part. B.

Begins: 15/7/80
Ends: 16/1/81

PO -CH /GH/0045

PART B

Chancellor's (Howe) Papers:

PUBLIC EXPENDITURE AND
FINANCE 1980

Disposal Directions: 25 Years

D Anderson
25/7/95

PO -CH /GH/0045
PART B

From: Peter Hordern, M.P.

HOUSE OF COMMONS
LONDON SWIA OAA

 2

As mentioned by me: I believe it's the FST who is already following up?

15th July, 1980.

Dear John,

I had a word with your Private Office yesterday about a matter which concerns me very much indeed.

As you know better than anybody, the Government's policy seems to me to be to try to exert control over Local Authority capital expenditure by means of loan sanctions. I thought the purpose of this policy was to see to it that Local Authorities could not borrow for the purpose of capital expenditure without specific sanction from the Government. I now find, however, that this is not the case. I am enclosing a copy of a document that I received from a friend of mine who is a Conservative Councillor on the Crawley Council. As you will see, it is the report of the Borough Secretary and the Borough Treasurer concerning the proposed terms for financing a new leisure centre, to be built at Bewbush in Crawley. I hope you will agree with me that this is precisely the sort of capital expenditure which ought not to be countenanced at this time. But you will see from the enclosed document that Morgan Grenfell have, apparently, found a way to bypass Government control of Local Authorities' capital expenditure. Indeed, paragraph 3(vi) goes so far as to say "No payment is made by the company to the Council at any point, so there is no question of the transaction being a loan and thereby breaching the control of borrowing regulations". I understand that the amount of money involved, £1.26 million, has now been proved to be too low an estimate, and that Morgan Grenfell are prepared to lend even more money to the Council for this purpose. I also understand that this is by no means the only form of transaction in which this bank has been engaged, and that there are possibly many other authorities who are getting money from the City in order to finance projects which would certainly not have Government sanction or approval.

/...

The effect of this process seems to me to be that Merchant Banks are bidding for money in the money market to finance projects such as these and, in the process, keeping interest rates higher than they would otherwise be. As you know, there are many small companies that are now crippled by high interest rates, and it seems to me absolutely monstrous that there can be closures and liquidations of small companies, caused in part by the high levels of interest rates to provide money to finance leisure centres and other forms of Local Authority capital expenditure up and down the country.

I have copied this letter to the Prime Minister, the Governor of the Bank of England, the Chancellor of the Exchequer and the Comptroller and Auditor General. It seems to me that something must be done to stop this business, and that very soon.

Yours sincerely,

Rt Hon. John Biffen, MP

Encl.

cc. Rt Hon. Mrs Margaret Thatcher, MP
Rt Hon. Sir Geoffrey Howe, QC, MP
Rt Hon. Gordon Richardson, MBE
Sir Douglas Henley, KCB

Phone IR and see if reply has been sent to this!

4

13944

HOUSE OF COMMONS SW1

CH/EXCHEQUER	
REC.	14 JUL 1980
ACTION	Mr Lewis IR
COPIES TO	~~PS/MST(C)~~
	~~Mr Dixon~~

action: Mr Lewis-IR

cc PS/MST/C
Mr Dixon

PA

Reply?

4/143/80
Higham

889031 PO HC G
449911 PO BS G

4054 1146 ~~FERNDOWN BS 217~~

THE HON SIR GEOFFREY HOWE MP HOUSES OF PARLIAMENT
LONDON

SUBJECT : FIRST YEAR ALLOWANCES TV RENTAL
FOR YOUR INFORMATION FOLLOWING IS A COPY OF A TELEGRAM SENT TO PRIME MINISTER STOP MAY I URGE YOU TO RECONSIDER STOP
SUBJECT : FIRST YEAR ALLOWANCES TV RENTAL REPORTS OF MEETING YESTERDAY BETWEEN PETER REES AND NATIONAL TELEVISION RENTAL ASSOCIATION INDICATE THAT TREASURY ARE NOT SIGNIFICANTLY ALTERING PROPOSAL TO REMOVE FIRST YEAR ALLOWANCES FROM TELEVISION RENTAL COMPANIES STOP MY LETTER TO YOU OF 22ND APRIL REFERS STOP MAY I URGE YOU TO INTERVENE BEFORE THEORETICAL TAX LOGIC IS ALLOWED TO UNDERMINE COMPETETIVE POSTION OF A GREAT BRITISH SUCCESS TO A POINT WHERE THE INDUSTRY MUST DECLINE AND CEASE TO BE THE MAJOR OUTLET FOR UK MADE TELEVISION AND VIDEO PRORUCTS I WOULD REPEAT SUGGESTION THAT YOUR MINISTERS STATE IN REPORT DEBATE THAT THIS SUBJECT IS BEING FURTHER DISCUSSED WITH THE INDUSTRY BUT AS THERE IS NO SIGNIFICANT REVENUE EFFECT THIS YEAR ANY DECISIONS TO IMPLEMENT THE PROPOSED CHANGES SHOULD BE INCORPORATED IN NEXT YEARS FINANCE BILL OR IN THE GEERAL REVIEW OR CORPORATION TAX NOW BEING UNDERTAKEN STOP THIS YEARS BILL CAN BE AMENDED ALONG THE LINES OF SIR WILLIAM CLARK'S PROPOSAL IN COMMITTEE STOP

We are providing a draft reply to this. RT 15/7.

DAVID D HURLEY , CHAIRMAN VISION HIRE LTD
AND ALSO CHAIRMAN DORKING CONSERVATIVE ASSOCIATION

COL 22ND ALSO READVIDEO PRODUCTS AND GENERAL REVIEW

449911 PO BS G
889031 PO HC G

Capital leasing Corr 5

VISIONHIRE
MEMBER OF THE ELECTRONIC RENTALS GROUP OF COMPANIES

Visionhire Limited Visionhire House, P.O. Box 43, Station Way, Crawley, West Sussex RH10 1JA Tel: 0293 31251 Telex 877772 VISION G

CH/EXCHEQUER
REC. -4 JUL 1980
ACTION PS/IR
COPIES TO MST(C) (L), Mr Battishill, Mr Dixon, Mrs Heaton, Mr Riley, Mr Corlett, Mr Crofter

SECRETARIES' OFFICE -9 JUL 1980 RECEIVED PARLIAMENTARY SECTION

PS4/143/80

DDH/EH

1st July 1980

Sir Geoffrey Howe
Chancellor of the Exchequer
House of Commons
LONDON SW1A OAA

Dear Sir Geoffrey

When we met at Penhurst Place the other evening, where I was present in my capacity as Chairman of the Dorking Divison Conservative Association, we did touch briefly on the problems facing the television rental industry as a result of your budget proposals on capital allowances. I hope you will now forgive me writing directly to you on this subject, which I know is being handled by Peter Rees, but I feel this is a matter of such importance that your attention should be drawn to it.

My concern is whether you and your Ministers are fully aware of the problem. The National Television Rental Association has written both to you and to Peter Rees seeking a meeting but so far meetings have only been held with your officials. I know Peter Rees has undertaken to introduce some improvement in the transitional arrangements at Report stage but no transitional relief can deal with the underlying problem.

Verybriefly, I believe your proposals seriously jeopardise the future of the television rental industry, which employs some 60,000 people, by altering the tax position to the advantage of the retailer, who benefits from stock relief and by not having to charge VAT on the interest/service element of credit allowed to customers. Apart from the one year 1952/53, television rental has never had less than a 45% allowance in the first year.

History shows that the television rental companies, with more than half the market, have to a very large extent (over 90%) purchased from British manufacturers and there is little change in this trend - a very effective non-tariff barrier. Retail trade disposals however have included large proportions of imported sets. Although the British manufacturers are taking steps to strengthen their own position, it must be vital to them that the rental industry remains healthy and viable.

continued....

DIRECTORS D.D. Hurley (Chairman), J.K. Johnson (Managing), T.E. Entwistle, W.M. Farley, F.E. Hall, P.J. Hawkins, I.P.S. Muirhead (Secretary), M.F. Payne, J.E. Roberts
Registered Office: 63 High Street, New Malden, Surrey KT3 4BT Incorporated in England Registered No. 473581

In conclusion, may I again ask you to ensure that the National Television Rental Association is given an opportunity to state its case. I myself believe that the best immediate solution is to leave the position as it is for a year by omitting any change from this year's Finance Bill to give time for discussion on the whole question.

Finally, on a personal note, may I say how much I am looking forward to your visit to Dorking on 14th November - you will receive a warm welcome.

Yours sincerely

David D Hurley
Chairman

Phone IR for PPS

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PA

BOARD OF INLAND REVENUE

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

25 July 1980

CHANCELLOR OF THE EXCHEQUER

TECALEMIT LIMITED

1. You have asked for advice on this letter to you from Mr de Paula of 16 July, in which he argues that "taxation has bled away the profits we need to retain in order to expand our activities".

2. A look at the accounts suggests that Mr de Paula's main problem is with stock relief. His company - like so many others - has found it necessary to reduce stock volumes. Therefore, the amount of stock relief he has been able to claim, under the present rules, has given the company much less than it needs, in order to maintain its value in real terms. As you know, we expect a good many companies to be in a similar position this year.

3. We are tackling this effect in the current review of stock relief with Lord Cockfield.

4. It is possible that Tecalemit's figures here are also distorted by the exceptional rapid increases in oil prices. However, that is perhaps a different story.

5. Finally, Tecalemit's capital allowances have fallen short of the provision which it has made for current cost depreciation. It is possible (it is difficult to be sure) that some of the company's investment has been in assets not qualifying for capital allowances.

6. I attach a draft reply.

A J G ISAAC

---

cc Mr Corlett
Mr Dixon

Mr Isaac
Mr McGivern
Mr Hamilton

Draft reply to:

F C de Paula Esq
Tecalemit Ltd
Old Court
Cox Green
MAIDENHEAD
Berks
SL6 3AQ

Thank you for writing to me on 16 July, and for sending me a copy of the Report and Accounts of Tecalemit Ltd. As you know, the Government is currently reviewing the stock relief scheme, as part of a general review of the corporate tax system and any changes that might be needed to respond to the effects of inflation on company profits. For that purpose, it was very helpful to me to see your company's Accounts which illustrate very clearly, if I may say so, one aspect of the problems which we are considering.

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10 DOWNING STREET

25 July 1980

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON SW1

A long analysis of of a simple, crucial, problem. Does it point us to any further practical steps?

Dear Geoffrey,

IS PUBLIC EXPENDITURE SELF-INDEXING?
- And does it matter if it is?

You will remember that we referred, in the table of contents for the "Long Campaign" paper (now in the process of serialisation, as agreed!) to the "auto-indexing muddle". We have done some more thinking about this and have the suspicion - I wouldn't put it stronger than that - that public expenditure is effectively self-indexing to such an extent as to threaten quite seriously the achievement of the financial strategy.

Accordingly, we have tried to set down our thinking in the attached paper. I would stress that we don't pretend to know the answer to the questions posed by the paper; we are really not qualified to do that. The paper therefore simply raises the underlying questions and tries to explain why we are worried about them. If we are sounding a false alarm, then there is no harm done. If there is anything in what we say, then, with so much at stake, the problem needs further thought by those properly qualified to tackle it.

Indexation, whether as a <u>policy</u> or as a <u>phenomenon</u>, is a very elusive subject as we found working in Sir Douglas Wass' small group last winter. I think most of us got fairly confused at various stages during that exercise. It is this elusiveness which makes it such treacherous ground; hence our concern and hence the paper.

I am copying this letter, and the paper, to the Prime Minister, Keith Joseph, and also to Robin Ibbs.

Yours ever
John

JOHN HOSKYNS

CONFIDENTIAL

21 July 1980

Policy Unit

10

IS PUBLIC EXPENDITURE SELF-INDEXING?
- And does it matter if it is?

1. INTRODUCTION

1.1 In earlier papers on public sector pay, we have emphasised the danger that the process of Transition from high to low inflation could end with further resources transferred from the private sector to the public, rather than vice versa.

1.2 We have a nagging suspicion that public expenditure may be to a large extent self-indexing so that, even if inflation is brought down, this switch of resources is extremely likely. A natural response to this suggestion may be to say that, given the will to set the right cash limits and stick to them, there cannot be a problem. But self-indexing could still take place despite the system of cash limits because:

(1) Only about two-thirds of all expenditure is cash-limited.

(2) Cash limits could in the event be set to accommodate full indexation in order to avoid the embarrassment of (3) below.

(3) Powerful economic and institutional forces could ensure that cash limits are exceeded (eg B.Telecoms).

2. ARE WE THINKING STRAIGHT ON PUBLIC EXPENDITURE DURING TRANSITION FROM HIGH TO LOW INFLATION?

2.1 It is Transition which makes self-indexation a potential problem

2.1.1 As we have stressed in earlier papers, Transition is different from Stable State. It poses distinctive problems, calling for different solutions, because it requires deceleration in the nominal increase of public expenditure as well as real cuts. With the present balance of the economy, we would still need to cut public expenditure and reduce the PSBR as a percentage of GDP, even if we had zero inflation. (Of course, there are, in the real world, all sorts of aggravating causal links between high public expenditure, high PSBR and the rate of inflation. But they should not be allowed to obscure the crucial systemic difference between Transition and Stable State.)

2.1.2 If public expenditure lags in accommodating to the MTFS, while the private sector leads, then the private sector will be damaged in several ways:

- Higher PSBR with both interest rates and exchange rate higher; <u>or</u> PSBR on target, but higher taxes.

- Higher nationalised industry prices.

- Cuts in public sector capital spending.

- Public sector pay knock-on encouraging private sector to damage itself further with high settlements.

2.1.3 This passing of the bill from the public to the private sector deepens the private sector recession, so that a larger bill for unemployment is passed back to increase public expenditure and reduce revenues still further.

2.1.4 We have heard it argued that no problem arises, provided the PSBR target is met; and that buoyant tax revenues will ensure that this is the case. We may have misunderstood this argument, but it seems to us that, if our fears are correct, the public sector <u>will</u> lag behind the private in adjusting to the MTFS. One of two things can then happen: either the private sector is damaged, via the PSBR, by recession (as described in Section 2.1.2 above) because the monetary contraction prevents the hoped-for buoyancy; or the buoyancy is provided by monetary accommodation - so that in effect both sides of the PSBR equation are multiplied by some higher GDP deflator. In other words, the struggle against inflation is relaxed.

2.2 <u>Are we clear who should bear the burden of monetary deceleration</u>?

2.2.1 The Government urges people to settle for pay increases which are well below the current inflation rate because, if they do not, transitional unemployment will be unnecessarily high. The

Government has accepted in principle that it must practise what it preaches as regards the Civil Service. But it is worth remembering that, only a few weeks ago, the Chancellor had to push hard to get this principle accepted. Although we have now established the right principle for the Civil Service, can we make it stick throughout the public services, with their 11-month pay round?

2.2.2 There is still an implicit suggestion in some of the public expenditure papers that inflation is something beyond Government's control, something which (even though it is caused by Governments) simply "happens" to the Government (just as it happens to, say, a medium-sized engineering company) making the fulfilment of its programmes unnecessarily difficult. It is a short step from that assumption to the further assumption that Government should therefore be free to adjust its own nominal spending to take account of inflation. Government is the only party to the whole economic process which can lead the way, by cutting its own spending and thus reducing the money supply without forcing the private sector into the vicious circle of high interest rates serviced by indexed revenues*. And yet it treats itself as the one party which can effectively escape from the effects of the inflation it has helped to cause. In doing so, it either perpetuates the inflation or increases the damage of Transition.

2.2.3 All this is obvious enough, and the simple answer is that we must cut public spending. But we need to dig a little deeper. About £34bn of the total public expenditure of £98bn (1980/81 cash) is formally indexed (transfer payments and defence) and there are other less firm commitments to index other large parts of public expenditure. What will be the result of this in the eventual pattern of public expenditure, as planned in the White Paper, at present expressed in constant prices? Will that pattern itself affect the chances of achieving the PSBR target? By how much more must we reduce the pay outturn for the public services in order to compensate?

2.3 Even if we are clear that "public expenditure must bear its share", what does that really mean?

2.3.1 What are the effects of selective indexation? The Public Expenditure White Paper shows all categories of expenditure in constant

* and secured on indexed debtors, to meet indexed pay awards!

prices. Does the real eventual distribution reflect any advantage in being indexed rather than un-indexed? How do the White Paper plans, expressed in constant prices, reflect the difference in outcome between public services pay settling at, say, 9%, and transfer payments being indexed on a forward-looking basis at, say, 16% for this year and with similar differentials for following years? (This raises further questions addressed in Section 3.1 and 3.3 below.)

2.3.2 What is to be learnt from past experience? Social security was effectively indexed on an ad hoc basis from the early Seventies until about 1975, and thereafter formally indexed. During that period, total social security expenditure rose significantly as a percentage of public expenditure. Is there a connection between the indexation and the increase? Did indexed transfer payments lead the way during the acceleration of inflation, just as we fear that it may trail behind during deceleration? Do we expect this to happen again over the period of the MTFS? Are the figures in constant prices adjusted to show that? (See also 3.1.1 below.)

2.3.3 If we believe that the MTFS will reduce inflation to negligible proportions, should there really be any fully-indexed exceptions to the rule? Should not everything within Government's control be de-indexed (or, to be precise, consistently and <u>partially</u> indexed) in line with our exhortations to the private sector and in line with the monetary deceleration to which the whole of the economy <u>must</u> in the end accommodate? After all, when we have no inflation, everyone enjoys a stable pound; there are no exceptions then. If we mean to end inflation, should we be so worried about protection of particular groups, as if inflation is going to continue for ever? Why, at this point of all points, are we about to commit ourselves to <u>full</u> indexation of child benefit, rather than a deliberate ad hoc increase if that is called for, followed by a partial indexation in line with MTFS and the monetary targets? Our thinking does seem confused. Either we wish to <u>increase</u> transfer payments by deliberately indexing them fully <u>during Transition</u>; or we are tacitly assuming that the rest of public expenditure, in aggregate, will in the event index itself fully in the same way - in which case, the whole question of the resulting damage to the private sector rears its ugly head.

3.4 Is indexation (both as policy and as phenomenon) confusing our thinking about public expenditure cuts? Are we cutting in order to get the real cuts called for in the White Paper? Or to get the monetary deceleration called for by the MTFS? Are we cutting to get the desired switch of resources from the public to the private sector, or to avoid the perverse switch in the other direction caused by the sheer momentum of self-indexing behaviour within the system? The underlying problem is obvious the moment you bring together the White Paper and the PESC Report. For example, in 1981/2, our total expenditure is expected to be £73bn, instead of £74½bn in the current year (1979 survey prices) - a fall of 2%. But the GDP deflator and RPI are expected to rise by 12.1%, and 10% respectively, during the same period (Annexes H and M of 1980 PESC). Is it possible to do PESC in cash terms, even if this forces early disclosure of cash limits?

2.4 <u>Where do we go next</u>?

2.4.1 The questions asked so far either have simple answers which show that there is no real problem, or else they lift the veil off a deeper problem and expose further underlying questions. On the assumption that it is the latter, the next section looks at some of those underlying questions.

3. <u>UNDERLYING QUESTIONS WE NEED TO ASK</u>

3.1 <u>How different are the processes of inflationary acceleration and deceleration</u>?

3.1.1 Can self-indexing public expenditure be a problem when inflation is <u>accelerating</u>? Will it tend to make the acceleration faster? Perhaps it makes no difference because, by definition, inflation means that all prices, all pay, all expenditures, are rising in money terms and public expenditure is no different from anything else. In that situation, the <u>social</u> reason for ad hoc indexing is understandable, even though it may end up by helping to perpetuate the very process which made it necessary. Perhaps the problem only emerges when one faces deceleration, the Transition downwards, as we are now doing. If we look at social security spending as a percentage of total public expenditure, over the period of the Healey deceleration, we see that it rose from 21.1% in 1975/6 to

25.3% in 1978/9. Was this the result of indexation, or rising unemployment, or deliberate changes in programme volumes? In the Public Expenditure White Paper, the proportion is expected to rise from 26% in 1980/81 to 27.5% in 1983/84. Again, is this the result of the indexation process, or a planned increase in volume? Or both?

3.1.2 What is the effect of inflation coming down quicker or slower than anticipated in PESC? What is the relationship between the GDP Deflator/RPI paths in PESC and the monetary targets in MTFS? If faster, does that increase the squeeze on the private sector, or does the nominal increase in public expenditure simply grow more slowly, so that the effect as between the two sectors is neutral? If slower, does that <u>ease</u> the squeeze on the private sector (although obviously at great inflation cost in other ways) or does the public sector simply absorb the extra money in the system by indexing its own expenditures?

3.1.3 We should, however, be clear that even if inflation comes down in line with the MTFS, public expenditure could still trail the deceleration process, with greater consequent damage (through the processes described at Section 2.1.2).

3.1.4 Is it possible to calculate the impact of inflation falling by, say, 3 percentage points <u>less</u> each year than was assumed? Is it possible to work out the effect of zero average growth over the next three years? Just so that we know what we might be up against.

3.2 <u>Dealing with the different bits and pieces</u>

3.2.1 Once we are clear about the processes at work, then we can decide how to deal with the different parts of public expenditure.

3.2.2 <u>Fully-indexed expenditure</u>. This includes most transfer payments, defence spending, possibly health spending, police pay, and armed forces pay. How far are these indexed on a forward-looking basis? Does the relationship between the monetary targets, cash limits and inflation rate, make this a satisfactory basis? Is it indeed a self-fulfilling prophesy? What happens with such indexed expenditures if the inflation rate falls more, or less, slowly than expected? Would a <u>partial</u> and backward-looking basis be better? Or even partial and backward-looking <u>or</u> forward-looking, whichever is the smaller? (This should not present any political problems, once people realise that the indexation process is part of the Transition to a stable currency, not a device for living with perpetual inflation, which is the way many people at present see it.)

3.2.3 <u>Pay which is negotiated and "de-compared"</u>. In the light of this discussion, what sort of outturn are we aiming for? Do we really know what we're up against in trying to achieve such an outturn on a case-by-case "do the best you can" basis with dozens of different groups negotiating in a virtually unending succession over the 12-month period? What percentage is compatible with the MTFS after we have satisfied those parts of public expenditure which are formally or effectively indexed, or better-than-indexed? (This question was examined more fully in our paper of 18 July on "Public Sector Pay".)

3.2.4 <u>The remainder</u>. How far can we go in de-indexing other current expenditures? What is the effect of a defence budget which is fully-indexed and then increased in real terms by 3%? How far should we resist the easy solution of further cuts in the public sector's capital spending? Has any work been done to estimate the long-term costs - political and economic - from such cuts? How do we prevent monopoly, trade union-controlled nationalised industries - Coal, Gas, Rail, Post Office, Electricity - from acting like a home-grown (but at least recycled) mini-OPEC exacting special levies by way of prices, increased subsidies, broken EFLs and reduced investment leading to lower future value for money?

4. <u>CONCLUSION</u>

4.1 This paper suggests that the very way in which we are conditioned to think about public expenditure <u>may</u> contain some dangerous optical illusions. <u>In particular, we may not yet appreciate just how large the cuts in public service pay will have to be</u>. Our fear is that it will not be possible to get a pay outturn which is sufficiently low, and, because it is difficult to shed manpower in the way that the private sector would have to do in such circumstances, the cash limits will be simply broken or expanded. The probability is therefore that the public sector will help itself to a greater proportion of the available cash in the system, passing the consequences, as already described, to the private sector.

4.2 All the thinking at present, from the original reluctance in some quarters to publish an MTFS at all, through to the present reluctance to publish early cash limits, suggests an implicit assumption that what must be endured by the private sector simply can't be endured by the public. Achieving the MTFS demands an approach to the public expenditure arithmetic which displays absolute commitment to results.

4.3 If we are roughly right in the foregoing analysis, perhaps we should consider turning the present process upside down: doing all the forecasting in cash terms, based on forecast inflation; forecasting cash limits, in exactly the same way as the MTFS; adjusting cash limits downwards only, if inflation turns out to be lower; but not upwards if inflation turns out to be higher.

C 18/5

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CHANCELLOR

STOCKTAKING BACKGROUND

The main notes I am submitting separately contain more than enough material for general circulation. You may remember agreeing a while ago that I should consult fellow advisers and CRD about strategic issues. This we have in part done, and you might like to skim the fruits of our labours at the end of June. Alan Howarth may be going to emit something based on our discussions in due course, but I rather doubt it, since he appears to have gone off to watch the US Democratic Party's Presidential Convention. This preliminary list was a prelude to more intense analysis and discussion for which we found no time. I would particularly stress items 4(a), 6, 7 and 11.

PLEASE

AR

ADAM RIDLEY
4 August 1980

STRATEGIC ISSUES

Preliminary Shortlist and Notes

1. Cash Limits

The system is coming under strain. Numbers of overspending departments growing from year to year. Scale of certain excesses becoming very damaging. Arguably one must act to strengthen the system quickly and pre-emptively to make it more secure. Gravest dangers would arise if it is thought to have broken down.

2. Public Sector Pay

Imperatives self-evident: clarify a firm attitude soon and publicise it before Recess; ensure modest increases; and engineer durable and unabrasive new machinery.

3. PSBR/Monetary Policy

Is the PSBR/CGBR path for the year secured firmly enough in relation to the target? Should the target path itself in the medium term be for a swifter fall? If answers are respectively "no" and "yes", very quick action required.

4. Nationalised Industries

(a) How much longer can EFLs last without being either rendered irrelevant by constant overshooting, or discredited because they necessitate cuts in investment which become unacceptable. NICG lobbying could accelerate this process of erosion of credibility.

(b) Privatisation at the <u>margins</u> not going very well. Could EFL pressure/sanctions be used to accelerate it; and to relieve the problem of financing the growing volume of "commercial" and generally desirable capital spending (telephones, BR) whose frustration otherwise might cause serious political controversy. Need for more impetus on disposals - not only in NIs proper?

(c) <u>British Columbia etc</u> It appears that major, imaginative initiatives for more large-scale privatisation have not been taken far enough or with sufficient vigour. Case for more effort? By whom? Perhaps more harnessing of city expertise?

5. <u>Local Authorities</u>

Present position threatens to resurrect - once again - the debates about: the future of rates; local authority autonomy; and more technical questions about the adequacy of LA Financial Control, since LG no 2 will not be fully operative for some time and full operability may be insufficient to deliver the stringent control now needed.

6. <u>Mobility/Housing/Building Societies</u>

A series of problems and anxieties which are linked both to one another and to other issues:

(a) With high and rising unemployment in certain "dead-end" areas, do we not need to promote some of the mobility seen in the '30s? If so how?

(b) Raising council rents and selling council houses will be both of marginal influence and slow to help mobility. Can/should anything else be done in the public sector? Assuming it probably can't, should one not reconsider possibilities of a wholesale assault on the rent acts to bring back into use the hundreds of thousands of units of accommodation which the Acts have induced owners to withdraw from the housing market? Such flexible accommodation essential to create scope for movement, and ideal for the mobile.

(c) Present monetary policy will increasingly create tensions in the areas of Building Societies and housing finance. Fingers of suspicion will rightly point at: fiscal privileges; need to control scale of Building Societies borrowing/lending; competition for deposits and in new instruments between BSs and other institutions (eg Banks). Conclusion: early and deep assessment of pressures, priorities and policies needed. Wilson report could actually help. All political pressures will contradict economic priorities.

(d) Phenomena of (c) will, one way or another, choke flow of money for home purchase and/or raise interest rates. Public anxiety could widen to house prices and availability of accommodation. Rent Act Reform perhaps the main answer to this, too.

7. <u>Unions/Labour Markets</u>

Present posture decreasingly strategic in character. Need to look ahead at range of related questions:

(a) Law? That question can probably be left open till DE's Immunities studies are complete. But does one want to "talk through" possible further changes in the interim?

(b) "Micro" actions are also valuable, union by union, industry by industry. Should targets/policies/actions be identified? Restrictive practices in Press, Radio, Posts all obvious examples of targets. Policies could include activating MMC to look at Labour monopolies, linkage with EFLs etc.

(c) Anything to be said about special problems of NIs? No strike agreements, contingency planning for disputes?

8. Unions/Politics

Maintaining constructive dialogue with individual leaders/TUC. Take more credit for contacts which do go on.

9. World Economy

Threat of rising oil price and Third World problems call for some genuine dialogue with OPEC.

10. Unemployment

Prospect is clearly for this to become acutely sensitive, and replace inflation as No 1 anxiety. Consider presentational/ substantive "softening" measures for use in Autumn onwards.

11. Enterprise

What else to be done?

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OTHER

12. North Sea Oil Fund

Case of presentation or substance for more consideration, not least with a view to using it to finance durable, viable and worthwhile investment projects.

BNOC.

13. Energy Conservation

Need to defend and consolidate support for basic policy of realistic prices; and fend off pressure for frivolous cosmetics.

14. Environment

Any news of the rural package? Could help. ? CRD.

15. Credit Ceilings

Any use anywhere? If not, explain why not to wider world, who will otherwise resent greater reliance on interest rates as main weapon of monetary control.

PRESENTATION

16. Government's Hard Image

Worth some countervailing action. The family, environment and wider-ownership all suggest themselves as foci for policy development.

17. Mood

Government must clarify its ambivalence about gloom/optimism.

24

Suspicion grows that patriotism/pride/regeneration could and should play more of a role.

EZ's

A.T.H:

Why work?
Import Controls
EEC qn.
Successes to consolidate
Damage limitation (Immigr.).
Nuclear Power (env. angle).
ILEA/GLC/LT.
Nuggets to deep[illegible]
Constitutions.
~~EZ's~~

Unit

Sek 8/8

6

25

Record of Meeting at No 11 Downing Street with Conservative Finance Committee Officers on 4 August 1980

Present:	Chancellor	Sir William Clark, MP
	Mr Cropper	Mr Jock Bruce-Gardyne, MP
	Mr Cardona	Mr Ralph Howell, MP
		Mr Ian Stewart, MP
		Mr John Townend, MP
		Mr John Wakeham, MP

The Chancellor began by saying that the two biggest problems he faced at present were public sector pay and the control and financing of nationalised industries. There appeared to be a general impression that all that was required for the solution of the problems posed by nationalised industries' EFLs was a more imaginative approach on the part of the Treasury.

2. Mr Howell asked whether the problem of the nationalised industries was greater than that of local authorities. The Chancellor replied that it seemed so; the local authorities' direct claims on central government were least clearly identified and set.

3. Mr Townend asked whether the Chancellor was satisfied with current arrangements for pay-bargaining for local authority staff. The Chancellor said he was not. But it was difficult to get away from national agreements.

4. Mr Bruce-Gardyne expressed the view that a moratorium on local authority capital expenditure would be a very bad idea. The problem was overspending on current account. The RSG should be reduced in order to give local authorities the choice of either reducing current spending or increasing rates. He was also worried by defence expenditure. MOD appeared to be getting away with last year's over-spending; this was unfair on other spending departments.

5. The Chancellor explained that the Party had become committed to two policies that were proving incompatible: rigid cash limits and 3% annual real growth in defence spending. He believed it was more important to stick to cash limits, but he recognised the importance of defence. It would be useful if officers of the

Finance Committee would stress to other MPs that Treasury Ministers were aware of the importance of defence. Mr Howell said MOD administrators could be cut back. The trouble with cash limits was that administrators cut services in order to stay within the limit. The Chancellor replied that he was aware of this problem; but there was no substitute for the discipline of cash limits. It had been suggested that Treasury officials should be outposted in spending departments. Sir W Clark thought this an excellent idea.

6. Mr Townend asked whether there was any improvement in nationalised industry pay settlements. The Chancellor said there was not nearly enough improvement. Controlling prices was no good: this led only to subsidies. It was best to concentrate on breaking the industries' monopolies whenever possible. Mr Townend said that for the natural monopolies like water and electricity there was no alternative to a public sector pay policy. Mr Bruce-Gardyne said this should be avoided. It had been tried again and again. There should instead be a clearly perceptible trade-off between higher pay and jobs. There were encouraging signs from Manchester: the Corporation were reducing staff numbers rather than increasing rates.

7. Mr Howell said that if the Clegg error in teachers' pay were not recouped there would be unfortunate consequences for the rest of the public sector. The Chancellor replied that it would not be easy to persuade Parliament to overturn the teachers' arbitration award. It might be better to act through the RSG.

8. Mr Townend asked what the Government were doing about Wages Councils. The Chancellor said the problem was being examined. There followed a general discussion of youth unemployment. Mr Townend thought that the young unemployed living at home caused the public relatively little concern. Mr Howell said not enough had been done to give people incentives to work. Sir W Clark thought the Government should be careful of extending youth employment subsidies: they could push older people out of work.

9. The Chancellor turned to the question of the computerising of PAYE (COP). He was concerned that this was being presented as a battle between the Department of Industry, trying to defend British industry, and a penny-pinching Treasury. But both departments had the same objective: the more they bought British, the happier he would be. COP, however, was a formidable undertaking. ICL were a growing company and he wished them well; but it was unfortunate that they had given the impression that a decision to adopt open tendering was equivalent to a calculated insult to ICL's abilities. Mr Bruce-Gardyne mentioned that an experienced computer user in his constituency had told him the Government would be ill-advised to use ICL for COP.

10. Mr Bruce-Gardyne was concerned that the effect of disintermediation on the money supply figures would be large. The Treasury should produce figures to show the effect which the corset had had on the money supply. The Chancellor agreed.

11. Sir W Clark asked whether there would be a consultative document on capital taxes. The Chancellor said there would probably not; but there might be a paper on trusts.

GEORGE CARDONA
5 August 1980

Distribution: Chancellor
Chief Secretary
Financial Secretary
Minister of State C
Minister of State L
Sir D Wass
Sir A Rawlinson
Mr Burns
Mr Ryrie
Mr Middleton
Mr Bailey
Mr Littler
Mr Bridgeman
Mr Battishill
Mr Dixon
Mr Monck
Mr Kitcatt
Mr Hansford
Mr Rayner
Mr Ridley
Mr Cropper

9 Oct

7

28

cc Mr Ryrie
Sir A Rawlinson
Sir K Couzens
Mr Ridley
Mr Macrae
Mr Cropper
Mr Davies
Mr MacAuslan

PS/CST
PS/FST
PS/MST(C)
PS/MST(L)
Sir D Wass
Mr Burns

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

8 August 1980

The Rt Hon Michael Jopling Esq MP
Government Chief Whip
12 Downing Street
LONDON SW1

Dear Michael

Thank you for your letter of 31 July about the Party Conference. I am content with Mr Mundie's motion and will be happy to reply to the debate on Economic Policy and Taxation on the afternoon of Thursday 9 October.

GEOFFREY HOWE

14688

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4/8

Ask etc

Contribute to

these comments

Government Chief Whip
12 Downing Street, London SW1

31 July 1980

Dear Geoffrey

PARTY CONFERENCE, BRIGHTON

7 - 10 October 1980

The Agenda for the Party Conference has now been drawn up and, on the afternoon of Thursday 9 October, the first subject for debate will be Economic Policy and Taxation. I attach the Motion which has been selected.

I have been asked to invite you to reply to the debate, and I shall be grateful if you will confirm that you are able to do so by Friday 8 August.

A speech of not more than twenty minutes is suggested.

Alan Smith, Secretary of the National Union, will be in touch with you nearer the time.

Yours

Michael

The Rt. Hon. Sir Geoffrey Howe, Q.C., M.P.,
Chancellor of the Exchequer,
Treasury,
Parliament Street,
London S.W.1.

Enclosure

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Area letter & number J9 Proposer Mr. C.G. Mundie

North Hampshire Association EC

"This Conference believes that, if a long-term economic recovery is to be achieved, the Government must not weaken in its resolve to reduce its spending, its borrowing and the overall levels of taxation, especially direct taxation. This Conference believes that only such measures, implemented with determination, will create the economic climate in which enterprise and investment may flourish."

RESTRICTED

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C 8

D.12

Tx. v.m. dft for appvl.

Let me see the letter now.

CHANCELLOR

FENTIMAN DINNER, 22 JULY

You asked me to look again at my notes, and the minute I sent you on 30 July recording the main issues raised to see if there were further action points which I had not included in my minute. I have now done this, and have found nothing more to report apart from:

(a) a vague proposal by John Nott to <u>either</u> tax the Banks <u>or</u> force them to finance some speculative investment;

(b) a tentative KJ suggestion that there should be scope for more "crumbs of compassion" from DHSS;

(c) the elucidation, by JP, of his ideas for early retirement, viz that it could be restricted by region and subject to a guillotine of some kind.

2. I think that your intuitive sense that more action was decided on than I have recorded may reflect either the general determination to do something about training, on which nothing further needs to be done given the MSC review; or your long dialogue with Mr Heseltine. The outcome of the letter was ambiguous. You urged him to come up with <u>new</u> ideas which you promised would be look at sympathetically. He was in effect arguing that his old ideas were good ones really, and only the stubbornness of the IR had led to their not being adopted. At the end you did not agree that anything should be done, I imagine because you feared one would end up raking over old coals again.

3. Looking ahead, I suspect the best thing to do would be to write a letter to John Nott on the lines of the attached draft, copying to the others present. Square brackets suggest possible omissions.

AR

ADAM RIDLEY 11 August 1980

RESTRICTED

CONF + PERSONAL

✓ 12/8

32

DRAFT PERSONAL LETTER TO JOHN NOTT

Copies for Sir Keith Joseph
Mr Prior
Mr Heseltine
Mr Howell
Mr Jenkin
Mr Biffen
Mr Lawson

I found our dinner of 22 July of great value, and was most interested in the ideas you and our colleagues raised. I shall certainly try to organise another such dinner in due course, since it seemed to be appreciated as worthwhile by everyone present. In the meantime it may be helpful to record one or two conclusions we reached. I note them below, and would suggest that the originator (mainly you) should now take the initiative by putting "flesh on the bones" in the appropriate formal way.

You raised several points:

(a) Export finance: we should allow foreign currency financing and allow the Bank of England to make the necessary forward market;

(b) Entrepreneurs: people starting a new business on borrowed money should not be taxed on its repayment as if it were a distribution of profits;

(c) Share purchases: companies should, in certain circumstances, be allowed, in effect, to buy their own shares to finance a new subsidy;

(d) Banks: as I recollect, you argued either that the Banks should be taxed, or that pressure should be put on them through the threat of taxation to finance additional speculative private sector investment.

(e) Share options: you seemed at one point to be suggesting a new provision for executives.

Keith Joseph suggested that there might be some compassionate nuggets which would help Patrick Jenkin. I do not know whether he or Patrick have any concrete ideas to put forward. I do not, of course, have to mention the financing problems in this context!

Jim Prior raised issues about training and unemployment which we shall, I think, be tackling in the normal course of events now that the MSC Review is to hand. But he also alluded to the issue of early retirement and the possibility of measures restricted to certain regions or subject to special cut-offs. Since Patrick's White Paper on the Elderly is nearing completion, Jim might want to work up his thoughts on the retirement issue in the fairly near future.

Finally there was the issue of satellites and telecommunications, where there was general agreement that a positive initiative was needed to focus responsibility for policy in this area on the Department of Industry. I assume that this is a matter for Keith to pursue in the first instance.

For my part I should stress that I am always on the lookout for new ideas to help the regeneration of enterprise and small business, preferably ones which do not involve great administrative complexity. If they are to be of any relevance to next year, I should need to see them by the early autumn.

I am copying this letter to Keith Joseph, Jim Prior, Michael Heseltine, David Howell, Patrick Jenkin, John Biffen and Nigel Lawson.

[illegible]

PPS/6 3A

PA. 9

FINANCIAL SECRETARY TO THE TREASURY

CHANCELLOR

cc Chief Secretary
Sir D Wass
Mr Middleton
Mr Ridley

JOHN REDWOOD ON THE CURRENT ECONOMIC SITUATION

I have seen Mr Ridley's minute to you of 27 August, attaching a copy of a letter from John Redwood.

Master Redwood is making a mouthful of a perfectly straightforward point. For all his verbiage, he is basically suggesting that we should do what we are doing, but more so. If this year's PSBR is £10 billion, as he suggests, that compares with an inherited (1978-79) PSBR equivalent to £13 billion at 1980-81 outturn prices. This is a significant reduction, which would be even greater on a constant employment basis. John Redwood's proposal, however, is that we should have reduced it further to £5 billion - not by increasing taxation, but by further public expenditure cuts. The fact that, had we done so, various advantages would have accrued, is not in dispute. The question is how? His letter stands or falls on the answer to that question.

NL.

NIGEL LAWSON
9 September 1980

19/11/80 - 35

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cc Chief Secretary
Financial Secretary
Mr Burns
Sir K Couzens
Sir A Rawlinson
Mr Ryrie
Mr Middleton
Mr Bridgeman
Mr Britton
Mr Cassell
Mr Evans
Miss Brown
Mr Turnbull
Mr Aaronson
Mr Folger
Mr Cropper

MR UNWIN

ECONOMIC DEBATE 26/27 NOVEMBER

The Chancellor has been gathering some thoughts for his speech in next week's debate. These are as follows:-

i. We should make sure that UK problems are placed in their full international context throughout the speech, even at the risk of some repetition. Thus we should refer to other countries where GDP is falling (Japan); to other steel industries in trouble (elsewhere in Europe); other countries de-indexing (Holland, Denmark, Sweden, Norway); other Governments cutting public expenditure, and not increasing borrowing (Germany); other countries where defence expenditure is increasing less rapidly than the NATO target (Germany and numerous others); other motor industries in trouble (USA, Massey Ferguson).

ii. A full exposition should be given of the Burns/Middleton thesis, in such a way as to emphasise that we are not discarding UK industry. We should explain the need for a switch from consumption to investment; from current to capital expenditure; from the personal to the company sector. This would be the context in which to explain the change in stock relief, ENIC and the decision not to change the NIS. This

/section might also

section might also include some discussion of the arguments set out by J Forsyth (on the PSBR in the medium term), and by Kay and P J Forsyth (on the change in the structure of UK output).

iii. We should make clear the inevitability of a decline, in present circumstances in GNP - and the consequent need to curtail public spending; the present situation is that public spending represents an enormous burden on a shrinking base.

iv. The speech should make clear the extent of the reductions achieved in the public expenditure programmes inherited from the previous Government, the foolishness of such commitments, and the fact that the previous Government would have had to make similar cuts if they had remained in office. The speech might say something about the cost - in terms of tax rates, interest rates, jobs etc - of trying to press ahead with the inherited programmes.

v. The North Sea oil revenues should be put in perspective; these revenues are not being "wasted" but are already being used to keep public borrowing within bounds.

vi. We should explain the impact of the recession on the PSBR, and indicate how big the PSBR might have been if tax and expenditure measures had not been taken to contain it. This section would also show that - after taking account of the impact of recession - the underlying change in public expenditure programmes is in fact a substantial reduction. It could also be useful to put in some comparisons with other countries' PSBRs.

JW

A J WIGGINS
19 November 1980

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11

CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir Douglas Wass
Mr Bottrill
Mr Aaronson
Mr Ridley
Mr Cropper

SPEECH IN ECONOMIC DEBATE ON 27 NOVEMBER

I attach a very provisional first draft which Mr Aaronson and I have concocted over the weekend.

2. I thought it would be useful to let you see this now, although it has necessarily been prepared before being able to take into account the reactions to your statement.

3. It covers, in a fairly low key way, most of the points you yourself raised (Mr Wiggins minute to me of 19 November). It seeks, after dealing in whatever manner with the Opposition opening speech, to reaffirm the Government's strategy by discussing the national and international background to current events, and by threading a logical way through the measures announced in your statement.

4. The section on MLR at the end is more provisional than most. The reaction of the markets will be particularly important to the way in which we justify this and write it up. We have also at this stage dealt with the public expenditure measures in fairly general terms. You will want to decide whether to go into the particular measures in greater detail (eg social security and defence). Unless reactions between now and Thursday make this imperative, my inclination would be to let it stay pretty general and concentrate on the broad strategy. Some of the ground will no doubt in any case have been covered by particular spending Ministers between now and Thursday.

5. This is very much a chopping block to help you give us any more precise guidance. I am not, therefore, circulating this draft widely, but we shall need to do so when we have prepared a new text in the light of your comments.

Bu

J B UNWIN
24 November 1980

INTRODUCTION

A1 [Section picking up Mr Healey's remarks as appropriate. General line of approach might be:-

all very clever, if you disregard inconsistencies such as (a) criticism of government both for failing to achieve monetary/expenditure targets and for operating excessively tight policy; can't have it both ways;

(b) ignores fact that Chancellor's statement does no more than reaffirm broad strategy that responsible Opposition members recognised as necessary - at least when in office [Healey etc quotes?]

Above all, refuses to face facts; ignores fundamental problems facing economy and need for fundamental - not short term and gimmicky - solutions to them.]

A2 What are the facts? They are that the British economy has for many years been suffering from a deep seated disease that cannot be cured by easy-way-out remedies overnight. This is where previous governments have failed. They have looked for the quick over night solution; the temporary easing of the symptoms, rather than the fundamental, and inevitably painful, cure of the disease itself.

A3 Of course the disease has not affected Britain alone. Inflation, loss of output, higher unemployment - all these have affected other countries as well. We are not alone in publishing gloomy predictions for national growth. Every major industrial country is suffering from a fall in industrial output. Other economies are reeling from the inflationary impact of the further substantial increase in the oil price since 1978. I shall say more about this later. But our resistance to the impact has been lower, because in our case the disease was rampant in the system already.

A4 Consider the facts on inflation and unemployment. Over the past 20 years each successive government in Britain has experienced a higher average inflation rate than its predecessor. The average rate during the first post-war Conservative government was 3½% per annum; the average rate in the second half of the 60s during the Labour government was 4½% per annum; during the early 70s it was 9% and during the last Labour government the average inflation rate was 15% per annum.

A5 Or consider unemployment. This has been increasing now for a quarter of a century. Just as inflation has climbed under successive governments, so has unemployment. The average level in the first post war Conservative government was 300,000. During the 1964-70 Labour Government was nearly half a million. Under the Conservative government in the early 1970s it rose to nearly ¾ million; and during the last Labour government it averaged 1¼ million.

A6. This insidious disease, now aggravated by world developments cannot be eradicated by temporary palliatives. Until we tackle inflation in Britain at its roots, until we change the underlying circumstances that have progressively weakened and rigidified our economy and made it viable to adapt to the changing pressures for new products and skills, the disease will continue to spread.

A7 This is why, despite the costs and pain in the short-term, we remain absolutely determined to get at the root causes. To apply a lasting cure to a deeply entrenched disease. And the most insidious element of that disease is inflation. We are already making good progress in getting it down. And the outlook for next year, as the forecast shows, is encouraging. But until inflation is thoroughly mastered, until its causes, not its symptoms, have been tackled, there can be no sustainable basis for renewed growth and prosperity. The lesson of history is that inflation cannot be mastered without controlling and reducing the growth of monetary demand.

A8 Achieving this is at the heart of the government's medium term strategy. My statement on Monday contained no more and no less than some of the continuing measures necessary to keep us on track. To ensure that fiscal policy next year, allowing for the effects of the recession on the economy, enables monetary restraint to be secured without excessive interest rates.

A9 I want now to give the House a fuller account of the background to my statement and the measures announced in it.

THE WORLD RECESSION

B1. The RHG appears to attribute all our economic difficulties to the policies of the present Government. He seems totally unaware that we are in the midst of a worldwide recession, brought on by an increase in oil prices just as sharp as that of 1973 and 1974.

B2. Let me remind him of a few facts. ~~With the exception of Japan,~~ Output has been declining ~~or at best stationary~~ in all the major overseas economies since the ~~second~~ first quarter of this year. Output in the USA fell in the second quarter at the unprecedented rate of 9.6% per annum - the steepest decline in US history. In the last three months for which figures are available industrial production fell at an annual rate of nearly 10% in the six major overseas economies. Even in Japan the fall was at a rate of 8.9%.

AT

B3. There are other signs of the severity of the world recession. (World trade has been falling since the first quarter of this year) Unemployment has risen by ~~[2.3 million]~~ over 2 1/2 million in the major seven OECD economies over the last eighteen months. Company profits have been hit too. The losses reported by the three largest motor manufacturers in the United States in the first nine months of this year total a staggering three and a half thousand million dollars.

B4. I hope that RHM's opposite will not try to argue that other countries have the same problems as us because they have pursued the same policies. For it is countries such as Germany and Switzerland, which have consistently given priority to fighting inflation, which now have the lowest unemployment rates.

(They have sent the unemployed back where they came from — Turkey, Yugoslavia, Italy & such like places.)

LOSS OF COMPETITIVENESS

C1. Nonetheless, we have continued to worsen these problems by our own behaviour. Over the past Longer two years we have suffered an unprecedented loss of competitiveness. Furthermore, this has occurred in a way which has benefited consumers at the expense of industry. The combined effects of lost competitiveness and an imbalance between the personal and company sectors could not fail to have a severe impact on industry and employment.

C2. This process has not been caused solely, or even mainly, by an appreciating exchange rate. The chief culprit is much more familiar to us: prices and wage costs rising much faster than those of our competitors. It is remarkable that in the last year, given their present difficulties, firms have allowed payments to employees to rise faster than in the previous year, faster than the planned rate of monetary growth and faster even than the rate of increase in prices.

C3. Over the past two years the exchange rate has risen by X%; at the same time our prices have risen Y% faster than elsewhere and our wage costs Z%. As a result, UK export prices have risen by 25% more than other countries and our wage costs are now 50% higher than elsewhere when compared with the position in 1978. With our costs rising so rapidly there is no conceivable way that extra unemployment could have been avoided.

C4. Of course the exchange rate has played a part in our loss of competitiveness. But there are a number of reasons why it has risen despite our higher rate of inflation. North Sea oil has obviously played a large part. The reduction of net imports caused by oil production has to be offset either by capital outflows or by an increase in net imports of other goods. By removing foreign exchange controls we have encouraged some outflow on capital account. But this is unlikely to be enough to offset all the effect of oil production on the current account. The result is that some of the adjustment is forced back on to an increase in the exchange rate relative to our inflation rate. Additionally, as market operators act on the assumption that this is likely to happen, the rate may be pushed up by speculative inflows. Any fears of a new oil price rise reinforces this tendency.

[To be checked against reactions to statement]

C5. [The government's commitment to a firm monetary policy has also contributed to sterling's recent strength. But there is no fixed relationship between interest rates and the exchange rate. With dollar interest rates now similar to sterling rates it is harder than ever to believe that our interest rates are the <u>main</u> factor sustaining the exchange rate.]

C6. We should not for get that the strength of the £ has brought major benefits in terms of lower inflation and cheaper raw materials. Nor is there reason to believe that the majority of our loss of competitiveness will be permanent. Some of the effect of North Sea oil will be long-lasting but the problems created by the large flow of OPEC surpluses and adjustment to lower monetary growth in Britain are unlikely to continue.

C7. But a lasting improvement in competitiveness can only be achieved by mastering inflation at home. If the government were to attempt to bring down the nominal exchange rate we would suffer the same fate as the RHM (Leeds East) in 1977. We would make little headway in resisting the forces of the market, and we would face a massive increase in the money supply. The resulting increase in inflation would leave us even less competitive than we are at the moment.

C8. The only way we will restore competitiveness and thus employment is to reduce dramatically the rate at which our pay and costs rise. The option of accommodating excess pay awards through a depreciating exchange rate is no longer with us. This means that prices and costs must bebased much less upon looking at past inflation; they must be directed towards those prices which rule in the international markets. Our prices cannot go up faster than those in our industrial competitors if we are to stay in business; and our pay similarly cannot go up faster than our competitors if we are to stay employed. It is only by appreciating the nature of these market constraints upon our pay and prices that we will be able to slow down and then reverse the decline in our competitiveness. Only then will unemployment start to fall.

C9. There are encouraging signs that this reality is now being accepted. Pay settlements in the current round are being agreed at a more realistic level. And the rate of inflation is coming down. In each of the last six months the increase in the RPI has been less than 1%. [Making due allowance for seasonal factors, I estimate that the underlying annual rate, based on the last six months, is some 11 or 12%.]

Do we want to say this in so many words?

MONETARY POLICY

D1. In order to consolidate the progress we are making on reducing the underlying rate of inflation we must continue with, and where necessary strengthen, our monetary policy. The measures I announced on Monday were directed to this end and to keeping our medium term strategy on course.

D2. Monetary growth has since the Budget been at a rate above the target range. To some extent, this rapid growth was predictable. I pointed out in my Budget speech that the ending of the corset controls imposed by the previous Administration - which of course flattered the monetary growth statistics in 1978 and 1979 - would result in abnormal growth in £M3. The July and August figures showed us just how large the corset-induced distortions in the financial system had become. Thus some of the recent growth in £M3 is properly attributable to the period before the institution of the current target.

D3. Nonetheless, the underlying rate of monetary growth has been so far above the target range. There are three main reasons. Public sector borrowing has been higher in the first half of the financial year than forecast. The external factors have been expansionary, largely because of the recent sizeable surpluses on current account. And bank lending to the private sector has continued at a relatively high level.

D4. But I believe a different picture will emerge in the months to come. The PSBR in the second half of the year [should ?] will be less than half that in the first. There are also signs of a downturn in the growth of bank lending. Considerable uncertainties remain; but we expect the rate of growth in £M3 to turn down quite significantly in the remainder of the period. Any overshoot of the target range will certainly be less than the figures for the period so far might suggest.

D5. The picture I have described - high underlying monetary growth combined with falling inflation and lower pay settlements - is not easy to interpret. Clearly £M3 does not tell the whole story. The narrower aggregates, the rate of inflation, and the financial pressure on the company sector all suggest a monetary stance tighter than indicated by the £M3 figures. Given the uncertainties we have decided not to roll forward the monetary target now, but to maintain the present range for the whole of the target period. By the time of the Budget we shall be able to judge the extent of the overshoot this year and assess its implications for the future. We shall also be able to take the fiscal measures necessary to validate a new target for 1981-82. But let there be no mistake. A progressive reduction in monetary growth remains the cornerstone of our strategy.

D6. To assist this strategy we have been reviewing our monetary control techniques. [I have been impressed by the argument] that we might strengthen monetary control if more attention was paid to the monetary base. But I am sure that if we move in this direction we must do so in an evolutionary way, and be prepared to learn as we go along. I have not yet reached a final verdict on monetary base control. That would not be sensible given our present state of knowledge. But the changes I announced on Monday, apart from their immediate benefits, should put us in a better position to judge the long term potential of this approach.

It is possible

D7. The first of these changes, phasing out the reserve asset ratio, was foreshadowed in the Green Paper on Monetary Control issued in March. Once consultations on new prudential liquidity norms are complete and new arrangements adopted, the present reserve asset requirement will be abolished completely. This will remove one obstacle to better monetary control.

Better explain why it is an obstacle?

D8. Second, the Bank of England will be discussing changes in the way it conducts its money market operations and lender of last resort facilities. The aim is to increase the flexibility of short term interest rates, and to allow market factors a greater role in determining the structure of rates. Use of the Bank's lender of last resort facilities will become relatively more expensive and, I hope, less routine. It is probable that, at some stage, the Bank will stop announcing its minimum lending rate altogether.

D9. These changes in money market techniques would remain appropriate if we were to move further in the direction of monetary base control. The two other changes I announced on Monday were primarily designed to throw more light on the desirability of such a move. The consultations following the Green Paper showed clearly that using monetary base control to meet short term targets for £M3, or any other broad monetary aggregate, would either be ineffective or likely to run into the sort of difficulties encountered with the corset. To get the best out of monetary base control we should have to set additional money supply targets either for the base itself or for a relatively narrow monetary aggregate.

D10. Before we can judge whether this approach would improve monetary control, we need to know more about the properties of the monetary base and about the economic significance of the narrower aggregates. Assessing whether we can remove the present 1½% cash ratio for the clearing banks, while preserving the Bank of England's income, and preparing a new statistical series for "retail" bank deposits are both changes designed to improve our understanding of these matters.

relate of wording of statement

D11. As a further contribution to improved monetary control, we intend to sell more Government debt direct to individuals. Since 17 November the indexed-linked National Savings Certificate has been available to anyone aged 60 or over [and already £ m has flowed in.] In due course I shall extend eligibility to purchase these certificates so that other sections of the population will be able to obtain the benefits of this form of saving. I have also decided to increase the maximum deposit in the Investment Account of the National Savings Bank to £200,000 and to improve the attractiveness of the Premium Savings Bond scheme. [Details of these changes are being announced separately today by the Department for National Savings.]

D12. I believe the enhancement of National Savings will make an important contribution to reducing reliance on the gilt-edged market and, by making it possible to achieve monetary objectives at lower rates of interest, encourage revival of the corporate debenture market.

D13. These monetary measures are essential to the government's continuing commitment to a progressive reduction in monetary growth. A new monetary target, which maintains the thrust of the strategy, will be announced at the time of the Budget. At the same time it remains vital that fiscal policy should be appropriate to our monetary objectives. It is to this I now turn.

PUBLIC EXPENDITURE

E1. As I made clear in my statement, some elements of public expenditure have grown more rapidly than expected as a result of the recession, which has been steeper and heavier in its impact than foreseen. Some revenue flows have also been lower than anticipated. [Figures for this have been reflected in the high PSBR in the first half of the year.] But as I said at the time of the Budget, there is no simple relationship between monetary growth and the PSBR. In a recession it is normally possible to achieve a particularly target rate of monetary growth with a somewhat higher PSBR than in other circumstances.

E2. I shall make a judgement at Budget time about the size of PSBR in 1981-82 consistent with the monetary objectives set out in the Medium Term Financial Strategy. It is already clear to me that in order to maintain that Strategy corrective fiscal action is necessary to offset some of the foreseeable pressures. Comprehensive decisions must await judgements in the weeks immediately preceding the Budget. However, certain operational decisions are necessary now. Managers of some expenditure programmes need guidance before Christmas as a basis for planning in the coming year. And certain kinds of tax changes have a long lead-time, particularly if we are to consult those concerned. So certain adjustments have been decided upon to ensure that the Medium Term Financial Strategy remains on course.

E3. So far as public expenditure is concerned, although some increases have been inevitable, the enormous burden it represents on a shrinking productive base still needs to be reduced. Following the usual Autumn review we have therefore announced an important redistribution of the volume of expenditure for next year, and severe limits on its rise in cash terms. Reductions are being made in most programmes to compensate for those increases caused by the recession.

E4. As a result the shift away from the expenditure plans of the previous Administration is being sustained. The planning total for next year will still be some £5 bn below the level planned by the last government. We aim to keep the planning total for the volume of public expenditure in 1981-82 about 1% below the outturn now expected for the current year. This is much the same rate of reduction as envisaged in the March White Paper. [Inevitable that previous government would have had to moderate their spending ambitions similarly. Alternative would have been rampant inflation or much higher taxes/interest rates.]

E5. Ultimately, of course, it is the actual cash spent which matters. It is therefore just as important to restrain the cost of public expenditure programmes as their volumes. We have already announced that the Cash Limit for the 1981-82 Rate Support Grant will provide for earnings increases of 6%. Provision for pay increases in other Cash Limits will be determined broadly within the same financial discipline.

E6. These Cash Limits will contribute greatly to the necessary restraint of public expenditure. It was on these grounds that the 6% figure was arrived at. We are no more adopting a pay policy in the public sector than is a private company which tells its employees that the amount available for pay increases is constrained by the financial position of the company.

REVENUE

F1. It is not only the size of the PSBR that matters. The impact of expenditure and the incidence of taxation on different sectors of the economy is also important. I mentioned earlier that our loss of competitiveness had occurred in a way that benefited consumers at the expense of industry. Consumers have gained from the effect of the strong £ on import prices and from rapid increases in earnings. Companies competing in international markets, however, have suffered because the level of sterling has prevented exporters from passing on cost increases in higher prices, and at home too profit margins have been squeezed between higher costs and lower competitors' prices.

F2. The sums involved in this re-allocation of income are very large. A rough rule of thumb is that a 10% appreciation in the real exchange rate will reduce the income of companies competing in international markets by up to [£6 billion]. Of this possibly [£4 billion] will go to persons and maybe [£2 billion] to companies not competing in international markets. The results of a redistribution of this sort can be seen in the performance of the economy over the past year. Consumption has been maintained while investment has been reduced and stocks run down.

<u>PPT</u>

F3. At the same time, the increase in the world price of oil has redistributed income from consumers of oil - firms as well as individuals - to producers. Since the last Budget I have been able to reconsider whether the North Sea fiscal regime now strikes a fair balance between the rights of the oil companies and the needs of the nation . After careful consideration, I have concluded that there is scope for an increase in the government's share of North Sea revenues. I believe there is room to raise a further £1,000 million next year - and significant, though smaller, amounts in future years - while still leaving the companies a fair return on their investment, and without prejudging future exploration and development.

F4. The existing tax on oil production profits - Petroleum Revenue Tax - was introduced in 1975. Circumstances since then have changed. For technical reasons, it is not well suited to raising the additional revenues I have in mind. I am clear that a new tax on UK production is necessary which will be payable in addition to PRT.

F5. I shall settle the details of this new tax after discussions with the oil companies. But I intend it to be based on the gross value of oil and gas produced, less a simple allowance. The new tax will spread the burden of the additional revenues fairly between all the oil fields in production - whether or not they are yet liable to PRT - while at the same time protecting the position of small fields of only marginal profitability.

F6. I have also announced a review of the reliefs within the petroleum revenue tax. I am not looking for a major contribution from this to revenue next year, but I am concerned to ensure that the reliefs are both effective and economic.

F7. In considering these measures, I was very much aware of the importance the oil industry attaches to stability in the North Sea fiscal regime. I appreciate that an industry with long-lead times for investment needs to have - so far as possible - a degree of certainty. But the increase in the world price of oil over the past two years is a major change in external economic circumstances which cannot be ignored. Nor can the North Sea be insulated completely from events in the rest of the economy. Although North Sea revenues will at their peak only amount to some [%] of total government revenues, they will make an important contribution to keeping public borrowing and interest rates down.

NIC

F8. As is usual at this time of year we have been reviewing National Insurance contributions. My decision to raise employee's contributions, while leaving those of employers unchanged, also took account of the imbalance I have referred to. But it was clear to me in any case that an increase in contributions of one sort or the other was needed.

F9. The National Insurance Fund has always been operated on balanced budget principles. Benefits paid out are expected to rise by some £2.3 billion in 1981-82. So some increase in contributions was inevitable. Furthermore, we thought it right to exclude the National Health Service from the general reductions in public expenditure programmes. Since the income from what used to be called the "health stamp" has declined as a proportion of total health expenditure over the years, we must look for more from the contributor in return for the maintenance of his health services.

F10. I do not think it is not widely appreciated that the contributor does not in fact pay for the whole of so called contributory benefits. For a very long time a Treasury supplement has been paid into the Fund. This is in effect an arbitrary amount payed by the taxpayer which keeps contributions lower than they would otherwise have been. Given the way non-contributory benefits have grown, and, therefore, the way the taxpayer is paying more towards benefits generally, we think that it is time to reduce the supplement and let the contributor pay in total something nearer the total cost of the contributory benefits.

F11. The combined effects of these changes will increase contributions from employees and the self-employed by around £1 billion in 1981-82. This is essentially a further contribution from people in work towards the benefits payable to those less fortunate than themselves.

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RESTORING SECTORAL BALANCE

G1. The measures I announced on Monday and which I have described in more detail today will enable the Government to maintain progress on the Medium Term Financial Strategy. They will reinforce the fight against inflation. And given the measures which the Government have already taken to improve the supply side of the economy, the defeat of inflation will lay the foundations for steady and sustainable growth in the future.

G2. The measures will also help to restore a proper balance between the different sectors of the economy. Companies outside the energy sector have so far borne an excessive share of the burden. The action we have taken to check the recession-induced rise in the PSBR will considerably ease their position. This action has already enabled us to help industry in two specific ways. We propose to revise the system of stock relief, thus giving an additional [£ m relief in 1981-82]. And I announced on Monday that we would be lowering minimum lending rate rate by two percentage points.

G3. Three main considerations have made this reduction possible. Inflation is coming down. In fact, it has recently fallen below the level of short-term interest rates. We have taken firm steps on both the revenue and the expenditure side to restrain the PSBR next year. And I expect the growth in bank lending to decline. As I said in my statement, I believe a large reduction would not have been justified. But I believe that the reduction I announced was justified by the circumstances and will now help to alleviate some of the problems faced by industry in recent months.

c CONFIDENTIAL

c. Mr Unwin

INLAND REVENUE
CENTRAL DIVISION
SOMERSET HOUSE

19/12

1258

D: 17/xii

1. MR GRACEY
2. CHANCELLOR

17 December 1980

STOCKTAKING NOTE - MATTERS FOR MINISTERIAL ATTENTION

... The attached notes set out briefly the state of play on the main Inland Revenue policy issues which are likely to require Ministerial attention between now and the Budget. At this time of year, many of the live issues relate to the Budget itself and the Finance Bill. We have not reproduced here all the various candidates for the Finance Bill, which are conveniently set out in FP Division's consolidated list of Finance Bill starters, but have concentrated instead on a smaller number of major issues. We have also included cross-references to items in the Treasury stocktaking note where there is a major Inland Revenue interest.

C STEWART

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cc

Chief Secretary
Financial Secretary
Minister of State (Lords)
Minister of State (Commons)
Sir Douglas Wass
Mr Middleton
Mr Battishill
Mr Cropper
Mr Ridley
Mr Cardona

Chairman
Mr Green
Mr Dalton
Mr Boyd
Mr Taylor Thompson
Mr O'Leary
Mr Beighton
Mr Isaac
Mrs Smallwood
Mr Ware
Mr Pollard
Mr Vernon
Mr Houghton
Mr Painter
Mr Rogers
Mr Boyles
Mr Walton
Mr Blythe
Mr Stewart
Mr Gracey

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Subject	State of play	Ministers and officials in lead	Other interested Departments (apart from Treasury)
A. PERSONAL TAXATION			
(i) Income tax rates and thresholds for 1981-82	Possible packages will be submitted to Ministers in the New Year. Decisions will be required by mid-February	Chancellor Mr Taylor Thompson	
(ii) Taxation of benefits paid to the unemployed, strikers etc.	Work continues on implementation from April 1982. Legislation necessary in Finance Bill 1981. Decisions on outstanding points needed in December.	Chancellor MST(L) Mr Taylor Thompson	DE, DHSS, CSD
(iii) Green Paper on Taxation of husband and wife.	Green Paper published 3 December. To be considered by Treasury Select Committee but no Ministerial decisions likely to be needed at this stage.	Chancellor MST(L) Mr Taylor Thompson	DHSS, DE
(iv) Mortgage interest relief at source.	Submission recently sent to Chancellor on possibility of giving basic rate mortgage relief by deduction at source. Basic aim - staff savings. Prime Minister has agreed to consultations with building societies, and announcement shortly.	Chancellor Mr Ware	DOE
(v) Fringe benefits.	Submission to be made shortly on possibilities for legislation in 1981 - chiefly, abolition of threshold, action on season tickets and possibly petrol. Also, decisions on car scales (which can be increased by Order).	Chancellor MST(C) Mr Taylor Thompson	DHSS (medical insurance) DoI (cars)

Subject	State of play	Ministers and officials in lead	Other interested Departments (apart from Treasury)
B. BUSINESS TAXATION			
(i) Stock relief	Public comments on consultative document requested by end December if possible. Decisions will then be needed for legislation in Finance Bill 1981.	MST(L) Mr Isaac	DoI, DoT, Bank
(ii) Corporation Tax review	A Green Paper promised in due course; but no major decisions required before the Budget.	MST(L) Mr Isaac	
(iii) Corporation tax rates etc for 1980/81	Submission will be made in New Year after discussion in Fiscal Policy Committee	Chancellor MST(L) Mr Isaac	
(iv) Purchase of own shares by companies	Submission recently made to MST(C). To be discussed by FASE group.	MST(C) Mr Isaac	DoT, DoI
C. OIL TAXATION			
(i) New tax on oil revenues	Consultations with industry on details began 9 December. Legislation in Finance Bill 1981	Chancellor MST(C) Mr Pollard	DEn
(ii) Review of PRT reliefs.	Consultative document in preparation for issue in early January. Legislation in Finance Bill 1981.	Chancellor MST(C) Mr Pollard	DEn

Subject	State of play	Ministers and officials in lead	Other interested Departments (apart from Treasury)
D. CAPITAL TAXATION			
(i) Capital Tranfer Tax	Decisions will be needed on items for Budget and Finance Bill - main issues are rates of tax, cumulation, treatment of trusts and international issues. Main submissions with Ministers; supplementary ones before Xmas. Main decisions required as soon as practicable.	MST(L) Mr Beighton	
(ii) Capital Gains Tax	Decisions needed on items for Budget and Finance Bill. Main issues - treatment of trusts and market value rules. Remaining submissions will be made shortly.	MST(L) Mr Ware	
(iii) Stamp duty	Need to consider what (if any) changes should be made in Finance Bill - e.g. thresholds for duty on house purchase. Submission probably at end of January for decision in mid-February.	Chancellor Mr O'Leary	

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Subject	State of play	Ministers and officials in lead	Other interested Departments (apart from Treasury
E. OTHER POLICY ISSUES			
(i) Non-domestic rates	Need to consider with DoE whether there should be a non-domestic property revaluation.	MST(L) Mr Ware	DoE
(ii) Section 478 - Vestey case etc.	Consultative document recently issued. Submission will be made to Ministers in the near future in the light of the response. Legislation for Finance Bill 1981	MST(C) Mrs Smallwood	
F. MANAGEMENT			
(i) Manpower	Ministers have agreed Estimates targets, but we await outcome of discussions with CSD	MST(L) Mr Houghton	CSD
(ii) Rayner scrutinies	Decisions needed soon on choice of scrutinies for next round. Submission to be made shortly.	MST(L) Mr Houghton	CSD

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Items in Treasury Stocktaking List

where Inland Revenue have major interest.

(i) Working Group on Tax and Savings

(ii) Benefits, taxation and incentives

(iii) FASE (small firms)

(iv) Smoothing the PSBR

(v) NIS - flexibility

(vi) Indexed gilts

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1 MR ~~UNWIN~~

2 CHANCELLOR

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Mr Burns
Sir Kenneth Couzens
Sir Anthony Rawlinson
Mr Ryrie
Mr Bailey
Mr Barratt
Mr Byatt
Mr Hancock
Mr Littler
Mr Middleton
Under Secretaries
Mr Folger
Mr Ridley
Mr Cropper
Mr Cardona
Sir Lawrence Airey - IR
Sir Douglas Lovelock - C&E

Despite attempts to shorten, this is still, I fear, a pretty long report. But I think Mr Bush has done an excellent job in pulling it together.

Inevitably some items are out of date before the typing is completed. I have added one or two marginal glosses where appropriate.

19/xii/80.

Ia v.m.

'A portrait * NCB, is this not an area where we really cd. + shd consider bringing in private capital

STOCKTAKING NOTE: MATTER FOR MINISTERIAL ATTENTION

1. I attach a note (for help in the compilation of which I am indebted to Mr Blower) setting out the more important matters which seem likely to come up for Ministerial attention in the first quarter of next year. This note is a successor to that submitted under cover of Mr MacAuslan's minute of 25 September. Many of the items mentioned there recur in the present note. Annex A, however, records briefly the outcome of items mentioned in September, but which are no longer live.

2. As requested by the Chancellor (Mr Tolkien's minute of 13 November) both Revenue departments have been involved in this stocktaking exercise. The Customs contribution is attached at Annex B. I understand the Revenue have submitted theirs separately, and this in future might be the best procedure for both Departments to follow.

3. The Central Unit stocktaking note does not, of course, provide a comprehensive view of all the matters that will come up for decision in the run-up to the Budget and should for this purpose be read in conjunction with FP's Budget starters list and Mr Folger's submission on the Budget timetable which will be sent up by close of play today (19 December).

Harry Bush

H J BUSH
CU
19 December 1980

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1 MACRO-ECONOMIC POLICY

(i) Economic forecasts

A revised forecast covering 1981-82 and the medium term is now being prepared and will be submitted to Ministers in the first half of January. The policy assumptions to be used in the forecast have been approved by the Chancellor. The next Industry Act forecast will be published at the time of the Budget in the FSBR.

Minister in lead:	Chancellor
Official in lead:	Mr H P Evans
Interested departments:	Bank of England, Inland Revenue, Customs & Excise

(ii) Budget Starters

An updated list of Budget starters was submitted to the MST(C) on 8 November. The next update will be submitted shortly after the Christmas break, and updated at regular intervals until the Budget.

Minister in lead:	MST(C)
Official in lead:	Mr Corlett
Interested departments:	Inland Revenue, Customs & Excise, Parliamentary Counsel

(iii) Monetary Targets

On 24 November, the Chancellor announced that the existing monetary target range of 7-11% annual rate from February 1980 to April 1981 would continue, but said he would announce a new target in the Budget. A decision on next year's target range will be needed soon after we have the provisional figures for banking January on 30 January. Discussions will need to begin early in the New Year and a special effort will be made to keep the Bank to the timetable.

Minister in lead:	Financial Secretary
Official in lead:	Mr Britton/Mr Monck
Interested departments:	Bank of England

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(iv) Monetary control techniques

Work will be in hand between now and the Budget to follow up the Chancellor's statement on 24 November. The main topics for decision will be the future of the Reserve Asset Ratio, on which interim decisions may be needed by early January, and of alternative prudential arrangements for the banking system; changes in the Bank of England's open market operations and last resort lending; the future of the cash ratio and alternative sources of income for the Bank; and the collection of banking retail deposits figures.

Minister in lead:	Chancellor
Official in lead:	Mr Monck/Mr Britton
Interested departments:	Bank of England

(v) Treasury and Civil Service Select Committee

Ministers will need to consider early in the New Year whether there should be a formal Government response to the Select Committee's 18 December report on economic policy and, if so, what form it should take. The Committee will also be publishing a report on its monetary enquiry, probably at the end of January. Again, the Government's response to this will need to be considered.

With the monetary enquiry completed, the Committee can be expected to turn its attention to other matters: the long-threatened hearing with officials about the nationalised industries may well materialise and hearings can be expected on the Armstrong Committee's proposals On the latter, officials have already submitted a draft Treasury response to the Chancellor and it is hoped to get an approved version across to the Committee before Christmas. In the Spring the Committee can be expected to take evidence on general economic policy in the light of the Budget. Advice on this and other Select Committee matters will be submitted as necessary.

Minister in lead:	Chancellor
Official in lead:	Mr Unwin

* Now approved by the Chancellor & about to be transmitted to the Treasury Committee.

[signature] 19/xii

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2. FINANCE

(i) Indexed gilts

Ministers have discussed the possible introduction of Indexed Pensions Stocks (IPS) but have not reached a conclusion. A decision of principle could be taken on the basis of a paper the Financial Secretary will be putting to the Prime Minister, subject to further work on eligibility and to favourable conditions for an issue.

Minister in lead:	Financial Secretary
Official in lead:	Mr Monck
Interested departments:	Bank of England, Department of Trade, Inland Revenue, Government Actuary's Department

(ii) National Savings

Increased reliance on National Savings and the target of £3 billion for 1981-82 will involve further decisions on extending eligibility for the new index-linked issue or on conventional certificates.

Minister in lead:	Financial Secretary
Official in lead:	Mr Monck
Interested departments:	DNS

(iii) Issue of non-marketable stock to the National Debt Commissioners

Details as in previous Report. Submission to Chancellor expected before Christmas.

Minister in lead:	Financial Secretary
Official in lead:	Mr Monck
Interested departments:	Bank of England

(iv) BNOC Revenue Interest Scheme

Mr Howell announced the scheme at the Party Conference in October. A reply is now awaited to the Chancellor's request for Mr Howell's views on marketability following officials' report on this aspect.

Decisions will have to be reached quite soon to ensure that the bonds can be issued in 1981-82. The scheme is a joint initiative with the Department of Energy.

Minister in lead:	Chancellor
Official in lead:	Mr Monck
Interested departments:	Department of Energy, Inland Revenue, DNS, CSD, Bank of England

(v) <u>Long-term corporate borrowing</u>

A number of proposals have been put forward for encouraging the company sector to switch borrowing from the banks to the bond market. The primary aim would be to ease the serious banking liquidity problem and hence to reduce interest rates for given monetary growth, though maturity pattern of the company sector's liabilities might also be improved. The proposals are being considered together under the auspices of WGTS and it is expected a report for Ministers will be ready early in the New Year.

Minister in lead:	Chancellor
Official in lead:	Mr Middleton
Interested departments:	Bank of England, Inland Revenue Department of Industry

(vi) <u>Deposit Protection Scheme</u>

The issue is whether or not to implement the scheme included in the last Administration's Banking Act. A submission on this should reach the Financial Secretary early in the New Year.

Minister in lead:	Financial Secretary
Official in lead:	Mr Monck
Interested departments:	Bank of England

(vii) <u>£1 coin</u>

Further action, including the possibility of proposals for consultation with interested parties will depend on the outcome of the discussion with the Prime Minister on 16 December.

Minister in lead:	Chancellor
Official in lead:	Mr Monck
Interested departments:	Bank of England, Royal Mint

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3 TAX

(i) Tax and Savings

Mr Middleton's Working Group, sitting both with and without outside experts, is considering a number of issues in this area. Their reports are expected to be submitted after Christmas.

Minister in lead: Chancellor
Official in lead: Mr Middleton
Interested departments: Inland Revenue, DOI, DOT, Bank of England

(ii) NIS

The Chancellor announced on 24 November that the rate of NIS from April 1981 will remain unchanged; but employers' payments will rise in cash terms as a result of revalorisation of the NI earnings limits and increased earnings. This does not preclude a mid-year rate change announced in the Budget or during the early summer. A decision will be needed by mid-February.

A report on the scope for making the NIS more flexible in its coverage and speed of change will soon be available.

Minister in lead: Chancellor
Official in lead: Mr Battishill
Interested departments: Treasury (in lead), Inland Revenue, DHSS

(iii) Benefits, taxation and incentives

A further report by a group under Treasury Chairmanship looking into work incentives at the lower end of the income scale and effects, inter alia, of benefits on this, will be submitted to Ministers shortly. The Chancellor has written to the Secretary of State for Social Services proposing a wide look at the interaction of Social Security and taxation systems, with a view to considering, in the first place, whether some kind of "outside" look might be taken at the way the whole system has grown since the war. Following a Treasury study initiated by the Prime Minister, the CPRS have been invited to look into aspects of youth unemployment, with reference, amongst other things, to possible modifications of the Social Security system in this respect, and a report is expected before the Budget.

Minister in lead: Chancellor
Officials in lead: Mr Battishill, Mr Kemp, Mr Dixon
Interested departments: DHSS, Inland Revenue, and others

(iv) Heavy fuel oil duty

An inter-departmental group under Treasury Chairmanship is currently studying the implications of abolishing or reducing the heavy fuel oil duty; and whether there is any case for treating differently fuel oil and gas oil. Its report should be available by early in the New Year.

Minister in lead: Chancellor
Official in lead: Mr Battishill
Interested departments: Customs & Excise, DOI, DEn.

(v) Bank profits

A note will come forward to the Chancellor later today. [signature] 19/XII

In the light of the Financial Secretary's meeting with clearing bank chairmen about export credit, Ministers will need to consider whether further action on the bank profits should be taken, eg in the Budget.

Minister in lead: Financial Secretary
Official in lead: Mr Monck
Interested departments: Inland Revenue, Bank of England

(vi) Taxation of financial services

An interim report on the scope for extending the tax base in the financial sector, seeking guidance on the direction of future work, will reach Ministers this week.

Minister in lead: Financial Secretary
Official in lead: Mr Battishill
Interested departments: Customs & Excise, Inland Revenue, Bank of England

(vii) FASE

FASE, which includes outside experts, has been looking at means to encourage equity investment in small firms. The Chancellor has now authorised confidential discussion with representative bodies on a possible scheme. The Group is intending to look at other related issues (possibly without the outsiders for some of them), including investment through intermediaries.

Minister in lead:	Chancellor (Chairman of MISC 14)
Official in lead:	Mr Battishill
Interested departments:	Inland Revenue, DOI, DOE, CPRS

(viii) Future of domestic rates

Ministers have still to consider collectively whether work on an alternative to domestic rates should be pursued, although this looks increasingly unlikely. Instead, it will probably be necessary to consider ways of making the domestic rating system more tolerable, eg more extensive rebates.

Minister in lead:	Chancellor
Official in lead:	Mr Battishill, Mr Kitcatt
Interested departments:	DOE, WO, SO, Inland Revenue, Customs & Excise

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4. PUBLIC EXPENDITURE

(i) Public Expenditure White Paper

A draft of part I, incorporating the planning totals agreed in the 1980 Survey, will be submitted in the second half of January.

The full White Paper will have to be circulated in draft to Cabinet early in February, if it is to be published on Budget Day.

GEP/GEA will report shortly on how we think we can best meet Ministers' wishes for some cash figures for 1981-82 in the White Paper.

Ministersin lead:	Chancellor, Chief Secretary
Official in lead:	Mr Bridgeman
Interested departments:	All

(ii) 1981-82 Main Estimates

The Estimates will be submitted to Ministers for approval in mid-January, for publication on Budget day. The timetable is affected by the need to carry-over cash figures to the White Paper.

Ministersin lead:	Chief Secretary, Financial Secretary
Official in lead:	Estimates Clerk
Interested departments:	All

(iii) 1980 Survey and cash limits

The outstanding issues are:-

(a) the planning totals for the next 3 years. A submission on them will be made in mid-January. Treasury Ministers will need to clear this with Cabinet - hopefully by correspondence.

(b) confirmation of the cash limits factors of 11% and 6%.

Ministersin lead:	Chancellor, Chief Secretary
Official in lead:	Mr Bridgeman
Interested departments:	All

(iv) Follow-up to the 1980 Survey

Groups and the CPRS are considering possible topics for policy reviews following the 1980 survey. Proposals will be put to the Chief Secretary early in the New Year.

Minister in lead:	Chief Secretary
Official in lead:	Mr Bailey
Interested departments:	CPRS, other departments selected for study

(v) Price basis of the survey

Following the Chancellor's meeting on 3 November, officials are doing further work on the 'cost terms' and 'year 1 cash' options. A submission will come forward to Treasury Ministers by mid-January, with a view to putting proposals to departments by the beginning of February so that any changes can be implemented for the 1981 Survey (beginning late March).

Minister in lead:	Chancellor
Official in lead:	Mr Littler
Interested departments:	All

(vi) 1980-81 Spring Supplementary Estimates

These will have to be published in mid-February, slightly earlier than usual if the Budget is on 10 March. They will cover any significant breaches in cash limits, notably Defence.

Minister in lead:	Chief Secretary, Financial Secretary
Official in lead:	Estimates Clerk
Interested departments:	Defence and others (as yet unknown)

(vii) Smoothing the PSBR

The Prime Minister has commissioned further work on this. A report on the tax aspects is expected to be ready in the New Year.

Minister in lead:	Chancellor
Official in lead:	Mr Battishill
Interested departments:	Inland Revenue, Customs & Excise

(viii) Local authority borrowing

An urgent study involving officials from other departments will look at the options for more accurate forecasting and better control of local government borrowing. If possible the report will be available in time to introduce legislation to take effect from 1982-83.

Minister in lead:	Financial Secretary
Official in lead:	Mr Bailey
Interested departments:	DOE, WO, SO, Bank

(ix) Local authority pensions

An inter-departmental study under DOE chairmanship will consider the feasibility and implications of defunding of local authority pensions. No date for completion can yet be forecast, but guidance from Ministers, particularly on the involvement of the Centre for Policy Studies, may be needed before it is finalised.

Minister in lead:	Financial Secretary
Official in lead:	Mr Kitcatt
Interested departments:	DOE, WO, SO, DES, DHSS, DEm, CSD, DTp, GAD, CSO

(x) RSG percentages

A review of the needs and resources of England and of Wales, possibly including Scotland and Northern Ireland as well, should provide an objective method of calculating relative rate support grant percentages. This will be needed in good time to consult local authorities about the recommendations before the RSG settlements next autumn.

Minister in lead:	Chief Secretary
Official in lead:	Mr Kitcatt
Interested departments:	DOE, SO WO

(xi) Defence Policy

Following the £200m public expenditure reductions in 1981-82, 1982-83 and 1983-84, the Defence Secretary will be reviewing the range of defence commitments. He is expected to report his conclusions to OD early next year.

Minister in lead:	Chancellor
Official in lead:	Mr Hansford
Interested departments:	MOD, FCO

(xii) Defence cash limit

The defence cash limit for 1980-81 is likely to be overspent by perhaps £350m. Discussions are continuing at official level on measures to constrain spending. Treasury Ministers have been kept informed and will be involved when the Defence Secretary seeks Supplementary Estimate provision at the beginning of January.

Minister in lead:	Chief Secretary
Official in lead:	Mr Hansford
Interested departments:	MOD

(xii) A common budget for defence and external affairs

Reports from an official inter-departmental committee (MISC 42) on the possibility of amalgamating the defence, aid and diplomatic budgets, and on a number of minor issues falling in the penumbra between these budgets, have been submitted by Sir Robert Armstrong to the Prime Minister for discussion in due course between her and the Chancellor and the Foreign and Defence Secretaries, if necessary. Advice will be submitted shortly.

Minister in lead:	Chancellor
Officials in lead:	Mr Hansford, Mr Mountfield
Interested departments:	FCO, MOD, Cabinet Office

(xiv) Health

DHSS Ministers propose to publish a Health Strategy Document early in the New Year setting out the Government's long term health priorities. A draft should be circulated shortly. DHSS and Treasury are preparing a paper on longer term health spending policy which should be submitted to Ministers early in the New Year. This will involve longer term questions of the role of private health care and private money in the NHS, and possibly the long term future of charging. A report on improved steps to monitor and encourage better efficiency in the NHS should be put to Treasury Ministers around the end of the year. Work continues on ways of bringing the non-cash limited Family Practitioner Service within a cash limit discipline.

Minister in lead:	Chief Secretary
Official in lead:	Mr Kemp
Interested departments:	DHSS, SHHD, WO

(xv) <u>Social Security</u>

Treasury officials are heavily engaged, with DHSS, in ensuring that the Social Security (Contributions) Bill reaches the Statute Book unscathed by the end of January. Detailed Social Security upratings need to be decided prior to the Budget, in the light inter alia of the Budget forecast of price inflation and decisions on tax thresholds. Legislation to recover the 1 per cent excess at November 1981 is in preparation. Legislation is also in preparation for the Employers' Statutory Sick Pay scheme and further decisions may be needed here. Papers concerning a review of the contributory system and reform of housing benefit should be with Ministers over the next month or so.

Ministers in lead:	Chancellor, Chief Secretary
Official in lead:	Mr Kemp
Interested departments:	DHSS principally

(xvi) <u>Civil Service Pensions</u>

The report of the Scott Committee on the value of index-linked pensions is expected shortly, and will call for difficult Ministerial decisions. These will involve not just the position of existing public sector employees but also the continued index-linking of present pensioners. Treasury and CSD officials are tentatively looking at ways in which the cost of the Civil Superannuation could be better brought to the attention of Department managers

Minister in lead:	Chancellor
Official in lead:	Mr Kemp
Interested departments:	CSD and many others

(xvii) Public Service Pay

A group of officials under Mr Ryrie's chairmanship is considering future policy for the determination of public service pay including, in particular, how expenditure considerations can best be brought to bear. A major related issue is the future of Civil Service pay research, on which the Lord President is in the lead.

Minister in lead:	Chancellor
Official in lead:	Mr Dixon
Interested departments:	CSD, CPRS, Employment, Cabinet Office

(xviii) Property Service Agency

Decisions are required on the PSA programme for new capital works to start in 1981-82, following the recent public expenditure cuts. A report by officials under Treasury chairmanship on the possibilities of applying repayment to PSA Services is to be submitted by Sir Derek Rayner to the Prime Minister shortly and may call for further work. Proposals are expected fromDOE for the private financing of the cost of the new Conference Centre; it may be that the refurbishment of Richmond Terrace could be funded similarly.

Minister in lead:	Chief Secretary
Official in lead:	Mr Kemp
Interested departments:	PSA, CSD and others

(xix) Other Allied Services

Officials are examining further aspects of the implementation of repayment for COI services, and will be reporting shortly. Officials are also examining aspects of the pricing policy of HMSO. Ministers may be asked to consider aspects of Ordnance Survey, following the Serpell report, with particular reference to the Ordnance Survey's efficiency and the options for improving their self-financing position. Following a meeting between the Chancellor of the Exchequer and the Chancellor of the Duchy of Lancaster on the one hand, and the House of Commons Commission on the other, efforts may be pressed forward to reduce the costs and increase the efficiency of Parliament.

Ministersin lead:	Chancellor, Chief Secretary, Financial Secretary
Official in lead:	Mr Kemp
Interested departments:	CSD, DOI, DOE

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(xx) Inner London Education Authority

H Committee have considered a Report by the Ministerial Committee (IL) advocating the retention of a single authority. Officials in MISC 41 are now re-examining the financial controls over ILEA. Revised proposals are being considered by IL Committee.

Minister in lead: Minister of State (C)
Official in lead: Mr Judd
Interested departments: DES, DOE, HO

(xxi) Schools Expenditure

A working group of Treasury and DES officials has examined the basis of expenditure plans for schools, in relation to the Government's political commitments on education. A report is to be submitted to Ministers before the end of the year.

Minister in lead: Chief Secretary
Official in lead: Mr Judd
Interested departments: DES

(xxii) Arts and Heritage

Treasury are associated with OAL studies into export controls of works of art (cf the Leicester Codex), sales of publicly owned works of art and income producing activities of national institutions. Reports may be coming forward. DOE are reviewing a number of aspects of policy and administration in their Ancient Monuments directorate.

Minister in lead: Chief Secretary
Official in lead: Mr Kemp
Interested departments: OAL, DOE

(xxiii) ITV levy

Home Office preoccupation with the delayed passage of the Broadcasting Bill and the companies' preoccupation with the franchise awards has inhibited progress on the Treasury's proposed two-tier (part revenue, part profits) levy formula. We now also have to deal with the consequences of reversion to Welsh TV broadcasting on the Fourth Channel. The issue is not likely to come to Ministers before the end of the first quarter, after consultations with the companies.

Minister in lead: Chancellor
Official in lead: Mr Gulvin
Interested departments: Home Office

(xxiv) Satellite television

The Home Office is likely to complete its study of a UK direct broadcasting satellite system and report early in the New Year. The study covers, inter alia, the potential industrial benefits of such a system and the financial and other implications for existing television services: decisions are likely to focus on the balance between these, though it will be necessary to take into account wider resource allocation issues.

Minister in lead: Chancellor, Chief Secretary
Official in lead: Mr Gulvin
Interested departments: Home Office, Department of Industry

(xxv) Data Protection

Pressure is building up, from CPRS, DOI, the Select Committee on Home Affairs, and from outside interests, for legislation to provide protection for personal data stored in, and processed by, computer systems. There will, however, be costs to central and local government, and to private sector users, and Treasury has been concerned to secure a proper assessment of both costs and benefits. H Committee recently referred the Home Secretary's proposals back for further study. Discussion is likely to drag on into the New Year, possibly leading to the production of a discussion document.

Minister in lead: Chief Secretary
Official in lead: Mr Gulvin
Interested departments: Home Office, CPRS, Industry and Trade, DHSS, Inland Revenue

(xxvi) Review of the Exchequer and Audit Department Acts

The Green Paper on "The Role of the Comptroller and Auditor General" was issued in March 1980. Subsequently the Public Accounts Committee decided to stage their own enquiry. They finished taking evidence at the beginning of December and their report is expected fairly early in the New Year. Their report will need inter-departmental discussion with the Treasury in the lead. The decisions to be taken by Ministers on the basis of this work will probably lead to legislation in the 1981-82 Session.

Minister in lead:	Financial Secretary
Official in lead:	Mr Carey
Interested departments:	(in principle) all

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5 NATIONALISED INDUSTRIES, ENERGY ETC

(i) Nationalised Industry Policy

Continuing work on market borrowing (HF in lead), greater involvement of private capital etc.

Ministers will need to consider again the topic of monitoring nationalised industry pension schemes (perhaps in the light of the Scott Inquiry Report). Work is in hand on efficiency audits (and this links with further work on the role of C & AG).

Minister in lead:	Chancellor, Chief Secretary, Financial Secretary
Officials in lead:	Mr Ryrie, Mr Burgner
Interested departments:	All sponsor Departments, CPRS

(ii) Finances of nationalised industries

1980-81 External Financing Limits. Further recession-induced increases in individual industries' EFLs seem inevitable, in addition to those already agreed for BSC, BS and BRB. Our current estimate is for an aggregate excess of £1 bn (cash).

At this level the excess would be found from that part of the contingency reserve relocated. to nationalised industries
[initials] 19/xii

Minister in lead:	Chief Secretary
Official in lead:	Mr Burgner
Interested departments:	All sponsor Departments

(iii) Rail Policy Review

Mr Fowler will circulate early in the New Year a paper examining major issues of rail policy and their financial consequences. He will probably seek additional funds for investment, including investment in a major programme of electrification, as well as some increase in support for the subsidised railway if present network and service levels are to be maintained.

Minister in lead:	Chief Secretary
Official in lead:	Mr Burgner
Interested Departments:	Department of Transport

(iv) British Steel

Mr MacGregor's long-awaited corporate plan is to be published in outline on 12 December, and will come before Ministers for collective consideration in January. Decisions will be needed before the end of January, when BSC run out of cash; a final EFL for 1980-81, and a new EFL for 1981-82, will then need to be set, and other measures consequent on the corporate plan will need to be considered, such as setting a financial target and performance aims, and the case for an interim capital reconstruction.

Minister in lead:	Chief Secretary
Official in lead:	Mr Burgner
Interested departments:	Industry

(v) National Coal Board

Mr Howell will circulate in the New Year a paper indicating the action necessary by the NCB to keep within their financial strategy and agreed public expenditure allocation. This will probably require substantial pit closures (causing particular problems for the regions, especially South Wales) and substantial reductions in the Board's capital programme. Mr Howell may seek some relaxation of the Board's financial strategy (and therefore increase public expenditure in 1981-82 and thereafter) in order to spare the NCB's investment programme from the substantial cuts involved.

Minister in lead:	Chief Secretary
Official in lead:	Mr Burgner
Interested departments:	Dept of Energy & Scottish & Welsh Offices interested particularly in regional aspects

(vi) Rolls Royce

Ministers have accepted that up to £150 million government finance will be provided to Rolls Royce in 1981 subject to the company's operating plan confirming that the agreed cash ceiling of £200 million will be held. Officials are considering whether there is any scope for savings on other DOI programmes to accommodate some of the funding requirement; the prospects of finding any savings are bleak.

Minister in lead: Chancellor, Chief Secretary
Official in lead: Mr Hansford
Interested departments: DOI, MOD, Cabinet Office

(vii) Ports

The ports of London and Liverpool face serious financial problems. The port of London already receives financial assistance from the Government in support of a plan to return it to profitability. Its latest results, however, indicate that it is failing to meet its objectives. The port of Liverpool is effectively insolvent and Ministers recently agreed in E(EA) to guarantee a £3 million addition to its overdraft. Decisions on its longer term future were deferred pending a further paper from the Minister of Transport dealing with port finances generally. This is expected to come forward in January.

Minister in lead: Chief Secretary
Official in lead: Mr Burgner
Interested departments: Department of Transport, Employment, Industry, Agriculture and Environment

(viii) Public Sector Asset Disposal (Privatisation)

There is likely to be some shortfall on the 1980/81 target (depending on decision on BAe flotation and progress with New Towns asset sales) Apart from BAe, there are unlikely to be major decisions about flotation in the period up to March.

Minister in lead: Financial Secretary
Official in lead: Mr Burgner
Interested departments: All those responsible for assets being disposed of

(ix) Royal Mint and Bank of England Note Printing Privatisation

The Chief Secretary has been requested by E(DL) Committee to submit a report on the possible privatisation of the Royal Mint and the

Bank of England's banknote printing operations. Aim is for officials to submit papers to the Financial Secretary before Christmas.

Minister in lead:	Financial Secretary
Official in lead:	Mr Monck
Interested departments:	Bank of England, CSD, CPRS, Royal Mint, DOI

(x) Royal Ordnance Factories (Privatisation)

Within MOD, the Study Group chaired by Lord Strathcona in response to the E(EA) remit is expected to put forward recommendations shortly as to the future status of the Royal Ordnance Factories. A similar study is in train on the future of International Military Services Ltd in response to an E(DL) remit.

Ministers in lead:	Chief Secretary, Financial Secretary
Official in lead:	Mr Hansford
Interested departments:	MOD, DOI

(xi) BNOC Privatisation

Mr Howell may seek a collective decision on the use of the powers, which it has been agreed should be included in the forthcoming Petroleum and Continental Shelf Bill to enable equity to be introduced into BNOC's upstream operations. Questions to be decided include the timing of the use, if any, of the powers and the extent of the introduction of equity capital into the Corporation's offshore activities.

Ministers in lead:	Chancellor, Financial Secretary
Official in lead:	Mr Burgner
Interested departments:	Department of Energy

(xii) British Aerospace

It has been announced that BAe will be vested as a limited company on 1 January 1981. Ministers have also agreed that there should be an early reconsideration of the BAe 146 feeder-liner project by

E Committee. The date of flotation remains uncertain. If it has to be delayed by more than about six months after vesting it will be necessary to consider new funding arrangements for the company.

Ministersin lead: Chief Secretary, Financial Secretary
Official in lead: Mr Hansford
Interested departments: DOI, MOD

(xiii) Royal Dockyards
The Ministry of Defence will in the New Year put papers to E(EA) on the recommendations of the Speed Report on the future of the Royal Dockyards. Treasury Ministers will be particularly concerned with the recommendation to set up a Treading Fund for the Dockyards.

Minister in lead: Chief Secretary, Financial Secretary
Official in lead: Mr Hansford
Interested departments: MOD, CSD

(xiv) Depletion Policy
BP have now submitted an application to the Department of Energy for a consent to increase production from their Forties field - "An upward profile variation". The Treasury interest is that increased production from Forties would increase substantially Government take from the North Sea. The Department are likely to be reluctant to grant the full consent requested. There may need to be a discussion in E Committee if the Chancellor and Mr Howell cannot come to agreement.

Minister in lead: Chancellor
Official in lead: Mr Middleton
Interested departments: Department of Energy, Inland Revenue

(xv) Energy Pricing
E Committee have still to discuss in depth Mr Howell's paper on energy pricing (E(80)120 and 128) and the subsequent reports of the CBI and NEDO. There will also need to be discussion of Sir Keith Joseph's proposals to tilt the electricity bulk supply tariff in favour oflarge industrial users at the expense of other

parts of industry, commercial and domestic users; to subsidise industrial gas prices by increasing domestic prices; and for abolishing the heavy fuel oil duty (on which FP Division are preparing a report in consultation with interested Departments). Reduction in the planned rate of increase in energy prices would have substantial consequences for the PSBR unless offset by other action.

Mr Ryrie has also commissioned a further Treasury look at the question of UK fuel prices in comparison with those in other countries. 14/xii

Minister in lead: Chancellor
Official in lead: Mr Ryrie
Interested departments: Department of Energy, Industry, Scottish Office (Scottish electricity)

(xvi) <u>Oil prices</u>

There is likely to be an increase in world oil prices some time this month with an increase in North Sea prices almost certainly following. There will also be continuing discussions in eg the IEA about international action to restrain increases in the world oil price. The Treasury interest here is for the increase in world prices to be kept to the minimum but for North Sea prices to be raised to the extent possible without triggering off an increase in the world price of oil.

Minister in lead: Chancellor
Official in lead: Mr Middleton
Interested departments: Department of Energy, FCO

(xvii) <u>Fast Breeder Reactor</u>

Mr Howell is likely to put proposals to E either before or after Christmas for collaboration with the French or possibly the Americans on the fast breeder reactors, probably the largest single civil project ever funded from public expenditure. We may advise Treasury Ministers to oppose his proposals because despite the ostensible collaboration proposed, the outcome might be a virtual independent, and enormously expensive, British FBR and because in any event our policy should be licence in the best FBR technology when it is required.

Minister in lead: Chief Secretary
Official in lead: Mr Burgner
Interested Departments: Department of Energy, Industry, FCO

6. SUPPLY SIDE

(i) NEDC

Discussion of macro-economic items in NEDC will continue at the February meeting when the Prime Minister will take the chair. The discussion will focus specifically on industrial trends and prospects.

Minister in lead:	Chancellor
Official in lead:	Mr Dixon
Interested departments:	Industry, Trade, Employment, Environment

(ii) Strategy Exercise

Ministers in MISC 14 have agreed that the Strategy exercise should continue, with work increasingly focused on a smaller number of areas of major concern such as the removal of burdens on industry, and ways of improving labour mobility. Reports on these and other items will come to Ministers over the next few months. Where Ministerial decisions are involved, it is likely that the reports will be presented to other Committees, such as E(EA), although MISC 14 will continue to structure the work and act as progress chaser.

Minister in lead:	Chancellor
Official in lead:	Mr Dixon
Interested departments:	CPRS, DOI, DEm, DES, DOT, DOE, Regional Ministers

(iii) Enterprise Zones

Consultations are going ahead with the local authorities responsible for the sites provisionally selected by Ministers for Enterprise Zones. Decisions will need to be reached on the boundaries and planning regime for each zone.

Minister in lead:	Chancellor
Official in lead:	Mr Dixon
Interested departments:	DOE (in lead), DOI, Regional Ministers

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(iv) Loan Guarantee Scheme

Consultations will begin shortly with the Bank, DOI and the clearing banks on a possible loan guarantee scheme. A proposal could be put to Ministers before the Budget.

Minister in lead:	Chancellor
Official in lead:	Mr Dixon
Interested departments:	DOI, Bank

(v) Industrial Training

The MSC is preparing a major consultative document (with which they hope the Government will be associated) on a "new training initiative", which would seek to secure a commitment from the two sides of industry to make major changes in apprenticeship and other forms of training and for the Government to take various measures, including an expansion in vocational preparation for young people. One idea under consideration is that 16-17 year olds might be given special status as "trainees" and, for example, exempted from National Insurance contributions. Mr Prior is also considering publishing a White Paper on training policy in connection with his forthcoming Bill to amend the Employment and Training Act. The remit to the CPRS to study the problems of youth unemployment is also relevant.

Minister in lead:	Chief Secretary
Official in lead:	Mr Dixon
Interested departments:	Employment, Industry, Education, CPRS

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7. PROCEDURE AND ORGANISATION

(i) <u>Parliamentary Supply Procedure</u>

The Select Committee on Procedure will probably be established early in the New Year. It will probably be necessary for the Leader of the House and a Treasury Minister (?Chief Secretary) to give oral evidence. There will also need to be an official background paper, largely prepared by the Treasury. The Cabinet Office propose that work should be co-ordinated through the Ministerial and Official Committees on Procedure.

Minister in lead:	Chief Secretary
Official in lead:	Mr Bridgeman
Interested departments:	Primarily Treasury and Chancellor of the Duchy's Office. But also all major spending departments.

(ii) <u>Review of Treasury/CSD</u>

A report on the feasibility of Treasury/CSD integration has been submitted to the Prime Minister, together with advice from Treasury Ministers and Permanent Secretaries on the policy issues involved. The Prime Minister has now received the views of the Treasury/Civil Service Select Committee. Depending on her decision on the main issue, there may then be decisions to be taken about the process and timetable of implementation: a response to the Treasury/Civil Service Committee will anyway have to be prepared (CSD in the lead) covering their recommendations.

The Prime Minister has now decided against merger, though no announcement will be made until the New Year.

[initials] 19/xii

Minister in lead:	Chancellor
Official in lead:	Sir Douglas Wass
Interested departments:	CSD, No 10

(iii) <u>Central Control</u>

Arising out of the reviews of expenditure divisions and other Rayner work, the Chancellor has asked for a note summarising central control responsibilities, for circulation to his colleagues.

Minister in lead:	Chancellor
Official in lead:	Sir Douglas Wass
Interested departments:	CSD, No 10, the rest

(iv) Manpower cuts

A manpower target for the Chancellor's Departments as a whole has now been made public. The published figure is some 5,000 below the target originally offered by the Chancellor. Ministers are considering how these additional savings might be achieved. The size and phasing of the Treasury's own contribution turns in part on the decision on integration but Ministers will in any case need to consider the future of RGPD (MST(L) has asked for advice from LG on the implications for local authorities), the outcome of the outstanding Sector Reviews (action on these reviews has been held up pending a decision on integration) and the outcome of revisions of supporting services.

Minister in lead:	MST(L)
Officials in lead:	Mr F E R Butler on Treasury numbers Mr McConnachie (Inland Revenue) on co-ordination of Chancellor's Departments
Interested departments:	IR, C&E, DNS, Chancellor's minor departments, CSD

8 INTERNATIONAL

(i) South Africa

Discussion is likely in OD Committee of our attitude in the event of pressure at the UN for economic sanctions (eg over Namibia)

Minister in lead:	Chancellor
Official in lead:	Mr Lavelle
Interested departments:	FCO (in lead), DOI, DOT

(ii) Energy: talks with the United States

Ministers will be consulted about the possibilities for an exchange of views with US officials on the outlook for oil prices and related matters. The timing will depend mainly on when the new administration is in a position to talk.

Minister in lead:	Chancellor
Official in lead:	Mr Lavelle
Interested department:	D.En, FCO

(iii) Iran

Ministers may need to be consulted on issues arising from the dispute with Iraq, the US freeze of Iranian assets and its possible unwinding, and the sanctions against Iran.

Minister in lead:	Chancellor
Official in lead:	Mr Lavelle
Interested departments:	FCO (in lead), DOT, DOI, Bank

(iv) Exchange Control Powers

Ministers may need to be consulted on issues arising from the proposed inclusion in the next Finance Bill of amendments to the exchange control legislation, to close gaps in existing powers to control inflows.

Minister in lead:	Financial Secretary
Official in lead:	Mr Lavelle
Interested departments:	Bank of England, DOT, DOI, FCO

(v) CAP prices/CAP reform

The Commission have just tabled ideas for introducing a general principle of producer co-responsibility into the CAP. In January they will table proposals for the 1981 price fixing which will presumably incorporate this principle. The UK's negotiating stance will be determined in OD(E). Decisions in Brussels are due by the end of March.

Minister in lead: Chancellor
Official in lead: Mr Lovell
Interested departments: MAFF, CO

(vi) Future policy on the SDR

Between now and the Interim Committee in April, Ministers may need to consider a number of questions related to the SDR, in particular the UK line on a general allocation of SDRs, the proposal that any new issue should be weighted in favour of the developing countries, and whether the substitution account proposals should be revived.

Minister in lead: Chancellor
Official in lead: Mrs Hedley-Miller
Interested departments: Bank of England, FCO, ODA

ITEMS DELETED FROM PREVIOUS NOTE

Health

The response has now been given to the Third Report from the Social Services Committee. The White Paper on the Elderly has now gone into a limbo and is unlikely to surface for some months yet.

Arts and Heritage

A decision has been taken to make a start on the new British Library building. Responsibility for the so-called "douceur" arrangements have been passed to OAL and DOE. The Treasury's Memorandum on Capital Taxation and the Heritage has been issued.

National Insurance and Social Security

Decisions have been taken on National Insurance Contribution rates to take effect from next April. Decisions have also been taken, in the same context, on the future of the Treasury Supplement to the National Insurance Fund. A reply has been given to the Third Report from the Social Services Committee. A White Paper on Frequency of Payment of Social Security Benefits has been published.

Civil Service

A flexible early retirement scheme for civil servants has been approved. Work on improving job prospects for civil servants in London has gone into CSD limbo.

Forestry policy

The Government's general support for expansion of forestry, with particular emphasis on the private sector will be announced to Parliament on 10 December and a Forestry Bill permitting the sale of Forestry Commission assets is about to be introduced.

Common Fisheries Policy

Decisions are expected in the Fisheries Council on 15/16 December.

Foreign Currency Debt

Papers are being submitted

Public Purchasing

E Committee reaffirmed in November the general policy, and agreed future policy on computer procurement.

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Chancellor made announcement on 24 November.

Business taxation (stock relief)

Chancellor made announcement on 24 November

National Insurance Contributions and Income Tax

Report submitted to MST(L)

Industrial rates

Report submitted to Treasury Ministers

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Annex B

CUSTOMS AND EXCISE ITEMS

(i) Alcoholic Drink Duties: Infraction and Harmonisation

Depending upon the outcome of the EC Fiscal Council on 22 December, the outstanding Infraction proceedings before the European Court on the UK duties on beer and table wine are likely to require further Ministerial consideration in the context of the Budget.

Minister in lead:	MST(C)
Official in lead:	Mr Freedman
Interested departments:	Treasury, MAFF, FCO, Cabinet Office, Health Departments

(ii) Cigarette tax harmonisation

Negotiations are likely during the first part of 1981 on a possible further stage of harmonisation of cigarette taxation in relation to the specific proportion of total taxation on cigarettes and on the continuation of the UK derogation allowing a surcharge on health grounds on higher tar cigarettes.

Minister in lead:	MST(C)
Official in lead:	Mr Freedman
Interested departments:	Treasury, DOI, Health Departments, FCO, Cabinet Office

(iii) Excise duty warehousing of wine and spirits

Two reports, one of them the result of a Rayner exercise, have recommended a number of changes in revenue controls at warehouses and distilleries. Opposition is expected from the Trade Union Side and, to a lesser extent, from trade associations. We expect to report to Ministers with our recommendations in January/February 1981.

Minister in lead:	MST(L)
Official in lead:	Mr Freedman
Interested departments:	Health Departments, MAFF, CSD

(iv) VAT liability of supplies by the Construction Industry

The inadequacies in present VAT liability law affecting supplies by the construction industry have become increasingly recognised and the subject of growing public criticism over recent years. Continuing effective operation and control of the tax in this area is now coming into question. The recommendations of an earlier policy review will very shortly be updated and re-presented.

Minister in lead: MST(C)
Official in lead: Mr Scholes
Interested departments: DOE, Treasury

(v) Review of VAT second-hand schemes

Following a decision of the House of Lords in the Corbitt case Customs and Excise are reviewing the treatment of second-hand goods.

Minister in lead: MST(C)
Official in lead: Mr Scholes

(vi) Review of appealability of discretionary decisions in VAT

As a result of the House of Lords decision in the Corbitt case Customs and Excise are also reviewing the appealability of discretionary decisions in VAT.

Minister in lead: MST(C)
Official in lead: Mr Scholes

(vii) VAT registration and deregistration

It will be necessary to consider for the 1981 Finance Bill whether the VAT registration and deregistration limits should be revalorised. At the same time certain other minor registration changes will be proposed to Ministers.

Minister in lead: MST(C)
Official in lead: Mrs Strachan
Interested departments: Treasury

(viii) Possible extension of car tax

A proposal to extend car tax to include motor cycles has been submitted. An inter-departmental review of the possibility of extending car tax to caravans is currently in hand.

Minister in lead: MST(C)
Official in lead: Mr Scholes
Interested departments: Treasury, Department of Transport, DOI

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CHANCELLOR

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Mr Burns
Sir Kenneth Couzens
Mr Ryrie
Mr Middleton
Mr Allen
Mr Aaronson
Mr Andren
Mr Folger
Mr Ridley
Mr Cropper
Mr Cardona

SUPPLY DEBATE, 15 JANUARY

I attach some preliminary notes, in separate sections, as a possible basis for a speech in the supply debate on Thursday. These are based largely on material collated by Mr Allen and others and broadly follow the outline theme (which I showed you on Friday) helpfully suggested by Mr Stewart. The theme therefore tries to concentrate on the signs of improvement ahead by relating each one to the causes of our economic problems and the evidence warranting hope for the future.

2. Assuming the announcement is made on Thursday as planned, you will also, of course, want to make it clear at the beginning of the speech that, with the Budget due so early, there is a good deal of ground you cannot reasonably be expected to cover. This will in part provide a legitimate cover for not in this speech dealing with the substance of fiscal and monetary strategy which is now under Budget review.

3. It would be very helpful to have your comments on this kind of material and the ordering of it as soon as convenient tomorrow. We will then continue with working it up in greater detail and Mr Aaronson will take on the task of beginning to translate it into something nearer speaking note form. As the notes indicate, Mr Ridley has kindly undertaken to let you have material on Mr Shore separately so that you can decide how much of this you are likely to want to use. Separate briefing, for drawing on as necessary, will also come forward on the Treasury Committee's last report.

JBU

J B UNWIN
12 January 1981

/PS

PS Since this was prepared I have received your own notes as transmitted by Mr Tolkien. Perhaps we can consider how to handle and fit these points in in the light of your reactions to the material attached.

J B U

A. INTRODUCTION

Main Theme - Despite problems, 1981 offers genuine hope of improvement on many fronts. Therefore intend to concentrate on this by examining main causes of present economic problems and relating them to changes for better which undoubtedly taking place.

2. Not seek to deny problems or that 1980 a very hard year for UK economy. But very hard for world generally; and, at last, picture far from uniformly gloomy. Already made great strides in central objective - rapid and sustained reduction in inflation. Many signs of enterprise and initiative reasserting themselves.

3. Need to build on this start. Crazy to abandon course and throw away opportunities that hard built foundation can provide. To adopt course advocated by Mr Shore would be sure recipe for return of roaring inflation. [Expand on Mr Shore on basis of material being provided separately by Mr Ridley].

4. Propose to pursue theme by concentrating on 4 main headings:-

- Oil and world economy;
- Industrial performance, competitiveness and "supply side";
- Overmanning and restrictive practices;
- wage bargaining and pay.

Will show in relation to each of these prospects for improvement ahead.

B. OIL AND WORLD ECONOMY

World economy in grip of serious recession. Major cause has been enormous oil price increase. Over 18 months to mid-1980 world dollar oil prices rose by around 150 per cent. In many ways problem strongly reminiscent of 1973-74 oil crisis. According to recent OECD estimates, effect of oil price increase has been to reduce real incomes in OECD area by equivalent of some 2 per cent of GNP. By third-quarter of 1980 industrial production in 7 major OECD economies [8] per cent below level at beginning of the year. Unemployment rates in these major economies is rising and forecast to go on rising in 1981.

2. Possession of N Sea oil undoubtedly great asset to UK. But does not mean we are insulated from effects of higher world oil prices and international recession. Benefits for UK economy in fact often over-estimated. Not subscribe to "leave bloody stuff in ground" school. But adverse effects on competitiveness and exchange rate; and NB North Sea oil and gas only some [4]% of GDP, compared with almost 30% from manufacturing industry.

3. So no doubt that, despite N Sea oil, Government's determination to achieve radical restructuring of economy embarked on in unfavourable context. Task made much harder. But nevertheless, still hopeful signs:-

(i) As recent OECD Report stresses, policy responses among countries following 1973-74 oil crisis differed considerably. Some attempted to offset deflation affects of OPEC surpluses through expansionary policies, with adverse consequences for domestic inflation. Response now - tightening of monetary and fiscal policies, - is uniform across countries. Thus Britain <u>is not "odd man out"</u> in adopting policies to resist inflationary consequences of oil price increase. We share with other major OECD economies top priority of reduction of inflation. [Quote IMF and Chinese evidence also]. Also recent statement by Dr Rutten.

(ii) There are real prospects (in absence of another oil price shock) that world recession will bottom out in course of year. Prospect thus for some growth, though this likely to be relatively show because of the generally cautious stance of economic policy. Similarly in the UK, recent forecasts by eg London Business School, Phillips and Drew, National Institute and CBI, (as well as Government's own November forecast) indicate that output may well stop falling later this year, though timing of any upturn very hard to predict. CBI and FT surveys also indicate marked improvement in business confidence.

(iii) On inflation [as indicated already] great progress in UK already [quote figures]. Further significant reductions likely over next few months. Possibly of single figure inflation before end of this year.

4. To sum up, policy of transformation embarked on in particularly adverse world economic climate. But much of worst over; and distinct signs of hope for future on output and inflation both in world and UK context.

C. INDUSTRIAL PERFORMANCE

UK industrial economy beset by "structural" or long term problems - out of date equipment, inefficient working practices, wage levels unrelated to productivity levels, poor industrial relations and appalling strike records. Old industries propped up too long at expense of new - unlike our most successful competitors.

(a) Nationalised Industries

2. This well illustrated by some of our nationalised industries. Too long over protected from economic realities. Over 1980's, for example, employment costs per head in all major nationalised industries rose faster than average for whole economy (and much faster in energy and telecommunications industries). Also, except for gas, electricity and telecommunications, labour productivity rose more slowly than in rest of economy. In BSC, for example, unit labour costs in last ten years rose 50% faster than in rest of the economy. Horrifying statistics. Explains much of recent problems of nationalised steel industry, and need for restructuring now being put into effect.

The two ringed points seem hard to reconcile?

3. Government committed to securing greater efficiency in nationalised industries generally and making them more subject to market discipline. Range of policies which bear on this - eg reference to Monopolies and Mergers Commission, setting performance aims, introducing competition (eg telecommunications and posts) and privatisation (eg ~~British Airways and~~ Aerospace and the National Freight corporation). Recent reports by MMC have shown ample scope for improving efficiency eg report on London Commuter Services found that: "since 1980 [there] has been a net productivity gain of only 5% [and] there has been little progress in the area of labour productivity since 1977". Also MMC report on Inner London Letter Post found: "during the 11 years 1968 to 1979 productivity in inner London appears to have declined by between 20 and 25%". International comparisons also show productivity per man lagging behind even in industries with best prospects, (eg telecommunications).

4. Role of Government? Obviously should not try to interfere in day to day management. But Government policies must encourage and stimulate

rather than cushion and protect.

5. Thus several initiatives which Government have taken:-

(i) First and foremost, action to deminish Monopoly element in nationalised industries. This is most effective single step since it introduces free play of competition. 1980 Transport Act was example of this - cf subsequent lively competition in coach, rail and air fares. Plan to extend this into posts and telecommunications. Also taking positive steps to return entire corporations, such as British Airways and National Freight Corporation, to private sector and also parts of other corporations where these perform separably operations in their own right.

(ii) Maintenance of financial discipline, mainly through EFLs and medium term financial targets. Financial pressures can produce lasting improvements in efficiency. Provide objective measures of success and failure and bench mark for setting prices which reflect true cost of production and can act as proper signal of consumer demand.

(iii) Development of new ways of getting more attention paid to cost reduction, efficiency, and standards of performance. Have therefore introduced <u>performance targets</u> - measures of cost reduction and performance for each industry. Also encouraging industries to publish indicators of performance in annual reports: eg British Rail has now published 18 indicators so that travelling public can see what is happening eg to average fare per passenger mile, costs per passenger mile, proportion of trains arriving on time, and so on.

(b) <u>The Private Sector</u>

6. Many of above problems also found in private sector. Government policies in past have not helped - cf recent OECD Economic Outlook - "there is a growing body of opinion that over the last decade or two the preference of regulations, controls and other impediments to the unfettered working of market economies ..... may have weakened the

ability of economies to undergo structural change, as well as reducing their responsiveness to changes in aggregate demand."

7. Hence importance Government attaches to policies for helping improve "supply side". One side of policies has been removal of controls on prices, dividends and overseas capital movements. More importantly, Government's macro-economic policies intended to secure, over the medium term, stable financial background against which firms can plan for future.

8. Combination of world and domestic policies and events has imposed considerable burden on companies. Evidence that burden of adjustment unfairly distributed between companies and consumers. One of objectives of 24 November measures was to redress this balance - cf stock relief scheme, MIR reduction, increase in industrial assistance and support for R & D, and so on. But other measures too to encourage new enterprise - enterprise zones, relief for losses on unquoted shares in closed companies, encouragement for employee share ownership schemes and new rules for demergers.

9. [Refer to Government's policy on energy pricing and participation in new NEDC Energy Task Force as another example of Government's flexible and realistic approach to problems of industry. Perhaps develop on lines of longer piece at Annex A, which would help to set NEDC record straight].

"<u>Success Stories</u>"

10. Above claims of more hopeful signs ahead validated by following examples:-

(i) <u>North Sea</u>

Major success story - first discovering oil and gas, then successfull extraction in hostile environment. Shows how private enterprise can rise to challenge and win return for self and nation. UK industry has responded splendidly to new North Sea markets. In 1974 UK-based companies won 40% of orders placed for goods and services to be used in North Sea. Latest figure is <u>79%</u>.

(ii) Northern Ireland

Refer to recent visit. Exceptional problems, but struck - even in traditionally depressed regions - by way enterprise flourishing. For example, visited two small business neighbourhood units - complexes of small workshop units in urban Belfast, constructed by NI Department of Commerce. Great success. All space let within few months of completion to small businesses. Waiting list. Fine example of private enterprise creating genuine new jobs.]We are also trying to gather suitable UK regional examples].

(iii) Mini-Metro

Outstanding example of what we can achieve. Generally recognised as best car in its class - BL run no risk with advertising practice standards in calling it car to beat world. Legitimate source of pride to all involved in development. Most economical and advanced small car on sale, introduced to time and cost. In December took over 10% of the UK market. Over three months since introduction has been in top four of models on sale in this country, with a cumulative market share of almost 7%.

(iv) The City

Financial Times refers to City's "uneasy prosperity". But no need to be apologetic about sector of economy where vitality and innovation unabated. [Refer to Stock Exchange Unlisted Securities Market, Traded Options Market, likelihood of gold and financial futures soon, and new corporate financing procedures emerging from merchant banks:] Part of vitality undoubtedly attributable to lack of Government intervention. Removal of corset and exchange controls showed we mean to keep it that way. Refer also to contribution to invisibles.

(v) Other specific stories

[Draw on DOI "Good News" list - see Annex B - plus any material on ICFC, System X etc].

11. No doubt that, despite all problems and long standing weaknesses, many encouraging signs ahead. Only these developments can create genuine jobs in future.

AMALGAMATE WITH §§14-16 of my note

D. LABOUR MARKET (OVERMANNING ETC) AND PAY

Real and tangible improvements over past 12 months:-

(i) Strikes: §15 of my note number of new industrial stoppages reported in second half of 1980 lower than any comparable period since war, and number of working days lost in this period lowest since 1966.

§16 of my note

(ii) Demanning [material and examples if possible to be provided]

(iii) Pay: Latest CBI pay data bank figures show that most settlements in new pay round under 10 per cent. This only half current year on year change in average earnings (still over 20%), which reflects laggs before new settlements recorded in the earning statistics [and partly small proportion of workers who have so far settled.] If settlements continue at present level we can confidentally expect rapid deceleration in earnings growth during 1981.

2. But, despite encouraging developments, wage levels still generally far too high in relation to productivity. 10% also too high in relation to losses of international competitiveness incurred over last few years. [Perhaps quote recent Peter Jay remarks that "as to the slump in the real economy ..... the basic explanation is that the normal balance of the British economy implies unemployment permanently in the low millions because of our deeply institutionalised and almost universal habit of posting prices for labour which are hugely above labour's market-clearing price".]

3. To match progress in private sector Government determined to keep public sector pay increases under control - eg 6% pay cash limit imposed on local authorities. This essential if Government to restrict growth of public expenditure and borrowing so that totals are consistent with medium-term strategy. [Perhaps also refer to large increases in public sector pay relativities over past few years. As result of pay explosion in 1974-75 and more recent Clegg awards pay for most public sector groups, in relation to private sector pay, well ahead of levels achieved in early 1970's. This particularly true of manual workers

who in central and local Government have improved their position viz a viz private sector by over 10% since 1970.

4. Thus moderation in pay as vital as ever. Cause for hope is that, though still long way to go, significant progress now apparent.

E. CONCLUDING SECTION

Nature of UK's problems, exacerbated by world recession, made fundamental change of approach necessary. Medium-term Financial Strategy essential part of that change. Never pretend it would be easy. Many problems still to face, but signs of hope on every front

- inflation (especially realism on pay)
- greater confidence among businessmen (success stories)
- demanning and removal of restrictive practices.

2. But inflation remains greatest threat, even though high unemployment has taken limelight. Therefore cannot relax; must build on start made and do nothing to undermine confidence of industry and workers by changing course now. Do not intend to do so.

ANNEX A

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We had an extremely good discussion at the NEDC last week on the subject of energy prices. This was a further example of the value of the NEDC as a forum for discussion by the Government, unions, employers and others with a leading role in the economy of the key economic issues facing the country.

I am glad to have this opportunity of commenting to the House on the recent discussion and the follow-up steps now being taken.

First, it is important to stress that there is general agreement that the policy of economic pricing should continue with each fuel priced so as to reflect the cost of supply on a continuing basis, while taking account of both short-term and long-term market factors. There is also agreement that, although comparisons are extremely difficult and any single "snapshot" is likely to give a misleading impression, most prices compared with their European competitors.

But we all recognise that particular sectors of British industry, notably the large industrial users of gas and electricity, feel that the prices they are charged are out of line with those charged to many of their continential competitors.

These issues are complicated and difficult to resolve and some of the statistical comparisons are still obscure. This is why the Government and the other parties present welcomed the establishment of an NEDC task force with the job of establishing the facts on energy prices in this country, Europe and the US, with particular rererence to the large energy users. All the major parties concerned will be represented, Government, CBI, TUC and the nationalised energy industries.

It would be wrong for me to try to anticipate the outcome of this review or of any subsequent decisions that may be taken. We shall study it when it is available in the context of other factors bearing on the current problems on industry. But what I want to stress is that, in this as in other fields, the Government are more than ready to explore these issues with those vitally involved and to consider whether there is any case for adapting its approach in the light of developing circumstances.

In the meantime, of course, the Government have urged electricity customers and suppliers to get together to make the best use of flexibility within existing price structures. The savings can be significant - the Department of Energy know of cases where annual savings of up to £800,000 on electricity bills have been identified. The position of large consumers will be further covered in the review of the electricity Bulk Supply Tariff.

On gas, the British Gas Corporation have concluded that for the time being firm gas contracts should be renewed at only around three-quarters of the gas oil price. The Government have accepted this, and asked the Corporation to look at other aspects of industrial gas pricing, including the range of discounts available within current practice.

ANNEX B.

GOOD NEWS

9 January 1981

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Northern Region

Californian based Magnuson Computer Systems plan to open a plant in Washington New Town with the prospect of 100 new jobs in the first year. The company decided on the North East to be near Newcastle University's microelectronics department.

NEI has been given the contract to build the turbine generators of the Heysham nuclear power station. The contract is worth £85m and will save thousands of North East jobs.

A new multi million pound Methanol and Ammonia plant at ICI Billingham, Cleveland, will provide 700 jobs during its three years of construction and then permanent work for 120.

Murray Pipeworks Ltd, a subsidiary of Glasgow based Hewden Stuart has just taken over a 10,000 sq ft factory in South Shields and hopes to increase its workforce from the present 30 to 100 in the next few months

Carlisle's leading engineering firm, NEI Cowans Sheldon, giant crane manufacturers, are introducing a double shift system in the fitting and machine sections involving 30 workers. The new arrangements result from the firm's healthy order book.

South East Region

Parsons and Whittemore Lyddon Limited of Croydon have won a £20 million contract to provide equipment and services for a pulp-mill in Portugal.

Stone-Platt (Crawley) Limited, electrical and mechanical engineers, have won a £2.5 million order from Iraq for buoys and beacons for use on the river Tigris.

West Midlands Region

Thornproof, waterproof clothing manufacturers of Rugeley, which started up 3½ years ago with two machinists now employs 70 people and exports 15% of its output.

The Austin Metro reached its year end production target of 3500 cars a week a month ahead of schedule. To meet demand BL is expected to take on 1000 additional production workers before the end of January. In recent weeks car output from Longbridge has been the highest since 1975

Land Rover has had a record breaking year turning out 61,000 vehicles compared with 54,000 in 1979. This amounts to over £175m of overseas sales.

South West Region

J I Case Ltd, UK subsidiary of the American Company, J I Case, has begun recruitment for a new crawler tractor manufacturing plant at Redruth. The plant will open in May and provide 343 jobs.

JW (Personal)

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THURSDAY SPEECH. MISC. POINTS
(Mainly defensive)

1. Case against import controls, Indonesia, USA textiles

2. EEC
   - first Budget cash receipts
   - improving export/import performance, prospects

3. Reasons for CGBR overrun, response & consequences

4. Energy prices for industry/NEDC
   - the "agreed" policy
   - the main facts
   - the changes <u>already</u> made
   - purpose of task force: likely HMG response
   - PSBR revenue cost of going too far, generalised tariff reductions, etc.

5. A recent report that China is reasserting control of its money supply to control inflation ("We're all monetarists now"!)

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THURSDAY SPEECH

MORE POSITIVE POINTS/STR

1. Clear to all that employment/unemployment balance depends on restoring health of trading/enterprise sector, industry in broadest terms

2. In a very difficult and inhospitable world:

   oil, recession, UK problems that have been "decades in the making".

3. We <u>are</u> making headway: there are clear reasons to look for improvement, slowly: but must keep eye on ball (or whatever).

4. Inflation <u>is</u> crucial. Been built-in too long. Many attitudes will have to change. Clear now that attempts to accommodate bear little fruit: less inflation leading to less unemployment leading to more growth.

5. Maintaining policy has essential role. No detailed discussion today. Like Volcker, Chinese: dismiss Shore.

6. We <u>are</u> succeeding on inflation. Spell out, fully and optimistically: interest rates, mortgage interest rates - prospect of re-opening long-term industrial borrowing.

7. Fall in inflation will continue to be main topic. Need to ensure that the squeeze continues to bear down more on inflation and less on growth.

8. Many encouraging signs: Cardona stuff. (Add success of North Sea/energy based industries ?). (And some stuff from SWPs: Chairmen's meetings. Hope for productivity).

9. Can we do more to help industry,

10. Ex. rate ?

    (A) Very difficult, practically

    (B) Also monetary consequences

    (C) Even more practically, inflation consequences.
    35 per cent off = 15 per cent <u>on</u> inflation.
    What does that do for pay bargaining?

"Enterprises must adjust to ex. rate and not reverse".

11. Energy prices: see separate notes.

12. Move from public funds?

    (A) Caution: interest rates first
    value of 3 per cent reduction so far

    (B) Don't underestimate what we <u>are</u> doing.
    Total all expenditure e.g. on

    nationalised industries
    regional programmes
    unemployment programmes
    (? restore growth?)

    What we've done for small businesses?

    (C) Scope for more depends on public spending control

13. Damage done by over-spending. Lambeth. ILEA.
How can industry cope?

14. Need for three-fifths of loss of competitivity pay moderation. And for it to be sustained over long period. Next stages. Look ahead.
public sector now.

15. Harm done by strikes.

16. Where do Opposition stand? Will they back case for moderation,

B.L.	)	Quotes from
Seamen	)	Wilson
Water	)	Callaghan

pwp 15

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A.5 speeches

CHANCELLOR

cc Mr Unwin
Mr R Allen
Mr Aaronson
Mr Cropper
Mr Cardona

POSSIBLE SUPPLY DEBATE: PETER SHORE

I attach a brief line of argument which you may find of some use and interest. In it I refer to Shore's "seminal" articles in the Sunday Times in early October ("the stalemate state") and the Guardian on 21 September, both of which I assume you already have and that George Cardona will re-submit.

There are photocopies attached of the sources of the other two references.

AR

ADAM RIDLEY
12 January 1981

devaluing the pound and adopting an incomes policy.

- Well let us look at his recipe for a lower pound: import controls <u>and</u> controls on capital outflow at the same time. Two measures more calculated to strengthen an already strong exchange rate are impossible to imagine. [To commend them as he does shows gross economic illiteracy.]

- Finally, how he can seriously advocate a voluntary incomes policy based on "cooperation between Government and unions" after the "shambles" (Shore's word, S Times article col 8) of '78-9 is really puzzling.

It all goes to show how right is the Shadow Junior Minister quoted by Graham Turner in the latest Sunday Telegraph

[B] (11.1.81 p.9):

"The assertion we as a party have the answers rings false even to those who make it ... I don't believe any sensible person would now join the Labour Party. That is why I think the party is dying and the position is irrecoverable."

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Brave faces and clenched fists: Callaghan, Foot and Co at last year's conference.

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time, he never questioned our commitment to Nato. The only time he raised doubts was over the supply of Harriers to China in 1979."

His own personal strategy, the Shadow Minister went on, was to wait and see how Foot worked out. Healey might still inherit the job—"Michael doesn't look too fit and he has a tendency to fall down stairs." Then he wanted to see how the trade unions reacted to the current disarray in the party. As the January 24 special conference would show, it was they who held the future of Labour in their hands. It was they who would determine how the leader was chosen, how constituencies dealt with MPs . . . they controlled the party, but they didn't seem to want to acknowledge it.

The last meeting between the Shadow Cabinet and the unions, he said, had been a shambles; he wasn't even sure the unions had fully taken aboard the gravity of the situation. "It is," he added, "a terrible indictment of the party that we have to rely on the trade unions to pull us out of the mess, but there are no prospects from anywhere else."

OVER, THEN to the trade unions, whose block votes will decide—or, for that matter, fail to decide—Labour's special conference. Their bosses face the prospect with all the radiant assurance of miners limbering up to dance "Swan Lake." "It's very much touch-and-go," admitted Tom Jackson, of the Post Office Workers, who has been helping muster votes for compromise solution

—and then the argument goes on for ever."

Some union leaders, however, cannot manage anything like Mr Jackson's calm despondency. They approach the conference with something akin to panic. "There are so many items on the agenda, so many amendments and resolutions, so much clutter," said a general secretary whose union has not yet decided which way to vote, "I don't know how on earth they'll deal with it. I looked at the agenda and said, 'Oh, to hell with it!' There could be so many split votes, they'll end up with nothing. It'll be bloody chaotic."

His union had a political adviser to tell him which way to vote. How unions not similarly provided for were going to manage, he just didn't know. Some would be trying to make up their minds in the middle of the conference, with delegations of 30 and in the course of a few minutes. "It's ludicrous," he said. "We could have everything voted down and, where we'd go from there, nobody knows."

What worries men like Sid Weighell of the National Union of Railwaymen is that the conference might vote for a solution which gives the Parliamentary party less than 50 per cent of the leadership votes. And that, the Shadow Cabinet has warned the unions, could lead to the break-up of the party. So did Weighell think the party *could* hold together? "I've *got* to think that," he replied doggedly. "If I don't, I might as well pack up."

There is little danger that Mr Weighell will have to start packing in the immediate future. Labour's special conference may well be a shambles, but any decline of the party is more likely to take the form of a slow crumble rather than a rapid collapse. Nothing now unites it save the hope of office and the fear of unemployment, but careers and pensions can be a powerful cement.

Many on the Right wing of the party are none the less deeply despondent. "The assertion that we as a party have the answers,"

said a Shadow junior Minister, "rings false even to those who make it. On the Left, particularly, I don't think they believe in their heart of hearts that, if they had power, they'd know what to do with it. I don't believe any sensible-thinking person would now join the Labour party. That is why I think the party is dying and the position is irrecoverable."

Yet the dissidents cannot yet decide how and when to make a move. They declare that they will leave the party only if their departure "contributes to the radical restructuring of British politics," as one Labour MP put it. The fact is, however, that radical political change is unlikely to be brought about by men who toy so nervously with ambition and convenience.

As for the vast mass of the party, they hope that Mr Foot will be as good at papering over the cracks as he once was at creating them, but that is not enough. The Labour party does not make sense merely as an alternative set of managers or as an assortment of pinkish trimmers who take advantage of the failures of the Tories. Without belief, it carries no conviction: it is, quite simply, a Church without a creed. If that creed is still alive, there are precious few human signs of it.

Nor will it be re-born through the agency of the plasticine men who are so prominent among the party's younger leadership, both Left and Right. They may congratulate themselves upon their cosmetic agility, but Labour will not be reborn at the hands of cosmetic surgeons grubbing out their own careers but by men of principle and honour who can lay before the nation a new and valid vision of Socialism.

13/7/81. pwp 16

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CHANCELLOR

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Mr Burns
Sir Kenneth Couzens
Mr Ryrie
Mr Middleton
Mr Unwin
Mr Aaronson
Mr Andren
Mr Folger
Mr Ridley
Mr Cropper
Mr Cardona
Mr Burgner
Mr Gordon
Mr Wicks
Mr Peretz
Mr Buckley

SUPPLY DEBATE, 15 JANUARY

I attach some revised notes, in separate sections, to which Mr Aaronson and others have contributed, for your supply day debate speech on Thursday. This follows the outline attached to Mr Tolkien's minute of 12 January, the Chancellor's written comments on that outline and his discussion with Mr Aaronson this morning. We have also attempted to take on board the points made by the Chief Secretary and Mr Ridley (their minutes of today) and Mr Cropper. Mr Ridley's note on 'Economic Recovery' has not, however, yet been taken on board but, if you wish, we would do that in the course of tomorrow.

2. A few specific points:

Energy prices. PE recommended against changing this section in the light of Monday's meeting at No.10, which I understand was inconclusive. The Department of Energy do not want the three options being considered to be mentioned at this stage both because industries have not been consulted and for tactical reasons - to leave something in reserve pending the work of this NEDC task force.

<u>Exchange rates</u>. The draft here was supplied by EF who have followed the Chancellor's outline except on item C where they have put forward a somewhat toned down reference to the implications for inflation.

<u>SEMS</u>. I attach (Annex A) a background note on special measures by IP which highlights the rapid recent rise in expenditure on demand determined programme.

<u>Point 16</u>. Mr Cardona is reseaching into suitable quotations from Wilson, Calleghan etc, but I have not yet received any material from him. You will find a few other gaps and om~~m~~issions.

3. It would be most helpful to have your comments on the material as soon as its convenient however, so that we can finalise points of detail and Mr Aaronson can convert it into something closer to speaking note form.

R.A

R I G ALLEN
EB
13 January 1981

CONFIDENTIAL

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pwp

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MR WIGGINS

cc Sir A Rawlinson
Mr Littler
Mr Bridgeman
Mr Unwin
Miss Peirson
Mr Williams

FST's SPEECH

Mr Bridgeman's minute of 15 January picks up two errors of fact in the section on public expenditure, of which point (ii) is the more substantial in the context of the FST's speech.

2. Mr Williams of my division checked the draft for factual errors and he did point out to the FST's office potential dangers if this particular section of the speech should be taken too literally, and out of context. In response to his comments, the wording was changed slightly but unfortunately the general message remained.

R.A

R I G ALLEN
EB
16 January 1981

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with the compliments of

Peter Hordern, MP

CH/EXCHEQUER

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