ryrie
Mr Middleton
Mr Battishill
Mr Kemp
Mr Caff
Mr Corlett
Mr Cropper

Sir Lawrence Airey
Mr Green
Mr Adams
Mr Beighton (origin)
Mr Mann
Mr Isaac
Mr Gracey
Mr Elliott

29

Sir Charles Carter
Policy Studies Industries
1/2 Castle Lane
LONDON SW1E 6DR

ECONOMIC PROBLEMS OF COUNTRY HOUSES

Thank you very much for your letter of 16 January with its advance copy of the tax chapter of the PS1 report.

You can imagine that at this time of year advance notice is very valuable; I have read the chapter with considerable interest, and can assure you that its contents will be in my mind in the review of capital taxation and the approach to the Budget.

I am looking forward to the publication of the report as a whole.

G H

29/1/80

Public spending cuts may be held to £1bn. this year

BY PETER RIDDELL, ECONOMICS CORRESPONDENT

CUTS IN specific public spending programmes being discussed by the Cabinet may not amount to more than £1bn to £1¼bn at most in 1980-81, but reductions could be much larger in later years.

However, the Government assumes in its Budget calculations that substantial savings in the volume of public expenditure in 1980-81 will be achieved through the tight application of cash limits, and that this will play a major part in holding down public sector borrowing.

This would be in addition to specific programme cuts where the likely total includes an assumed £350m from reductions in the UK's net contributions to the EEC budget, already offered.

The likely total of cuts contrasts with the £2bn target in 1980-81 which Mrs. Margaret Thatcher, the Prime Minister, earlier this month said she would be "quite pleased" to achieve.

The difference is largely, though not entirely, because this target included big savings from payments to the EEC and it now looks improbable that further savings will be agreed before the Budget. The limitations on securing further large-scale domestic cuts in 1980-81 because of forward commitments have also been recognised by the Cabinet.

There has been a clear desire over the last week to play down extravagant expectations for 1980-81 while emphasising the Government's determination to reduce spending in the following few years to well below the level in 1978-79.

The Cabinet is due to have a further discussion on the issue on Thursday and it is hoped that most of the decisions will be completed then. The largest contribution will come from housing (subsidies on council rents and capital investment) and from social security (notably by changes in the linking of short-term benefits to the inflation rate).

In addition, smaller amounts will be cut from the budgets of departments such as education and sales of public sector assets will be larger than the £500m total for 1980-81 proposed last November.

The full spending White Paper is unlikely to be published until the third week of March, about a week before the Budget on March 26.

But to avoid probably inevitable leaks in the interim, ministers are considering whether individual departments should make a series of announcements, partly to inform local authorities and others of the changes. The main alternative is a Treasury statement summarising the decisions ahead of the White Paper.

The distinction between a cash limits squeeze and specific programme cuts is that the former involves a hidden or back-door reduction in volume decided by programme managers and local authorities while the latter involves an explicit decision on priorities by the Cabinet.

A generalised cash limits squeeze on volume is likely in 1980-81 because the pay and price increases of 14 per cent assumed in fixing the limits will probably be lower than the actual rise in costs expected for the period. The inflation assumptions were disclosed in a leaked Treasury letter published in the Press earlier this month.

Doubts over spending cuts strategy. Page 4

CONFIDENTIAL

PWR 31

THE CHANCELLOR

cc: Sir Douglas Wass
Mr F E R Butler
Mr France
Mr Unwin
Mr P G Davies

MR PETER RIDDELL AND PUBLIC EXPENDITURE REDUCTIONS

You asked how far Mr. Riddell's piece in the Financial Times on 29th January reflected official briefing.

2. I have discussed this with Mr. Butler and Mr P. G. Davies. Neither Mr. Butler nor any member of his group has talked to Mr. Riddell recently. However, Mr. Davies did see Mr. Riddell on Friday 25th January, and gave him some general guidance. Mr. Davies tells me that the point about the importance of cash limits squeeze was put to him by Riddell, but that he did not make any substantive comment on this. Nor did he give any indication of where the largest savings were to be found, although he points out that the possibility of some measure of de-indexation of short-term benefits has now been widely mentioned. Mr. Davies did, on the other hand, seek to lead Riddell in the direction of not expecting a very large further package which would achieve £2billion savings in 1980/81; and the Financial Times piece reasonably reflects that wish to reduce expectations about the prospective impact of the current exercise.

3. Mr. Butler commented that Riddell has shown himself unusually well informed about public expenditure issues under both the present and previous Governments - so well informed that he never needs to make any attempt to get in contact with any member of the GEP group. Riddell is particularly strong on health and social security issues.

JW

A. J. WIGGINS
31st January 1980

CONFIDENTIAL

Reference 32

29/1/80

Public spending cuts may be held to £1bn. this year

BY PETER RIDDELL, ECONOMICS CORRESPONDENT

CUTS IN specific public spending programmes being discussed by the Cabinet may not amount to more than £1bn to £1¼bn at most in 1980-81, but reductions could be much larger in later years.

However, the Government assumes in its Budget calculations that substantial savings in the volume of public expenditure in 1980-81 will be achieved through the tight application of cash limits, and that this will play a major part in holding down public sector borrowing.

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In addition, smaller amounts will be cut from the budgets of departments such as education and sales of public sector assets will be larger than the £500m total for 1980-81 proposed last November.

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Doubts over spending cuts strategy. Page 4

CODE 18-77

28/2

CHANCELLOR
CHIEF SECRETARY
FINANCIAL SECRETARY
MINISTER OF STATE (COMMONS)
MINISTER OF STATE (LORDS)
MR RIDLEY
MR CARDONA
SIR DOUGLAS WASS
SIR KENNETH COUZENS
SIR ANTHONY RAWLINSON
MR T BURNS
MR W S RYRIE
MR UNWIN

c Sir Lawrence Airey - IR
Sir Douglas Lovelock - C & E

CONSERVATIVE PARTY FINANCE COMMITTEE - 26 FEBRUARY 1980

Lord Armstrong of Sanderstead

1. Lord Armstrong expressed approval of the Government's efforts. "I find what the Government is doing is wholly in accord with what I think is required" and "What the Government is doing is a damned sight better than what it says it is doing".

2. "For a long time people had felt their taxes were too high". One could judge that by the growth of the Black Economy. "If people are not prepared to pay the taxes that are demanded from them, then Government expenditure must be cut". People had got used to Keynesian theory, according to which the worse your economy was doing the more you were entitled to borrow. This was very demoralising. It would be an uphill struggle to teach people that the worse they are doing the less they should borrow.

3. The Black Economy needed to be understood. Lord Armstrong believed that Sir William Pile's estimate, that the Black Economy was $7\frac{1}{2}$ per cent the size of the GNP, was very conservative. The unrecorded fringe was now quite big enough to have its own economic consequences. It was now big enough to explain why the normal economic variables were going wrong - an interesting new Joker in the pack.

/4. Exchange control.

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4. Exchange control. Lord Armstrong "unrepentantly cheered the abolition". He gave the Government enormously full marks. "It was a wonderful thing, of which we have not yet seen the benefit."

5. Lord Armstrong, under questioning, gave a fairly conventional justification of bank profits. "We are barely keeping abreast of our capital needs". "I arrived in the City thinking we should pay interest on current accounts, but I learned that there were many reasons against - not least, because customers do not demand it. They like to get their account services cheap. It is a fact that the proportion of current accounts to total accounts is higher in the UK than elsewhere."

6. Lord Armstrong did not regard leasing as an abuse of the system. Remember that much of the tax reliefs which the banks secure in the first instance on leasing, ends up by passing through to the benefit of the firms to whom plant is being leased on competitive terms.

7. Would Lord Armstrong consider a one or two per cent reduction in MLR? "I honestly doubt it. Today it would be dangerous." But sometime around the middle of the year demand for borrowing would fall and there would be the opportunity to reduce MLR.

8. Lord Armstrong felt Monetary Base control would probably be too swift in its action. "I like the loopholes in the present system" and "I do not particularly disapprove of the recent £500 million purchase of gilts from the banks. It is not a matter of morals or virility. What is mainly important is the trend of M3, and its effect on the rate of inflation."

P J CROPPER

28 February 1980

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PWP

4/3

No. 1 of 4 copies

CHANCELLOR OF THE EXCHEQUER

MEDIUM TERM FINANCIAL STRATEGY

Over the past few weeks I have made known to you my reservations about the publication of a set of economic statistics covering the expected life span of this Parliament. As you know I have privately assured you that I would accept the collective judgement on this matter, and I have not committed views in writing lest there was any danger - however remote - of our differences of opinion becoming known and possibly magnified.

I did, however, explain that I would send you a short minute following the meeting held on March 3 to consider a Medium Term Financial Strategy.

It seems to me there are at least five reasons which militate against the publication of these statistics as a Medium Term Financial Strategy.

1. The demand for such a Financial Strategy comes from journalists, academics and commentators rather than from those in the commercial world.
2. If the statistics are to generate confidence they will have to become forecasts backed by government authority rather than illustrative tables.
3. If the Strategy statistics are to establish the credibility of a monetary policy over several years they will assume some mechanistic relationship between public sector borrowing requirement, monetary aggregates, and recorded inflation. I do not believe such a relationship can be thus demonstrated.

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forecast

4. Indeed the omission of [recorded] inflation (the RPI) from the proposed Financial Strategy underlines the difficulties I have observed in point 3 above; particularly as the price index is the statistic of supreme political importance which justifies the policy.

5. Our monetary policy is still at the stage of apprenticeship. The Financial Strategy, on the other hand, will suggest a certainty about pace and direction that we do not possess, either technically or politically.

I could elaborate my reservations at greater length - but the above points serve to illustrate my main anxieties.

I am sending copies of this minute to the Prime Minister and to Sir Douglas Wass only.

W. J. B.

JOHN BIFFEN
4 March 1980

37

7/3

10/3

Chancellor,

Wd you be content for figures like these to be bandied around in speeches, etc?

MW 13/3

M/M:

1 Are you worried?

2 Were they [illegible]?

Chancellor,

1 No, not at all

2. None of the copy recipients has complained: [illegible] material [illegible] useful

MW 18/3

CHANCELLOR OF THE EXCHEQUER

c Chief Secretary
Financial Secretary
Minister of State C
Minister of State L
Sir D Wass
Sir A Rawlinson
Sir K Couzens
Mr Ryrie
Mr Burns
Mr Littler
Mr F Jones
Mr Unwin
Mr F E R Butler
Mr Cassell
Miss Peirson
Mr Bottrill
Mr Butt
Mr Folger
Mr Burr
Mr White
Mr Morris
Mr Daykin
Mr Prescott
Mr Willetts
Mr Ridley
Mr Cropper
PS/Inland Revenue

TUC ECONOMIC REVIEW 1980: COST OF THE PROPOSALS

You asked for some more work on the cost of the TUC's proposals.

2. As Mr Willetts pointed out in his minute to you of 4 March, most of the proposals are not precise enough to be quantified. I think the answer is to assume that the TUC are demanding, at the very least, the expenditure planned in Cmnd 7439, and then to add on those major proposals in the Review that are roughly quantifiable and not in Cmnd 7439. The procedure is probably more than fair to the TUC: the Review calls for restoration of cuts in several specific areas of expenditure and attacks the Government's general policy of reducing expenditure; and some of the unquantifiable proposals (such as holding down nationalised industry prices) were not in Cmnd 7439 but would be very costly.

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3. A difficulty here is that before the next expenditure White Paper is published, we can compare only the reductions between Cmnds 7439 and 7746: the familiar figure of £3,500 million in 1980-81. But this is not a serious problem.

4. Other expenditure proposals (paragraph numbers are from the TUC review):

		£m (1979-80 prices)
§95.	New £1,000 million a year lending facility jointly funded and underwritten by Government	say 500
§136.	State retirement pensions equal to $\frac{1}{3}$ average earnings for single person and $\frac{1}{2}$ average earnings for married couple	7,500
§138.	Inclusion of the unemployed in entitlement to long-term SB rates	80
§138.	Align child benefit to level of child support available for claimants of short-term National Insurance benefits	1,000
	Total	9,080

5. Revaluing £3,500m (the difference between Cmnds 7439 and 7746) to the same price-basis brings it to £3,850 million. The total so far is therefore £12,930.

6. Paragraph 139 recommends cutting the reduced rate of income tax from 25% to 20%, and widening the reduced rate band from £750 to £1,000. This would cost £1,430 million at 1979-80 income levels.

7. The total additional cost of the TUC's proposals is therefore £14,360 million.

8. I am grateful to GEP division and the Inland Revenue for help with the figures.

GC.

GEORGE CARDONA
7 March 1980

PA

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TESCO STORES (HOLDINGS) LIMITED

Tesco House, P.O. Box 18,
Delamare Road, Cheshunt,
Waltham Cross, Herts. EN8 9SL
Telephone: Waltham Cross 32222
Telegrams: Testore Waltham Cross
Telex: 24138

From the Office of The Chairman
Leslie Porter, Ph.D.(Hon.)

LP/JW 10th March 1980

Rt Hon Sir Geoffrey Howe
Chancellor of the Exchequer,
Downing Street,
London SW1.

Dear Sir Geoffrey,

I enclose a paper prepared by our Financial Director, Ralph Temple, which complements our previous submission to your Office asking that consideration be given to extending the Industrial Building Allowance to cover retail premises in your forthcoming Budget.

My Company fully appreciates the present need to contain public sector expenditure; nonetheless the present disparity between assistance provided for the manufacturing and service sectors (especially when considering the role of service industries as tax generators) has generally been accepted as inequitable - especially when retailers have made such a significant contribution in helping to realise the nationally stated objective of containing price inflation.

In the present financial climate, where rising external costs have to be set against diminishing profit margins, it is becoming increasingly questionable whether my own industry will be able to play its anti-inflationary role for very much longer - unless, that is, the Government recognises the equity of our case and provides the industry with some "regulated and consistent assistance" to achieve its own, stated ends.

In this connection, I hope that you will give sympathetic consideration to the attached paper; as to our previous submission of January 1980.

Yours sincerely

Leslie Porter

L. Porter
Chairman

Directors: Leslie Porter, Ph.D.(Hon.), Chairman. Ian C. MacLaurin, Managing Director.
D. Behar, FSVA., M. Darnell, D.G. Harris, BA., Miss D.D. Hyams, OBE., H. Kreitman,
F.R.N. Krejsa, FRICS., A.D. Malpas, BA., H.F. Pennell, R. Temple, FCA., G.R. Wood.
Registered in England. No: 445790 Registered office: Tesco House, Delamare Road, Cheshunt, Waltham Cross, Herts. EN8 9SL.

THE RETAILER

AS

A TAX COLLECTOR.

A

Pre-Budget Submission to

the Chancellor of the Exchequer,

the Rt. Hon. Geoffrey Howe

Tesco Stores (Holdings) Ltd.
Cheshunt, Hertfordshire.

March 1980

INTRODUCTION

1/1 In recent years, successive administrations have recognised, and welcomed, the role that the retail industry has played in combating price inflation. Currently, the consumer is again faced with a period of high, and rising inflation, the R.P.I. for February revealing that inflation rates are now running at 18.4 per cent.

1/2 As far as the retailer is concerned, such an increase reflects the rising cost to the industry of development; of wages; of energy; and the increasing cost of financing stock. Conversely, the cumulative impact of external inflationary tendencies, has to be laid against the contracting profit margin of the industry itself.

1/3 It is on these grounds that Tesco Stores (Holdings) Limited submit the following paper for Treasury consideration: a submission concerned first, to analyse the existing role of the retailer as a tax collector for government; second, to analyse the existing allowances to the industry from government; and third, by contrasting the former with the latter, to suggest that the industry earns any relief that it may be granted by government.

TESCO: TAX COLLECTOR

2/1 The role of the retailer as a tax collector is rarely appreciated; neither the annual report and accounts nor the Value Added statements of companies giving precise information on the amount of taxes collected as a result of a year's trading. While the amount of V.A.T. on sales is disclosed, together with details of P.A.Y.E., social security deductions, rates and Corporation Tax; they do not provide a complete picture of a company's role as an arm of the revenue services.

2/2 Broadly speaking, such taxes can be broken down under two headings: those collected on behalf of government, and those borne by a company as a charge against, or part of the appropriation of profits.

2/3 In the case of Tesco, the group achieved a turnover of £1,235 million and a pre-tax profit of £37.1 million (i.e. approximately three per cent of total turnover) in the year to February, 1979. In the same year, total taxes collected by the Company amounted to £143.5 million or twelve per cent of turnover, and nearly four times the pre-tax profits.

2/4 The attached table shows that £122.8 million was made up of tax collected on behalf of government, and the remaining £20.7 million was the tax borne by Tesco itself. Little explanation is required for tax collected on behalf of government, beyond mentioning that the V.A.T. figure materially underestimates the present position as a result of the Budget increase of 1979.

2/5 As far as taxes borne by Tesco itself, however, some amplification is required. Thus:

i) Employers' N.H.I. The Company's contribution to N.H.I. totalled £9.3 million.

ii) Corporation Tax: The Company's Corporation Tax for the year ending February, 1979 totalled only £1.1 million on pre-tax profit, due largely to Stock Appreciation Relief.

iii) Advance Corporation Tax: The tax for the year ending February, 1979 totalled £2.6 million, though it is questionable whether this item should be regarded as a tax borne by the group. However, given that tax at a rate of 30 per cent on dividends is accountable to the revenue in the quarter following the payment of dividends (whether or not Corporation Tax liability arises in due course), it must be treated as a tax borne by the Company. While it is anticipated that the tax can be recouped against Corporation Tax liability in the future, the timing is obviously uncertain.

iv) General Rates: The Company's General Rates for the year ending February, 1979, totalled £6.98 million. While accepting that this is purely a form of local taxation, it must be recognised that the figure will increase in the coming year as a result of rate increases by local authorities. (N.B. In the figure quoted above, the element of water rates which are treated as a service, has been removed).

v) Sundries: The sundry taxes borne by the Company (i.e. Road Fund Tax, Stamp Duty on property acquisitions, fuel taxes etc.) totalled £0.8 million in the year ending February, 1979. Again, this figure disguises the present, real totals as a result of subsequent increased taxation on, for example, petrol and DERV.

2/7 While the government publishes figures showing the cost of various forms of tax collection (currently amounting to £480 million p.a.), no reference is made to the time or financial costs borne by companies to collect these taxes.

Highly sophisticated accounting and administration systems are required to deal with the increasing complexity of the existing tax structure. Taking labour costs and bank charges specifically relating to the collection of taxes, the estimated cost to Tesco for tax collection in the financial year 1978/79 amounted to a minimum of £250,000.

TESCO: THE TAX BENEFICIARY

3/1 It is not suggested that by virtue of paying tax a company has a claim on government for assistance. So much would be nonsense. Nonetheless, successive administrations have accepted that tax revenues both can, and should be, employed to grant aid industry - though its aid programme has traditionally favoured the manufacturing rather than the service sector of the economy.

3/2 For example, in the year ending March, 1979, regional development grants to industry totalled £417 million, with a further £124.3 million being grant-aided under Section 7 of the Industry Act, 1972 - all of this assistance going to the manufacturing sector, none to service industries.

3/3 With one exception, in fact, services are exempt from all aid programmes, yet the sector's contribution to the national economy is now widely accepted. In 1977, services employed 7,481,000 men and women (2.5 million in retailing) and accounted for 31.5 per cent of the Gross Domestic Produce. As such, it is now the largest, single sector of the U.K. economy.

3/4 The exception to this rule is Stock Appreciation Relief. Introduced in 1974, primarily with the intention of helping companies holding stock during a period of rapid inflation, S.A.R. has been of major benefit to many retailers. In the 5 year period ending February, 1979, Tesco had obtained £44.7 million via this route, or £23.2 million in terms of Corporation Tax Relief.

3/5 However, while retailing is a major employer of labour, a major generator of G.D.P., and a significant contributor to the national exchequer (not least through its invisible earnings from foreign tourists), its successive representations to government have either been ignored, or treated on a piecemeal basis.

CONCLUSIONS

4/1 While this situation is widely regarded as inequitable, it is the discriminatory impact of such policies on the future performance of retailing that are now of prime concern.

4/2 In the past half decade, retailers have made a significant contribution to the national objective of containing inflation "in the shopping basket". The cost, however, has been high and during a renewed period of negative economic growth, falling disposable income and contracting profit margins, it is increasingly unlikely that the industry will be able to continue aiding central government's counter-inflation strategy.

4/3 In short, government cannot continue to have it both ways; it cannot continue to invoke an industry that is a major tax collector to support its own campaign to contain price inflation yet continue to deny its claims for some regulated and consistent assistance to achieve its own, stated ends.

4/4 Today, in fact, the choice of whether the price of the housewife's shopping basket can be kept within reasonable bounds no longer lies with retailers, but with government. It is for this reason that Tesco Stores (Holdings) Limited trust that in his forthcoming Budget, the Chancellor will recognise the fiscal equity of the industry's case; in particular with regard to the Industrial Building Allowance.

-oOo-

Taxes Collected on Behalf of Government

	£M	
V.A.T.	34.1	
P.A.Y.E.	12.7	
Employees N.H.I.	4.1	
Duty on Tobacco, Wines & Spirits and petrol sales	69.7	
Import Duties	2.2	
		122.8

Taxes Borne by Group

Employers N.H.I.	9.3	
Corporation Tax	1.1	
Advance Corporation Tax	2.6	
General Rates	6.9	
Sundries, including Road Fund Tax and Stamp Duty on Property acquisition	0.8	
		20.7
		£143.5M

4

C – You could with profit include both bracketed passages. One or two small titivations.
MAH 11/3

F/A40

CHANCELLOR

LORD THORNEYCROFT

I attach the draft letter you asked for after your meeting with him yesterday was curtailed. I have bracketed two optional passages. I assume that Mr Hall has in his possession the note on enterprise zones but that you may wish to revise the classification before sending it to Lord Thorneycroft. I imagine you do not want to solicit his considered views on EZ's. If you do this letter should say so.

AR

ADAM RIDLEY
11 March 1980

I suppose that, if you wanted to give Lord T a bit more of an idea of your Budget themes, we could work up the notes I put in to you yesterday (suitably revised).

On the Child Benefit/Politics Today front I will be making separate recommendations when I have probed a little further.

Personal : in confidence

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~~DR~~AFT LETTER FOR THE CHANCELLOR

TO SEND TO LORD THORNEYCROFT Chairman of the Conservative Party

I was most sorry that we were unable to meet for more than a fraction of our allotted time yesterday evening. No one is more concerned than I am about getting the presentation of the Budget right, on which your views are particularly valuable. If there are any points you would like particularly to draw to my attention in the next few days, please don't hesitate to do so. Equally, if it would help you to talk through the Budget themes further, I should be delighted to arrange for you to see Nigel Lawson or Adam Ridley ~~to do so~~ ~~and you will~~ (and so you know at first hand) if, as I fear is all too probable, I cannot find another suitable time in the near future.

You asked us yesterday about the proposals for Enterprise Zones, and expressed some anxieties about them. To fill in the background a bit and, I hope, reassure you somewhat, I am enclosing a note which sets out their main features. Since the formal announcement of them is to be made in the Budget, I would be grateful if you could treat the note and the information it contains as strictly for your personal information ~~confidential.~~

~~... [I have it. – will doctor so as not to look like dept consultation doc. overtly].~~

G — H —

C 43

CH/EXCHEQUER
REC. 17 MAR 1980
ACTION Miss Sinclair
COPIES TO Mr Ridley
FST
Mr Cropper

THE CHAIRMAN OF THE PARTY

The Rt. Hon. The Lord Thorneycroft

CONSERVATIVE & UNIONIST CENTRAL OFFICE,
32 SMITH SQUARE,
WESTMINSTER, SW1P 3HH,

Telephone: 01-222 9000

PT/SOB

17th March 1980

Personal & In Confidence

Dear Geoffrey.

Thank you for your letter and accompanying notes on Enterprise Zones. I valued our short discussion and quite understand the pressures. I am myself leaving for the north today so won't see you before the Budget but wish you the very best of luck.

You can count on all the support we can give you from here. As soon as the Budget is over I want to ensure that Adam and others keep in close touch with Alan on presentation from a Party point of view.

With many thanks.

Yours Peter.

The Chancellor of the Exchequer

IN CONFIDENCE

44

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

T Lankester Esq
Private Secretary to
the Prime Minister
No 10 Downing Street

19 March 1980

Dear Tim,

ENTERPRISE ZONES

Since the question of Enterprise Zones arose in the Prime Minister's talk last week with Lord Thorneycroft, you may be interested in seeing the enclosed correspondence.

Yours ever,

M A HALL
Private Secretary

cc: Financial Secretary
Mr. Ridley

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

14 March, 1980

Dear Peter

I was most sorry that we were unable to meet for more than a fraction of our allotted time on Monday evening. No-one is more concerned than I am about getting the presentation of the Budget right, on which your views are particularly valuable. If there are any points you would like particularly to draw to my attention in the next few days, please don't hesitate to do so. Equally, if it would help you to talk through the Budget themes further, I should be delighted to arrange for you to see Nigel Lawson or Adam Ridley if, as I fear and, as you know at first hand, is all too probable, I cannot find another suitable time in the near future.

You asked us about the proposals for Enterprise Zones, and expressed some anxieties about them. To fill in the background a bit and, I hope, reassure you somewhat, I am enclosing a note which sets out their main features. Since the formal announcement of them is to be made in the Budget, I would be grateful if you could treat the note and the information it contains as strictly for your personal information.

Yours ever,
Geoffrey

(GEOFFREY HOWE)

The Lord Thorneycroft, PC.

ENTERPRISE ZONES

The Government intends to set up about half a dozen Enterprise Zones of approximately 500 acres each. The sites will be in areas with problems of economic and physical decay. A short list of the sites from which candidates are likely to be chosen is attached. Enterprise Zones will initially be designated for a period of 10 years. During this period both new and existing firms within the Zones will benefit from the following measures:

a. Exemption from Development Land Tax

b. 100% capital allowances (for corporation and income tax purposes) for commercial and industrial buildings

c. Abolition of general rates (but not water rates) on industrial and commercial property

d. Simplification of planning procedures

e. Establishments within Enterprise Zones will be excluded from the scope of Industrial Training Boards (ITBs). This will exempt the establishments concerned not only from the training levy, but also from any requirement to furnish information to ITBs.

f. Any remaining requirements for Industrial Development Certificates will be abolished

g. The Government will reduce to a bare minimum its requests for statistical information

h. Controls over development will be administered as swiftly and simply as possible

2. The purpose of these Zones is to test as an experiment, and on a few sites, how far industrial and commercial activity can be encouraged by the removal of certain fiscal burdens, and by the removal or streamlined administration of certain statutory or administrative controls.

The aim is to stimulate economic development by removing the hand of Government as far as possible. The fiscal concessions should offer a real incentive to the private sector to take on tasks which it was hitherto thought could only be tackled by injections of public money.

LIST OF SITES AND AUTHORITIES FOR INITIAL CONSULATIONS

The location and boundaries of Enterprise Zones will be decided after consultation with local authorities and other organisations.

Discussions will initially be concentrated on the following areas within which Enterprise Zones might be located. These represent a first list for consideration. Additional sites may be considered in the light of the development of the discussions and proposals.

England

Region	Area	Local Authorities
Northern	A Tyne and Wear site	Gateshead District Council Newcastle City Council Tyne and Wear County Council and the District Authorities
Yorks and Humberside	Attercliffe, Sheffield	Sheffield City Council South Yorkshire County Council
North West	A Merseyside site Trafford Park Manchester and Salford Docks	Merseyside County Council Liverpool City Council Greater Manchester County Council Trafford District Council Salford District Council
West Midlands	Bilston	Wolverhampton District Council West Midlands County Council
South East	A London site	Local Authorities concerned Those presently represented on Docklands Joint Committee
Scotland	A site on Clydeside	Glasgow District Council Renfrew District Council Strathclyde Regional Council Clydebank District Council
Wales	Lower Swansea Valley	West Glamorgan County Council Swansea City Council
Northern Ireland	Belfast inner city site	

CH/EXCHEQUER
REC. 17 MAR 1980
ACTION Mr Sinclair
COPIES TO Mr Ridley, FST, Mr Cropper

C 49

THE CHAIRMAN OF THE PARTY

The Rt. Hon. The Lord Thorneycroft

CONSERVATIVE & UNIONIST CENTRAL OFFICE,
32 SMITH SQUARE,
WESTMINSTER, SW1P 3HH,

Telephone: 01-222 9000

PT/SOB

17th March 1980

2

Personal & In Confidence

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The Chancellor of the Exchequer

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CONFIDENTIAL

CHANCELLOR -
CHIEF SECRETARY
FINANCIAL SECRETARY
MINISTER OF STATE (COMMONS)
MINISTER OF STATE (LORDS)
SIR DOUGLAS WASS
SIR KENNETH COUZENS
SIR ANTHONY RAWLINSON
MR W S RYRIE
MR T BURNS
MR UNWIN
MR RIDLEY
MR CARDONA

2/4.

c Sir Lawrence Airey - IR
Sir Douglas Lovelock - C & E

CONSERVATIVE PARTY FINANCE COMMITTEE - 1 APRIL 1980

The Chief Secretary to the Treasury introduced a discussion on Public Expenditure. Members' questions were directed as follows:-

A Beaumont-Dark How can you possibly turn round the nationalised industries on the scale of the Public Expenditure White Paper, given their investment programmes? And how can you really double rents, which is what the PEWP means?

John Townsend Public sector pay the real problem.

David Atkinson The 4 per cent reduction over the PEWP period is disappointing, compared with Mr Healey's 6 per cent.

Michael Latham Can we please have a set of forecasts for expenditure and construction beyond 1980-81?

Tim Sainsbury Will the Enterprise measures have any effect during this Parliament?

Mrs Kellett-Bowman Are you not in danger, through your welfare spending cuts, of estranging the electors in the shires?

Albert Costain Can you not possibly have a reserve band of construction plans ready so that when spending restraints are eased towards the mid-eighties you can snap promptly into action?

Nicholas Budgen I would be in favour of a faster course. You may not be able to hold people throughout a four year programme of austerity.

Bowen Wells Ditto.

/Roger Hamilton

CONFIDENTIAL

<u>Roger Hamilton</u> Should we not start charging for hospital visits now? And cannot we begin now on the serious discussion of how to use the proceeds of the North Sea?

<u>Alan Clark</u> Will not the burden of servicing past debt become intolerable if inflation is brought down?

<u>Terence Higgins</u> Can the post-corset bulge in M3 be quantified? Are we safe in relying on a squeeze on cash limits rather than specific programmes of expenditure cuts?

P J CROPPER

2 April 1980

RESTRICTED

x p/. 55

C

E.12 (Control)

CHANCELLOR

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Mr Cardona

PUBLIC EXPENDITURE CONTROL - MR BRUCE-GARDYNE, SUPPLEMENTARY ESTIMATES AND THE NATIONALISED INDUSTRIES

x May I raise an issue which develops naturally out of the recent letter by Jock Bruce-Gardyne to Mr St John-Stevas (10 March), to which the Chief Secretary has sought a draft reply. The system of supplementary estimates does not cover certain categories of expenditure in which it would be valuable both to have some systematic Parliamentary control, and, in particular, procedures analogous to the scrutiny of supplementary estimates which Mr Bruce-Gardyne is asking for. In particular the EFLs for the nationalised industries fall right outside the supplementary estimates system. At present there is nothing to prevent Ministers increasing cash limits during the financial year and simply announcing the fact to Parliament by written PQ, as David Howell did on Budget Day. If Mr St John-Stevas is to consider Mr Bruce-Gardyne's basic point favourably, should he also not be asked to bear in mind the spirit as well as the letter of Mr Bruce-Gardyne's suggestion? As far as I can see, this would be doubly welcomed by members of Parliament of all parties - first because it gave them a wider area of scrutiny, and second because it would permit them to get a little closer to the activities of the nationalised industries, something which they normally find very elusive. Quite apart from anything else, such an innovation would help to expand the Treasury's "constituency" amongst backbenchers.

AR

ADAM RIDLEY

16 April 1980

RESTRICTED

c - 56

22/4

E.12

MR HALL

cc Chief Secretary
Sir Anthony Rawlinson
Mr Bridgeman
Mr Butler
Mr Monck

PUBLIC EXPENDITURE CONTROL - MR BRUCE-GARDYNE, SUPPLEMENTARY ESTIMATES AND THE NATIONALISED INDUSTRIES

The letter from Mr Bruce-Gardyne of 10 March, on which the Chief Secretary will shortly be receiving a draft letter and comment to Mr St John-Stevas from Mr Butler, provoked me to suggest to the Chancellor that Nationalised Industry EFLs raised a similar problem, which a tightened Supplementary Estimates procedure would not resolve. You informed me yesterday that the Chancellor had approved the point made in my minute of 16 April on this subject, and suggested that officials should be consulted as to how to give effect to the idea. I have now spoken to Mr Butler and can report progress.

2. As things stand, EFLs cannot properly be regarded in the same light in the Estimates. With the exception of certain specific voted grants and subsidies which industries such as the NCB receive, EFLs are dependent on the National Loans Fund and set out in the PEWP or FSBR. Parliament has no formal, systematic role of scrutinising or approving them in either case. Mr Butler therefore observes, rightly I think, that ensuring a better supervision of the EFLs is outside the Procedure Committee's present responsibilities. So it would not be appropriate to bring up the issue in replying to Mr St John-Stevas.

3. However, assuming Mr Bruce-Gardyne's initiative is accepted by Mr St John-Stevas, the Committee will be moving into action again before very long. At that moment it will need terms of

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reference, and it should be a fairly straightforward matter to ensure that they cover the proper scrutiny of advances to the Nationalised Industries made by the NLF. In the meantime Mr Butler is setting in hand work on possible evidence to the Committee which, he reports, can be extended to deal with the substance of the issue. This seems to me to be the right way to proceed.

AR

ADAM RIDLEY
22 April 1980

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CHANCELLOR

CPC - MONDAY 28 APRIL

In view of your Hamburg trip you may wish to put the final touches to this at the weekend and you must let me know if I can come up and help.

David Knapp wants to put out a short précis as a Press Release.

Meanwhile, if this is any use as a start I could circulate it during the balance of this week to Brian Unwin et al.

P J CROPPER
22 April 1980

You will probably want to put more in the final version on the MTFS.

Ftg no 6

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DRAFT SPEECH FOR DELIVERY TO CONSERVATIVE POLITICAL CENTRE
CITY OF LONDON 28 APRIL 1980

"STABILITY, REALISM AND CONFIDENCE"

I want to address myself today to an explanation of the Government's policy towards that sector of the economy falling between the nationalised giants on the one hand and the small business sector on the other. This is broadly synonymous with the quoted company sector and I would call it the powerhouse of British industry.

Small business

During the first year of the new Government we have placed deliberate emphasis on the small business sector. It is this sector that has suffered worst from the steep progression of personal income tax during the past forty years, and it is this sector which will - in the opinion of many observers - provide the larger proportion of new jobs in the future.

We have now taken steps to encourage the establishment of new firms and to soften some of the risks inherent in new enterprise - insofar as this can be done by manipulating the tax system. We are in process of easing the burden of tax on those who emerge from the "starters" lottery with success, and we are pledged to knock the capital tax system into more reasonable shape during the next year or two. We are now turning our minds to the encouragement of the demerger movement, with the aim, where appropriate, of encouraging large companies to break themselves up into smaller units.

Nationalised industry

Meanwhile we are pressing on with the privatisation of state industries, the aim being to introduce a greater element of commercial discipline into the conduct of the state monopolies.

The larger companies in the private sector

I appreciate that while all this is going on we might be accused of neglecting the bigger companies in the private sector - by which I mean broadly speaking the 3,000 firms whose shares have a Stock Exchange quotation. After a decade in which the IRC, the NEB and other do-gooding predators have been on the loose, I suspect that most companies will be only too thankful for a bit of benign neglect at the hands of the Government. Interventionism has been one of the least attractive and least successful of the modern cults.

I do not propose some new version of this failed idea; in so far as further neglect can be looked on as benign, then neglect it shall be. Nevertheless there are things that government can do to improve the circumstances in which companies operate; and it is to those circumstances that we must now turn.

Availability of capital

First, consider access to capital. Thanks to the highly organised contractual savings industry in this country, it would be difficult to find fault with the aggregate level of savings as a whole - although even there I would counsel caution in interpreting the savings ratio, which appears from published figures to be hovering around the 20 per cent level. Savings figures can do some funny things in a time of rapid inflation, and there is an element of running to keep on the same spot.

But even if the overall savings ratio is healthy, the same is by no means true of the allocation of available savings between the public and private sectors.

I recently saw some figures (Rowe Rudd, I think they came from) which showed that in 1979-80 the PSBR almost exactly matched the net sum available for investment in the hands of the savings institutions. The figures were, if I recall it, £9.3 billion for the PSBR and £10 billion for institutional cash flow.

In other words the State was neatly pre-empting the whole of the country's institutional savings flow.

This cannot be right by any reckoning, and its wrongness is summarised in the fact that the long term rate of interest is about three points higher than corporate treasurers have ever felt justified in the past in paying for debenture and loan stock money.

The Keynesians are fond of saying that there is nothing wrong with a big public borrowing requirement so long as it is financed by borrowing from the non bank financial sector. I have no sympathy whatever with that idea. It may be strictly true, although I doubt it, that a large PSBR financed wholly in the non bank financial sector is compatible with strict control of the money supply.

What is not true at all is that a large PSBR, even if it is financed in the non bank sector, is compatible with a healthy company sector. Savings absorbed by the State are savings lost to the private sector. If one believes, as I do, that the private sector is more likely to bring prosperity to this country than is the public sector, then the sooner the PSBR falls towards zero the better.

This is the rationale behind the Medium Term Financial Strategy, published in this year's Budget Red Book. In that strategy we state the Government's intention, over the coming four years, to get the PSBR down from $5\frac{1}{2}$ per cent of GDP to $1\frac{1}{2}$ per cent of GDP.

Returning for a moment to the Rowe Rudd presentation, we are envisaging a situation in 1984 in which the PSBR has dropped from £9.3 billion to £4.6 billion while the investible surplus of the savings institutions grows from £10 billion to £15.7 billion. That, to put it bluntly, is the backbone of the Government's industrial strategy, the creation of a £11 billion capital balance available to those companies that know how to use it.

Accounts and taxation

Next in the matter of scene setting come accounts and taxation. We have said from the beginning that accountancy was mainly something for business to sort out. I am more than happy to learn that the accountancy profession has now agreed on a style of inflation accounting which it is felt will be effective in producing meaningful accounts for the major part of the company sector.

The Government is, in its turn, working hard to put corporate taxation onto a logical basis. Our proposals will be set out in a consultative Green Paper later this year, and they will include ideas both on taxation of mainstream profits and tax treatment of stock and price changes. At a later stage I hope it will be possible to marry together the new accounting standards and a final revision of company taxes.

Structure of ownership

Next we turn to the structure of share-holding in British companies. During the past twenty years the balance of share-holding has swung around from 60 per cent private, 25 per cent institutional to 25 per cent and 60 per cent. Nobody can be happy with this, but nobody can be surprised.

When we took office the tax rate on dividends in the hands of a pension fund was 0 per cent. The marginal tax rate on dividends in the hands of a private individual - and not a particularly rich one at that, was 98 per cent. It requires little more than O-level economics to understand why shares were rushing like lemmings out of private hands and into institutional hands. The Labour Party was pursuing its collectivist intentions by impeccable market methods.

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We have so far reduced the top value of personal tax on investment income from 98 per cent to 75 per cent. This sounds rather more impressive when it is expressed as an increase in the retention ratio from 2 per cent to 25 per cent, but I do not consider that we have yet reached either a just or an economically sensible basis. Meanwhile direct investment in shares is also, in a sense, prejudiced by the powerful tax incentives that exist to encourage home ownership. Those incentives are very worthy in themselves, but one cannot help asking oneself whether the relationship between yields on money invested in houses and money invested in shares may not account for some part of our industrial lassitude.

Then again, the Capital Transfer Tax concessions to assets held in the form of farming land and family businesses are very worthy in themselves. But there is no entirely logical reason for levying a top rate of CTT at 75 per cent on assets held in ICI or Woolworths, and 37½ per cent on assets held in the form of shares in a family owned hotel.

We have a long way to go if we are to re-establish direct personal investment in stocks and shares. Many decades of hostile preaching from the Left, and several decades of unstable economics, have left the average investor in a beleaguered frame of mind; it is not surprising that his savings have tended of late to move in the direction of owner occupied housing, retirement annuities and high yielding gilts.

It must be our aim to coax the private investor out of his bunker and bring him back to a central position in the structure of company finance. That is the best way, in my view, of encouraging individual citizens to revive their interest in the workings of the productive economy.

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Working with the markets

Finally, this Government is committed to the idea of working with the grain of markets, rather than seeking always to defy their operation in the manner of a Dr Dalton or a Stafford Cripps. The removal of exchange controls was a major - and some would say a daring - step in this direction. At a humbler level I hope the City has observed the minor change in taxation in the recent Budget with which we sought to remove the obstacles from the way of the new Traded Options market. It is also our aim to co-operate with any reasonable objective of the Stock Exchange, Lloyds, the Baltic or any other free market. Of all countries, it is in Britain's interest to open up her markets to free and open competition. The role of London as a mercantile centre is - and always has been - a vital factor in the prosperity of Britain as a whole.

Stability, Realism and Confidence

The Government's policies are, above all, designed to restore confidence. There has been too much instability, too much experimentation, too much economic and social engineering in the past half century. Indeed, I might almost say, in the past century. I do not think the economic history of Britain in the 1880s - right up to the first war - now reads like a real success story.

The economy now cries out for stability, for non-intervention and a chance to shake down. The bonus of North Sea oil should help. I believe that, so far from heralding the deindustrialisation of Britain, North Sea oil provides the wherewithal for restoring stability to our national finances. If we can ensure that, then I have no doubt that prosperity will follow. The next two or three years could be the turning point, and I look to the City for steadfast support in seeing our present policies through to a successful conclusion.

PJC
22 April 1980

CONFIDENTIAL

c [illegible] 65

[illegible] ANG 6/6

[illegible] 7/5

CHIEF SECRETARY TO THE TREASURY

MR ~~HALL~~

cc Sir Anthony Rawlinson
Mr Bridgeman
Mr F E R Butler
Mr Monck
Mr Ridley

PUBLIC EXPENDITURE CONTROL - MR BRUCE-GARDYNE, SUPPLEMENTARY ESTIMATES AND THE NATIONALISED INDUSTRIES

The Chief Secretary has seen Mr Ridley's minute to you of 22 April.

He thinks that the idea of extending the Procedure Committee's activities to cover nationalised industries' EFLs opens up more difficult ground than the Bruce-Gardyne request on the Supplementary Estimates, and that we should see where we get on the latter first.

He has commented that bringing EFLs into more direct Parliamentary scrutiny and control could lead to even worse relations with Nationalised Industry chairmen until they realised the potential advantage in a partnership with Parliament in exposing the highly arbitrary nature of EFLs and their shortcomings as financial/ business control mechanisms.

A C Pirie

A C PIRIE
23 April 1980

† Is ~~[illegible]~~ it home, i.e. mtgs ~~with~~ NICG, to make them aware of this?

CONFIDENTIAL

PUP 66

CONFIDENTIAL

CHANCELLOR
CHIEF SECRETARY
FINANCIAL SECRETARY
MINISTER OF STATE (C)
MINISTER OF STATE (L)
SIR DOUGLAS WASS
SIR KENNETH COUZENS
SIR ANTHONY RAWLINSON
MR W S RYRIE
MR T BURNS
MR UNWIN
MR RIDLEY
MR CARDONA

2 1/5

c Sir Lawrence Airey - IR
Sir Douglas Lovelock - C & E

CONSERVATIVE PARTY FINANCE COMMITTEE - 29 APRIL 1980
LORD COCKFIELD, TO TALK ABOUT THE FINANCE BILL

Lord Cockfield concentrated on Capital Taxation. He explained the political and budgetary constraints which had restricted the Chancellor's action this year. He advised Members not to underestimate what had been achieved, and drew particular attention to the Chancellor's phrase about this being an earnest of our determination for the future. He then outlined the capital tax changes in the Budget.

Albert Costain asked about the proposed advance clearance for Development Land Tax and hoped that on, for example, a 100 acre site, it would not be necessary to pay all the tax due in advance. The Minister of State replied that it was always possible to sub-divide a big estate project.

Peter Emery asked whether, in parallel with the Capital Gains Tax relief for a property partly let, there would be CGT relief for e.g. a serviceman who has let his house for a period while serving abroad.

Ralph Howell was sorry the Government had not done more to raise thresholds in order to help the poverty trap.

Archie Hamilton reminded the Minister of State that Capital Transfer Tax would still have devastating effects on the medium sized business.

John Townend wondered whether there would be Capital Gains Tax relief for somebody who used one or two rooms in his house as an office.

/Brandon Rhys-Williams

CONFIDENTIAL

CONFIDENTIAL

Brandon Rhys-Williams asked what the Green Paper on Taxation of Husband and Wife was likely to say. He was asked to wait for the paper to be published.

P J CROPPER
1 May 1980

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CHANCELLOR

MORE BRIEFING FOR PEWP DEBATE

1. Bray. I have been unable to find Bray saying the National Plan's growth rate was inadequate. But in the course of searching I found Callaghan saying something similar:

> "We should be aiming in the latter part of the 1960s for a 5 per cent and then a 6 per cent growth rate" (Hansard, 20th July 1964, Col. 75).

> "An expansion rate of 4 per cent will not be sufficient to enable us to overcome the backlog of rates, housing and schools, and if we expand no faster than this, it will take us a generation to modernise Britain" (Cardiff, 11th July 1965).

2. Select Committee. The Financial Secretary has been talking to me this afternnon about tomorrow's debate, and has urged me to suggest that you should not dwell on the Select Committee's report in your speech. Not only would it make the Committee seem more important; you risk allowing the rest of the debate to be dominated by their report.

G.C.

GEORGE CARDONA
6 May 1980

pwp 69

CONFIDENTIAL

sent for n/s

cc Mr Ridley
Mr Middleton
Miss Brown
Mr Monck
Mrs Case

CHANCELLOR
CHIEF SECRETARY
FINANCIAL SECRETARY
MINISTER OF STATE C
MINISTER OF STATE L
MR RIDLEY
MR CROPPER

9/5/80

MEETING OF CONSERVATIVE FINANCE COMMITTEE, 6 MAY 1980

The meeting was addressed by Sir William Barlow. Sir William Clark was in the chair. The meeting was poorly attended.

Sir William Barlow began by saying that it was a pleasure to be in the House but not to be addressing a Select Committee on the record. He explained that he was Chairman of the NIGC as well as the Post Office. Most of what he was about to say would have the approval of his colleagues on the NIGC.

What Sir William and his colleagues disliked was that cash limits had become the overriding measure of success or failure. The current limits for the nationalised industries had been set in the previous autumn, but most of the industries prepared their budgets in the period January to March. They had been forced to make assumptions in November which had become out of date by the beginning of the financial year. The industries had been forced to make their own assumptions, and there had been no reaction from the Government to their choice of assumptions. This was unreasonable. Sir William gave examples of assumptions about pay, prices and GDP made in November, which had proved unrealistic.

Short-term cash control sounded attractive. It was obviously useful for Government departments. But it was not appropriate for big businesses. The Post Office had a turn-over of £5,000 million. It was very difficult to meet a cash limit without arbitrary cuts in investment.

The Post Office was investing £1,500 million in telecommunications. Almost all this investment was internally financed. Other large telecommunication businesses around the world had self-financing ratios of 70-80%. France had a telecommunications industry comparable in size to Britain's but was investing twice as much, and half the investment was financed by borrowing. Other ways of raising money were being progressively denied to the nationalized industries: sale and leaseback had now been ruled out by the Treasury.

The NICG understood the need to keep down the PSBR. But there was a big difference between wealth-creating industries which happened to be owned by the Government and the big loss-making industries. The Chairmen would like to be able to borrow from other sources such as banks and overseas. Privatisation was one option, but monopolies always had regulatory problems. Selling subsidiaries was a way of losing profits.

The NICG had put their views on financing to the Chancellor. They believed a financial target for 3-5 years should be set for each industry, and should be tailored for that industry. Sir William had headed the Post Office for three years and in that period had been subject to three financial targets.

Sir William then turned to the Public Expenditure White Paper. He stated that it would be impossible to achieve the nationalised industry turn-round envisaged in the White Paper. This was a personal view: he was not speaking for the NICG. The PEWP theme of "eliminating underpricing" was an open invitation to monopolies to raise their prices. It had made his own negotiations with trade unions very difficult.

Tim Sainsbury asked Sir William whether:

(i) he would accept that the cash limits were an inevitable consequence of public ownership;

(ii) there were not opportunities for subsidiaries to be floated off;

(iii) the Post Office did not own too much property, particularly prime High Street sites;

(iv) Sir William agreed that it was unreasonable for the Post Office to want to own its sites while at the same time it forced its customers to lease rather than own telephone equipment.

Sir William Barlow replied that:

(i) the PSBR was a relatively new concept (and cash limits were there for PSBR control); some companies, Rolls-Royce for example, were not in the PEWP and so were not subject to cash limits /Jock Bruce-Gardyne: "Should be"7; the coverage was therefore "spotty";

(ii) it took time to arrange the sale of subsidiaries;

(iii) there was no incentive to sell property, because the new Treasury rules did not allow the Post Office's cash flow to benefit; but in fact many High Street Post Office sites were leased;

(iv) he agreed about selling equipment: it would be sold from now on.

Tim Eggar asked whether it might be sensible for the Treasury to have a single fund for nationalised industries' investment, and for which the industries would have to compete with each other; and whether the industries could borrow without a Treasury guarantee.

Sir William Barlow said Government ownership was an implied guarantee.

Jock Bruce-Gardyne agreed. There was no way to escape the Government guarantee.

Sir William Barlow: "Is it or is it not a fact that this country needs a first class telecommunications system?" [Maurice Macmillan: "But at what price?"]

Jock Bruce-Gardyne said the nationalised monopolies could service debt by loading the price on to the consumer. The answer was to break the monopoly.

Sir William Barlow commented that a significant part of his reason for resigning was that he did not want to defend something in which he did not believe: monopoly. He was in favour of relaxing it. But this took a long time. It took 15 years in the USA.

Maurice Macmillan said that managers in private industry faced problems of sudden change similar to those described earlier by Sir William. For example the Lords' decision on charges for school transport had meant a severe cutback on the buying of his schoolbooks.

Sir William Barlow pointed out that a private sector firm had the option of making less profit in a bad year; but he was bound by an EFL.

Nick Budgen listed the ups and downs of Government policy for nationalised industry prices over the decade, and then asked Sir William what would happen next.

Sir William Barlow pointed out that Mr Budgen's question showed that it was impossible to forecast Government policy.

John Patten asked whether Sir William would accept some braking of monopoly in exchange for being allowed to borrow outside the PSBR.

Sir William Barlow said he was broadly in favour of relaxing monopolies, but if the postal monopoly were relaxed the service would require a subsidy.

Tim Renton said that surely the problem about this year's cash limits was not that the wages assumption was too low, but that the industries did not keep their pay down. He also suggested splitting cash limits into one for current and one for capital expenditure.

Sir William Barlow agreed about splitting the limits. He intended to ask Sir Keith Joseph for a split cash limit. "But who imposes this mixture of capital and current? Our friends in the Treasury". As for wages, if Mr Renton had any ideas for keeping them down, Sir William would gladly hear them. He personally thought free collective bargaining was not working. It was very costly to endure a strike. There was talk of some kind of economic forum at which Government, employers and unions would discuss what the nation could afford. This might work; it was being tried in the Post Office, where they now gave the unions all the facts and figures and let them do the arithimetic.

Stephen Dorrell asked whether cash limits were useful for static or declining industries like the postal service.

Sir William Barlow thought this was more reasonable. The argument with the Government was really about the big expanding industries.

Hal Miller asked whether POUNC was effective.

Sir William Barlow said it was ineffective as far as prices were concerned. Only experts could investigate the pricing policies of a monopoly.

GC

GEORGE CARDONA
9 May 1980

pmp.

CONFIDENTIAL

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These pps relevant to Ryrie paper in earlier box

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Minister of State (C)
PS/Minister of State (L)
Mr Ridley
Mr Cropper
Mr Cardona

MEETING OF CONSERVATIVE FINANCE COMMITTEE, 6 MAY 1980

The Financial Secretary read with great interest Mr Cardona's note of the Conservative Finance Committee meeting addressed by Sir William Barlow.

The Financial Secretary thinks that Sir William clearly has a case on external financing limits and the trade cycle. It would thus be helpful, in his view, for Sir William's remarks somehow to be fed into the reappraisal that is now under way.

SAJL

S A J LOCKE
9 May 1980

CHANCELLOR

Yes: how many people owned in Scotland?

c Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Mr Ridley
Mr Cardona

PUBLIC REACTION TO THE BUDGET

George Cardona's summary (14 May) of our post-Budget poll indicated a Mean Score of + 33 in favour of the proposition:-

"People who live in historic houses should be helped by the state to continue to do so provided the public can visit them".

2. George then pointed out a curious regional side to this:-

Scotland	+ 04
South	+ 51
Owner-occupiers	+ 51
Local authority tenants	+ 07

3. This finding accords with a comment Robbie Browne Clayton, our CRD agriculture desk officer, made to me in Perth. "It would be a great mistake from a Scottish point of view to meet the CLA's demands on tax treatment of "Let Land". Robbie knows his Scotland very well. Landlords are still objects of lively detestation up there.

PJC

P J CROPPER
2 June 1980

C 76

CHANCELLOR

For further discussion: my mind is by no means closed

c Financial Secretary
Mr Ridley
Mr Cardona

OIL FUND

I had written the attached note before this morning's discussion of the Tax Burden, the future of Tax Cuts, the balance between further tax cuts and further reductions in Government borrowing, etc.

2. They will all come together in the note I will now be doing.

P J CROPPER
3 June 1980

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CHANCELLOR

c Financial Secretary
Mr Ridley
Mr Cardona

OIL FUND

I may not have made my point very well (16 May): certainly the Financial Secretary was less than impressed (19 May). But there is an issue here, and I think it will need to be faced in the framework you have set for the trilogy of "Coningsby" speeches in June and July. May I therefore come back to it?

2. In the Medium Term Financial Strategy we showed a Fiscal Adjustment at 1978-79 prices of £2½ billion in 1982-83 and of £3½ billion for 1983-84. We had no need to do so; we could have designated the whole of the spare oil revenue to bringing down the PSBR, as Mr Forsyth would have recommended. But for good reasons we decided to show this item of uncommitted revenue in the projections, and there it is.

3. Let us assume that the outturn is as projected. If the oil price goes up further, the sum available for the Fiscal Adjustment may actually be more than £3½ billion in 1983-84. Or it may turn out to be less. But let us assume it is right.

4. Then that sum of £3½ billion will be available for use in any, or all, of three ways:-

(i) to do a Forsyth;

(ii) to cut taxation (rough equivalent 5p off basic rate);

(iii) to pay for additional Government expenditure.

Rule out, for a moment, the first. Then there is a straight choice, when the time comes, between tax cuts and public expenditure.

5. I personally think it would be deplorable if any of this precious oil revenue went on improving social security transfer payments. That would be frittering with a vengeance.

6. What I am not so sure about is the balance of advantage - both national and political - between tax cuts and Government capital expenditure.

/7. A lot

7. A lot of people come back from the Continent feeling rather ashamed of the crummy condition of many of our public assets. Certain of our railway stations and rolling stock, the surface of many of our roads, the endless traffic jams facing anybody who tries to drive into London from Dover or Folkestone. And if they delve deeper, they are ashamed at our Victorian prisons and mental hospitals. Furthermore they have little confidence that governments are planning adequately for the future energy needs of the country when the oil tails off.

8. I do not think I am alone in feeling that I would like to see at least some of the Fiscal Adjustment used on this sort of thing rather than on cutting the basic rate of income tax.

9. The Financial Secretary pointed to the dangers of counting one's eggs before they are hatched, and of the probability that the Oil Fund would end up as a recipe for a major expansion of quasi-Bennite expenditure.

10. My own feeling was that advance planning of the Oil Fund would help to save us from just these dangers, and act as a positive bulwark against waste. Surely it would be regarded as reasonable to head the whole discussion with the words "No Fiscal Adjustment - No Oil Fund". After that, surely, it would be better to work out a rational programme of public expenditure rather than leave the £3½ billion of the Fiscal Adjustment to be put up for grabs each Budget time.

11. I sense that "How to spend the Fiscal Adjustment" may become something of a parlour game among economists and commentators - which is why I raise it now. There could be merit in leading the discussion rather than waiting to be carried along by it.

12. Do we mean the Fiscal Adjustment to be quite firmly linked in the public mind with the 25 per cent income tax target, or are we prepared to encourage a broader public discussion of the issue?

PJC

P J CROPPER
2 June 1980

Confidential

CHANCELLOR OF THE EXCHEQUER

Mr Hall

1. Sir D. Wass D.W.
2. Mr Bailey AMB 10/6
3. Sir A Rawlinson AR 10/6
4. Mr France

To see and return please.

M.A. Hall
10/6

384/6

CONFIDENTIAL

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CHANCELLOR

TREASURY AND CSD

You asked for Opposition material on the question of reuniting Treasury and CSD. I attach the parts of the Machinery of Government Policy Group Interim Report relevant to the Treasury and CSD (see particularly paragraphs 40-42). The Report was dated 11 May 1977.

GEORGE CARDONA
3 June 1980

143/6
30.10.6

~~to be relatively easy to make a change of appointment.~~

80

THE FUTURE OF THE C.S.D.

40. There is both considerable overlap and under-lap, between the central Departments causing problems for the departments who have to maintain separate contacts with two central departments for purposes which are closely related. Experience has shown that splitting the responsibility for the efficient management of the public sector between the Civil Service Department's manpower control and the Treasury's financial control

is neither logical nor practical. At the level of generality at which the central departments must and should work there can be no real separation between efficient financial and efficient manpower management. To pretend that there is simply causes the C.S.D to treat the perfecting of the civil service as an end in itself and gives it a vested interest in maintaining the power/strength of the bureaucracy.

AA 41. We strongly recommend the objective of bringing the control of manpower back under the control of the Treasury. It is fair to warn, however, that this will be a very sensitive step to take politically because the Fulton Committee called for the creation of the Department and the Civil Service Unions to give it their support.

BB 42. As an interim step therefore, the Department might retain an independent existence for a time but be placed under the charge of a senior Treasury minister (Paragraph 51)

SPLITTING THE TREASURY?

43. It has been put to us strongly that this would overburden the Chancellor and his senior officials, and that while the existing division at the centre is clearly wrong, there is a more appropriate division between a department in charge of economic and financial policy and a department which would bring together all the central review and control functions and would have a strenghened analytic capacity.

44. Those who argue for this step believe that there is a natural break in the continuism of policy from the determination of public spending totals through expenditure ceilings for departments to allowances for individual programmes. They further add that there will be a need, at a time of severe restraint in public spending to ensure the cost effectiveness of every pound spent in terms of policy and to view the detailed make up of the spending total in perspectives other than the economic if it is to become the servant of policy and not simply the result of crude horse trading.

45. We examined this proposal thoroughly, but felt that it would be out of line with the 1975 reorganisation of the Treasury whose

1/ Wrah

82

main thrust was to integrate more closely than before the expenditure controlling side of the Treasury with the groups responsible for taxation policy, industrial policy, incomes policy and monetary policy. There is continuing pressure to bring the management of taxation closer to the management of public expenditure, and there is a natural political logic in having the man who approves the expenditure plans of his colleagues take public responsibility for raising the money to pay for these plans.

46. Even if there were an independent Budget Bureau it would tend to be seen as a subordinate department to the Treasury with little real autonomy.

47. We do not believe that the decision on the total level of spending and its major components can be divorced from the continuous dialogue which goes on about its detailed make up, nor do we think it sensible to divorce the taxation and expenditure components of transport, housing and agriculture, for example, or the relationship between tax, spending and monetary policy in providing incentives for industry.

48. We have thought it right to set out briefly both sides of this argument since we accept that this is only the plausible way in which to divide the pre-Fulton Treasury should the strain on the Chancellor of placing him in charge of a fully reunited Treasury prove excessive. We recommend, however, that the Treasury should not be split and that the centre must once again be brought together.

CC

STRENGTHENING THE TREASURY

49. We believe that the Treasury must be strengthened in other ways, and in particular that the Treasury should have a second minister of considerable status in the Cabinet.

50. There is no need for us to find ways of encouraging ministers to pursue their departmental interest. We should be concerned with finding ways to commit the entire Cabinet to the most rigorous review of public spending, and to making the process of weighing policy output and priorities more explicit and more thorough.

DD

51. To this end, we believe that the Treasury should be given a

83

greater capacity for sustained analysis and this should operate under the second Treasury Minister in the Cabinet, who would, under the Chan cellor's direction, have responsibility for the public sector divisions of the Treasury, and who would also be responsible for the C.S.D.

all ?

52. The Treasury should be geared to look more closely at the actual impact of specific tax changes on the individual, on social groups, on firms and whole industries, and should study also the integration of taxation and social policies. The Inland Revenue and Customs departments should be brought into much closer contact with Treasury thinking under the supervision of a senior Treasury minister. EE

BUDGETARY SECRECY

53. We felt that the doctrine of budgetary secrecy was an outmoded concept, certainly so far as the Cabinet was concerned, and that there is a good deal to be gained from having the chance to cross check its forecasts and assumptions in a more general and open process. The numinous value attached to budget day itself seems no longer relevant when economic policy making is a continuous process.

54. We recommend therefore that the Budget, fiscal, monetary and economic policy generally should be brought into open Cabinet discussion.

FROM: THE RT HON MICHAEL JOPLING MP

pwsp (X)

c. Mr Ridley
Mr Middleton
Mr PG Davies

C return, pl.

83a

Government Chief Whip

12 Downing Street, London SW1

4 June 1980

Dear Geoffrey

X I understand that Chris and John Patten are writing an article for publication in the Guardian next week urging that there be a reduction in the National Insurance sur-charge to ease the liquidity problems of industry.

I have told Chris Patten that as a PPS he must clear this with you before this article goes for publication.

Yours

Michael.

Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury
Parliament Street
SW1P 3HE

CD Cleave(?) X pl
JW 2/6

Mr Kemp

2. Chancellor of the Exchequer

This refers to the query set out in Mr Tolkien's note of 22 May. We have not spent a lot of time on it, but it seems that Mr Wainwright is off beam. The workings have all come from published sources and one would have thought Mr Wainwright - an accountant - would be better at figures! [initials] 30/5

2a v.m

84

NATIONAL INSURANCE CONTRIBUTIONS: MR RICHARD WAINWRIGHT'S OBSERVATIONS.

In his intervention in the Public Expenditure debate on 7 May (OR cols 343-344) Mr Wainwright asserted that if unemployment were to rise to $2\frac{1}{2}$ million the total 'take' of national insurance would increase from the present rate of just over 20% of gross pay to well over 25%. In Mr Tolkien's minute of 22 May you asked for comments.

To arrive at his figure of just over 20%, Mr Wainwright has included the National Insurance Surcharge (currently $3\frac{1}{2}$%) as part of National Insurance. It is of course, simply a tax on employment which rides on the back of N.I. contributors, but is quite unrelated to the requirement's of the National Insurance Fund. The make-up of Mr Wainwright's figure is as follows:-

Employee's contribution	6.75
Employers contribution	10.20
	16.95
plus N.I. Surcharge	3.5
	20.45

In projecting an increase to well over 25% if unemployment were to rise to $2\frac{1}{2}$ million, Mr Wainwright is indulging in a flight of fancy.

Even if one assumed that the proportion of those entitled to unemployment benefit (effectively only available during the first year of unemployment) remained the same while the total number of umemployed rose to $2\frac{1}{2}$ million, a rough estimate of the likely effect on the contribution rate, derived from the Government actuary's report on the last contribution review (Cmnd 7771) would be roughly as follows:-

Increase in umemployment over projected level for 80/81	=	700,000
Cost to N.I. Fund in terms of additional benefit and reduced contributions	=	£1,225 million
Increase in joint contribution needed to balance fund (1% on the rate raises £1b approx).	=	$1\frac{1}{4}$%

Thus, Mr Wainwright should have come up with a figure of "under 22%" rather than "well over 25%" (including the 3.7% NIS in both cases).

In practice, the calculation would be more complex, taking account of the likely split of the unemployed between N.I Fund and Supplementary Benefit (borne on the Consolidated Fund), benefit rates ruling at the time, and the buoyancy of employment income. What is certain is that Mr Wainwright's guesstimate is well over the top.

A M WHITE
30/5/80

86

CHIEF SECRETARY TO THE TREASURY

CHANCELLOR OF THE EXCHEQUER

cc Financial Secretary
Mr Cropper

I refer to Peter Cropper's note of June 13.

2. I think he is right that we are - perhaps - dangerously moderate in our counter-inflation policy. The preferred speedy action that can be taken on the PSBR is an increase in direct tax (as opposed to an increase in indirect tax or in public sector charges). I would not be averse to such a move.

3. I think his proposals on public sector pay are unwise and probably inequitable. I would prefer the more Fabian route of cash limits and realistic comparability as a means of reducing the pay component of public expenditure.

WJB

JOHN BIFFEN
16 June 1980

CONFIDENTIAL AND PERSONAL

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FINANCIAL SECRETARY TO THE TREASURY

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Mr Cropper

STRATEGY

You asked for my comments on Peter Cropper's minute of 13 June.

Peter's main proposition is that the policies set out in the medium-term financial strategy would only reduce inflation (and interest rates, I take it) very slowly, whereas the superimposition of a 5% cut in the real level of public sector wages and salaries would speed things up immeasurably.

The MTFS route might in any case prove rather faster, I suspect, than either Peter or our forecasters imagine. But whether it does or not I am doubtful whether the 5% pay cut would make as much difference as Peter imagines. There are so many other factors at work.

That said, a reduction in public sector (and in particular Government sector) pay levels would clearly be desirable. It would of course mean abolishing Clegg and Pay Research, and also admitting that we were wrong ever to have accepted Clegg in the first place. Even if we agree to all this (and I for one on the whole do), I would not favour throwing down the gauntlet in the way Peter advocates. Nor, of course, would I countenance for a moment a 3% increase in all income tax rates.

All this looks suspiciously like panic.

NIGEL LAWSON
16 June 1980

PERSONAL & CONFIDENTIAL

CHIEF SECRETARY TO THE TREASURY

CHANCELLOR OF THE EXCHEQUER

INCOMES, INFLATION AND UNEMPLOYMENT

I refer to your personal note of July 7 following my House of Commons Speech of July 1 on the above topics.

2. As best as I am able to judge there really is not much difference in substance between us; although I do not feel equipped to judge on the range of factors which affect short term movements of inflation as opposed to short term movements of individual prices.

3. Obviously there will often be nuances of style in the way we present broadly similar arguments. For example I recently did a BBC-2 broadcast and expressed a cautious optimism on the likely trend in prices. I am afraid this could be contrasted with your Panorama broadcast on July 7 when you forecast inflation falling "sharply" during the second half of this year.

IN "THE MONTHS" AHEAD

4. Perhaps it would be helpful if the Financial Secretary and ourselves had a discussion on these matters.

Yes

WJB

i.e JUNE FIGS (NEXT WK)
JULY FIGS (IN AUG)

JOHN BIFFEN
9 July 1980

21.9%
↓
? < 17%
= "SHARPLY"!!

BUT U'RE RIGHT TOO!

PERSONAL & CONFIDENTIAL

c 89

E.12

10/7

CHANCELLOR

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Mr Cropper
Mr Cardona

CASH LIMITS: A MONTHLY SPENDING RATION

You will by now have had a chance to study Mr Littler's submission of 9 July, in particular the note on the monthly spending ration proposal. May I urge that you do not despatch this note to No 10, and that we discuss the basic issue at tomorrow's ministerial meeting? My reasons are as follows.

no risk! It's hidden away at the back!

2. We are all well aware that a system of cash rationing - or of Treasury authorisation of spending - could imply great rigidity in a fluid and unpredictable world. One would not lightly wish to tamper with a system which leaves people the maximum of discretion and the minimum of surveillance, provided that:

(a) they are committed to the system and keen to work it properly;

(b) they are competent enough to make it work.

The note by officials takes both these assumptions as given. The present position, however, is one in which we know that (a) does not apply to one major Department, and perhaps to the LAs and NIs as well; and one must be uncertain about (b), given the rise in overspending recorded from one year to the next, and the growing pressures on cash limit managers from inflation, squeezes and so on.

3. Given the extreme vulnerability of monetary policy and the strategy generally to sudden, substantial, unforeseen or

90

irreversible increases in spending, one then asks whether there is, at the very least, a case for having a remedy to hand - perhaps rough and ready - to prevent or correct such unwelcome events. This implies an emergency mechanism which could be put into operation selectively or across the board. The very knowledge that such a safety device existed and could be implemented could be very helpful, always provided that it is credible. It would be a deterrent to your colleagues and would greatly reassure financial markets.

4. But there remains, in principle at least, a broader case for going further. There are moments when it is helpful to go back to naive and childish first principles. They would suggest that one of the jobs of the Treasury is to control expenditure. The essence of the present cash limits system is monitoring, not control. To achieve control in the present framework one depends on various political and administrative processes which are not watertight. Why not make them so, and by the simplest possible route, namely ensuring that the Treasury regulates the value of cheques written, money appropriated or whatever?

5. A final point of substance remains to be considered should possibilities such as these be rejected. Under the present system it is clearly open to cash limit managers to conceal a trend towards overspending until late in the financial year and to reveal it only when a correction is unachievable. The present sanction against such behaviour is the offsetting deduction in the following year. But is that quick enough? Intuitively one feels that it would be better if there were some kind of review procedure after, say, six months which resulted in a firming up of the expenditure profile for the remaining months of the year. In effect one would be seeking by so doing to ensure that the offsetting deductions were made within a time span of one year rather than two. Ideally this would need to be done every six months, but given the rigid nature of the financial year to do so might be rather complicated. This line of thought raises a multitude of complications. But so does overspending!

AR

ADAM RIDLEY 10 July 1980

CONFIDENTIAL

Chancellor, You'll want, I think, to discuss this with Ministers & advisers: it all fits into the defence picture. [illegible] 10/7.

ASAP + the next stages on defence

91

CHANCELLOR

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Mr Ridley
Mr Cropper

CASH LIMITS : A MONTHLY SPENDING RATION

10/7/80

Mr Ridley's note of today's date.

2. I hate to disagree with Adam about anything, but now that I have had a chance to think about the idea of monthly spending rations, I would recommend against it. This is not to say all is well with our mechanisms for control of expenditure: they are very far from satisfactory, and I hope to let you have some thoughts soon, in the form of comments on Mr Bailey's Review of Expenditure Divisions.

3. I think monthly cash limits would give you the problems of annual cash limits, but more often. The problems of over and underspend would remain unsolved; and Mr Pym would be able to overspend his month's allowance just as he overspends his annual allowance. He overspends because he has deliberately chosen to do so, because you have no sanction against him (except deductions from the next year, which is no sanction at all) and because he thinks (we hope mistakenly) that Cabinet will retrospectively validate his actions.

4. I agree with Adam's last paragraph that we need some review procedure part of the way through the year. But we already have it. I recently attended a meeting with MoD officials which reviewed the first 3 months. MoD made it clear they were overspending as a matter of policy.

5. I agree with Adam's paragraph 4. But there is already a procedure whereby the Treasury has to approve money appropriated.

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It does not work as a control on overspending, largely because there is no effective sanction short of cutting off money completely: but we are not going to stop paying soldiers, etc.

6. I do not think you should send the note attached to Mr Littler's submission to No. 10 as it stands. My recommendation would be to alter it to say that monthly rationing looks unpromising but that we are considering other - perhaps more drastic - sanctions.

GEORGE CARDONA
10 July 1980

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