TREASURY

FILE NUMBER PO - CH/GH/0193 Part A

FOR DISPOSAL ADVICE SEE INSIDE COVER

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DISPOSAL DIRECTIONS	DESTROY AFTER YEARS	RESERVE

FILE BEGINS 10-5-79

ENDS 20-12-79

FILE TITLE

PO - CH/GH/0193 Part A

Waste In Public Expenditure

Completed Box F 23/12/2015

Waste in public expenditure

General papers

1st - ~~PERSONAL INFO~~

2nd - DEFENCE / INT. RELATIONS

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1979

FOR RECORDS SECTION USE ONLY

THIS FOLDER HAS BEEN REGISTERED ON THE REGISTRY SYSTEM

T.R.1.

1

Chancellor

Thursday's motion, as approved by Legislation Cttee.

CAN I NOT HAVE THE DOCS CITED, WITH DRAFT SPEECH

" The Prime Minister

et al

Chancellor
We will get a full set of the documents tomorrow. These are provisional
SEC(79) 1578

EEC BUDGET CONTRIBUTION

That this House takes note of Commission document 9093/79 (= Com (79) 462 final) (a Reference Paper on Budgetary Questions), together with supplementary information in documents 9369/79 and 9721 with Addendum 1, and also Commission document COM(79)620 Final (on Convergence and Budgetary Questions), and fully supports the Prime Minister in her determination to secure from our Community partners an equitable and early reduction in the unacceptably large net contribution by the United Kingdom to the Budget of the European Communities.

Italicised footnote on the Order Paper:-

Commission document 9250/79, and unnumbered documents on the Draft of the General Budget of the European Communities for 1980, and on a Letter of Amendment thereto, are also relevant."

ANNEX

"That this House takes note of Commission document 9093/79 (a Reference Paper on Budgetary Questions), together with supplementary information in documents 9369/79 and 9721 with Addendum 1, and also Commission document COM(79)620 Final (on Convergence and Budgetary Questions), and fully supports the Prime Minister in her a substantial determination to secure from our Community partners ~~an equitable~~ and ~~and~~ early reduction in the unacceptably large net contribution by the United Kingdom to the Budget of the European Communities"

Italicised footnote on the Order Paper:-

"Commission document 9250/79, and unnumbered documents on the Draft of the General Budget of the European Communities for 1980, and on a Letter of Amendment thereto, are also relevant."

"That this House takes note of Commission document 9099/79 (a reference paper on budgetary questions), together with supplementary information in documents 9250/79 and 9?.? with Addendum 1, and also Commission document COM(79)620 Final (on convergence and budgetary questions), and fully supports the Prime Minister in her [illegible] determination to secure from our Community partners an ~~equitable~~ [illegible] and ~~and~~ early reduction in the unacceptably large net contribution by the United Kingdom to the Budget of the European Communities"

[illegible]

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"Commission document 9250/79; and unnumbered documents on the Draft of the General Budget of the European Communities for 1980, and on a letter of Amendment thereto, are also relevant."

C3

CONFIDENTIAL

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

CHANCELLOR

PRESENTATION OF THE BUDGET

1 Dermot Gleeson, acting director of CRD, convened a meeting last night to discuss Presentation of the Budget. Also present, Chris Mockler, Anne Bulloch, David Nicholson and myself.

2 It was agreed there was no time to lose if we wanted to launch a campaign, ahead of the Budget, to create a favourable atmosphere for the Direct/Indirect tax switch.

3 One of the weekly briefing notes will be devoted to this subject.

4 Any input that Ministers can make in the form of speeches or part-speeches on the subject will be helpful, ie as quote material. (Maybe in the Chancellor's speech in the Debate on the Queen's Speech.)

5 David Body from Central Office has also raised the subject.

6 Maybe the question should be raised at a Ministerial 9.00 am meeting.

P J CROPPER

17 May 1979

4

MINISTER OF STATE TREASURY

CHANCELLOR OF THE EXCHEQUER

Budget

May I make an outrageous suggestion.

Petrol (and derv) account for half of the revenue from the increase in specific duties but account for only a quarter of the increase in the RPI.

Suppose we say we don't propose indexing at all this year. But because of Iran, energy policy and queues at the pumps not to mention the fact that if we don't put up the price the oil companies will, we propose putting 9p on petrol (and derv). Increase in yield almost the same but increase in RPI halved.

Arthur Cockfield
18.v.79

PERSONAL AND
CONFIDENTIAL

CH/EXCHEQUER
REC. 17 APR 1979
ACTION
COPIES TO

C
5

10 DOWNING STREET

From the Private Secretary

16 April 1979

Mr. Peter Hennessey: Articles on the Strategic Nuclear Deterrent

The Prime Minister has seen your Secretary of State's minute of 11 April. He agrees that an approach to the Times would not be productive, and is content with the course of action which Mr. Mulley proposes in that minute.

I am copying this letter to Tony Battishill (H.M. Treasury), George Walden (Foreign and Commonwealth Office) and Martin Vile (Cabinet Office).

N. J. SANDERS

Roger Facer, Esq.,
Ministry of Defence.

PERSONAL AND
CONFIDENTIAL

PM

6

[illegible] Mr Jackling (MOD). No distribution.
MAP 12/4

WITH

THE COMPLIMENTS OF THE

PRIVATE SECRETARY

MINISTRY OF DEFENCE, WHITEHALL

Telephone: 01-218 9000
01 218

CONFIDENTIAL PERSONAL C 7

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

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MO 22/8

PRIME MINISTER

MR PETER HENNESSY: ARTICLES ON THE STRATEGIC NUCLEAR DETERRENT

You should be aware that Mr Peter Hennessy has given my Public Relations Department, with a request for security clearance, proofs of two articles (of which // I enclose copies) relating to the British strategic nuclear deterrent and its future. I understand that Mr Hennessy is submitting the articles to The Times for publication on Tuesday, 17th April, if the newspaper re-appears on that day.

2. With the exception of an undesirably precise reference to a building in my Department at Bath, these articles contain nothing that is sensitive on grounds of national security. Nevertheless, and I refer particularly to pages 3 and 4 of the article entitled "Deterrent", they could produce very serious political embarrassment for the Government. I have considered the possibility of an approach at a very high level to The Times, with the aim of dissuading them from publication. After taking account of consultations that have taken place between my officials and Sir John Hunt, I have concluded that, since national security is not at issue, such an approach would not be productive. It could be based only on grounds of embarrassment to the Government, which would be precisely the object of publishing the articles. I am therefore asking my Public Relations Department to inform Mr Hennessy that we are not confirming or denying anything

/ in ...

CONFIDENTIAL
PERSONAL

CONFIDENTIAL PERSONAL

in his draft but simply asking him to amend the one point of defence security significance.

3. I am sending copies of this minute to the Chancellor of the Exchequer, the Foreign and Commonwealth Secretary and Sir John Hunt.

11th April 1979

Private Secretary

Approved by the Secretary of State
and signed in his absence

The National Archives

DEPARTMENT/SERIES T639 PIECE/ITEM 13 (one piece/item number)	Date and sign
Extract details: FOLIO 9	
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Use black or blue pen to complete form.

Use the card for one piece or for each extract removed from a different place within a piece.

Enter the department and series,
eg. HO 405, J 82.

Enter the piece and item references, .
eg. 28, 1079, 84/1, 107/3

Enter extract details if it is an extract rather than a whole piece.
This should be an indication of what the extract is,
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WHITEHALL BREIF

Home News

Submarines - 2

Hennessy

Mr McCaffrey may be a man of influence but he cannot censor old notebooks, the buried treasure of journalism. Two years ago, when the Ministry of Defence was more relaxed about the subject of the nuclear deterrent, it permitted a visit to one of the most sensitive inner sanctums of the defence community, Block C at the Ships Department in Bath.

Nothing that was said or seen there need upset any Cabinet with a rational attitude towards open government. But the issue of the deterrent is not one that stimulates an onrush of reason in ministerial circles at the moment thanks to the Prime Minister's difficulties with his own party about a replacement for Polaris. Those scratchy notes scribbled on a fine August day in the Cotswolds in 1977 and never used have, all of a sudden, become hot property.

The first thing that strikes the visitor to Block C, the "deterrent" hut, is the elaborate security control at its entrance. The second impression is its supreme shabbiness. Block C is part of the long tradition of the Scientific Civil Service housing its people, particularly if they are engaged on important work, in conditions of near squalor. Foxhill Hutments, as the whole collection is poetically named, is a bit of an eyesore and has been ever since it was hastily thrown up as a temporary hospital on a hillside south of Bath in 1938 ready to take the anticipated victims of the Bristol blitz. The Admiralty, as it turned out, got there first.

more

WHITEHALL BREIF

Home News

Submarines – 3

Hennessy

Block C, housing the "corps d'elite" , as the inmates of the other huts descri the deterrent men, actually leaks when it rains, or it did in 1977. The scientists inside it, jolly, herbivorous sort of people, with nothing "mad-bomberish" about them, say they do not mind overmuch, though it is a bit of a nuisance having to move the blueprints around from wet zones to dry to prevent them getting smudged.

Morale is high, they add, because they are in ~~[illegible]~~ no doubt that their work is vital. If they make a mistake in hull design or maintenance, the boats are at the bottom of the ocean with many men lost. Submariners are a tight-knit, interdependent group and this ~~includes~~ includes the scientists who keep their vessels going.

Particularly important to Block C are the four, huge, 7000 ton Resolution Class boats of the 10th Submarine Squadron, based at Faslane, the carriers of the country's 64 Polaris missiles. The fact that there are only four means that the men of Block C have to ensure that none of them is laid up beyond the normal refit time or the certainty of at least one boat, lurking in the thermal layers just south of the Greenland-Iceland-Faroes Gap is lost and the deterrent gone. Without the boffinry in Block C humming away efficeintly the Royal Navy Commander, with his finger on the missile button deep beneath the North Atlantic, will not be in a position to do the right thing for England when all other hope is gone.

more

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WHITEHALL BRIEF

Home News

Submarines - 4

Hennessy

Asked in 1977 what they were doing about a system to succeed Polaris in the 1990's, the scientists replied : "We are not doing any work for the future, but we are thinking about the need for a replacement and how it would look. In a few years time we will think about operational replacements, whether it will be a bigger and better Polaris or a cruise missile or anything at all."

Block C is confident the country can produce submarines to match anything coming out of the Soviet or United States yards at least for the rest of the century. They are in no doubt, too, about the threat posed by the Warsaw Pact. Indeed, so strong are their pro-deterrent feelings, according to a friend of Block C in another part of the defence hierarchy, they will do anything to keep it going even if they have to strap the missile tubes to the Royal Yacht!

ENDS

EXCLUSIVE

FOR MONDAY NIGHT.

13

Home News

Deterrent - 1

By Peter Hennessy

Mr Fred Mulley, Secretary of State for Defence, has provoked a private but outspoken dispute with an all-party Select Committee of the Commons by his refusal to permit serving officers, civil servants and government scientists to give evidence about the options for a third generation British nuclear deterrent to replace the Royal Navy's Polaris submarine squadron.

Feelings between the Ministry of Defence and the Defence and External Affairs Sub-Committee of the Select Committee on Expenditure have become progressively strained over recent months with MP's and their advisers taking the view that the ministry has been niggardly in the provision of documents and witnesses across a range of inquiries. Differences deepened into strongly worded exchanges about the constitutional rights of backbench committees when Mr Mulley made it clear that the only witness form the ministry on the deterrent issue would be himself.

The argument continued until Parliament was dissolved with Mr Mulley determined to avoid widening, through public or private debate, the pronounced rift of opinion within the Labour Party about the desirability of a successor system to Polaris, and the committee increasingly jealous of its rights. A meeting was arranged for March 27 between the committee's chairman, Sir Harwood Harrison, Conservative MP for Eye, its Clerk, Mr Matthew Cooper, Mr Mulley and Sir Frank Cooper, Permanent secretary to the ministry, to air the committee's accumulated grievances.

The meeting was postponed, however, because of the confidence debate in the Commons the next day. Mr Mulley may still reply to the committee's criticisms by letter before polling day. Sir Harwood's last letter to Mr Mulley, drafted by Mr Cooper, in blunt terms, caused offence inside the ministry which feels the committee has exhibited faults of its own in its approach to the deterrent inquiry.

more

Home News

Deterrent - 2

Hennessy

Among the officers and officials debarred by Mr Mulley from attending the committee's private hearings were Sir Neil Cameron, Marshal of the Royal Air Force and Chief of the Defence Staff, Rear Admiral Sir David Scott, Chief of the Polaris Executive, Rear Admiral Ronald Squires, Flag Officer Submarin Admiral Sir Henry Leach, Commander-in-Chief Fleet and Mr David Cardwell, Director of the Atomic Weapons Research Establishment.

The committee's wish to visit the establishment at Aldermaston was also frustrated by Mr Mulley. The ban extended into the academic world when Mr Peter Nailor, Professor of History and International Affairs at the Royal Naval College, Greenwich, and a former Chief Administrative Officer to the Polaris Executive, was forbidden to accept the committee's invitation to appear before it as he remains a civil servant.

The committee's attitude towards the Ministry of Defence has become markedly more robust since last autumn when Mr Cooper, a young military historian with firm views about the rights of MP's, became its Clerk.

The Prime Minister and Mr Mulley have made a consistent effort in recent months to conceal not only from the Select Committee but from most of their party colleagues as well the degree of thinking that has been going on inside Whitehall on the deterrent issue in the past 15 months. The reason for this is the Labour Party's 1974 election manifesto which pledged "we have renounced any intention of moving to a new generation of strategic nuclear weapons".

Home News

Deterrent - 3

Hennessy

Early in 1978 the Ministry of Defence and the Foreign and Commonwealth Office sought ministerial approval for the preparation of studies of possible systems to replace Polaris in the 1990's. The Prime Minister convened a small ad hoc group of colleagues which gave permission for work to begin.

The ministerial group has met from time to time since, with its prime and most urgent concern being the modernisation of Nato theatre nuclear weapons in the early 1980's when Britian's Vulcan bomber force will have been withdrawn. It also considered papers on a third generation Strategic nuclear deterrent as and when the Civil Service completed them.

Of the four ministers belonging to the group, the Prime Minister is thought to favour a replacement for Polaris as is Dr David Owen, the Foreign Secretary. Mr Denis Healey feels the same way though, as Chancellor of the Exchequer, has some worries about costs. Mr Mulley is thought to be agnostic on the issue. Institutionally, as Secretary of State for Defence, he is is in favour of sustaining the deterrent into the 21st century, but intellectually he is against.

Mr Callaghan's desire to wean his party from its unequivocal stand of 1974 was reflected in the wording of the 1979 election manifesto, the deterrent passage of which reads :

> "In 1974, we renounced any intention of moving towards the production of a new generation of nuclear weapons or a successor to the Polaris nuclear force; we reiterate our belief that this is the best course for Britain. But many great issues affecting our allies and the world are involved, and a new round of strategic arms limitation negotiations will soon begin. We think it is essential that there must be a full and informed debate about these issues in the country before any decision is taken".

more

Home News

Deterrent - 4

Hennessy

No decisions have been taken and no formal negotiations with the United States begun. But the ministerial group is thought to be clear in its collective mind that a successor system to Polaris would have to be submarine borne. Great pains have been taken to conceal this thinking from the full Cabinet and its Defence and Oversea (sic) Policy Committee, which contains ministers likely to be rigid about maintaining the spirit and the letter of the 1974 manifesto commitment.

At official level two committees have been involved in preparing papers on a new deterrent for the ministerial meeting. The first, a political-military group, chaired by Sir Anthony Duff, a deputy secretary at the Foreign Office, includes among its membership Sir Clive Rose and Mr Clive Whitmore from the Cabinet Office, and Mr Michael Quinlan and Professor Ronald Mason from the Ministry of Defence. It has produced a lengthy study arguing the pro's and con's of a British strategic deterrent in the 1990's and beyond.

A second scientific group, chaired by Professor Mason, Chief Scientist to the Ministry of Defence, drafted a paper on the technical options. Both ministerial and official meetings have proceeded in the knowledge that the signing of the strategic arms limitation agreement, SALT II, will not impede the purchase of weaponry and experience from the United States provided a new British system remained about the same in destructive power as the Polaris squadron.

Should a Conservative government inherit the files produced by the committees chaired by Sir Anthony Duff and Professor Mason, they are certain to authorise the procurement of a new generation of strategic deterrent. The decision will be taken at Cabinet level by the end of 1980.

ENDS

CONFIDENTIAL

17

20 MAY 1979

HOUSE OF COMMONS
LONDON S.W.1.A. 0.A.A.

CHANCELLOR OF THE EXCHEQUER

cc as appropriate

Dear Geoffrey

You asked for comments on the draft speech for to-morrow attached to Mr Unwin's minute of 16th May.

I do not think it is quite right yet.

There are a number of unnecessary political traps - at least in House of Commons terms - in the early sections. I am thinking in particular of paragraphs 7, 9 & 11.

More important, there is not nearly enough emphasis on the appalling nature of our inheritance. Only 10 out of 42 paragraphs are devoted to this, and these 10 are too weak. If the speech is delivered as drafted, both the House and the press - making the invetitable allowance for political hyperbole, and in the light of expectations already aroused - will inevitably conclude that the inheritance is not really so bad, after all. Nor is there any reason to fear that, by strengthening this section, you would follow the unhappy precedent of the incoming Labour Government of 1964 and trigger off a massive run on the £. Those who draw this parallel are ignoring the total transformation in the position of sterling since 1964 - thanks largely to North Sea oil and the weakness of the dollar.

As for paragraph 4 of Mr Unwin's minute, perhaps I may arbitrate between him and the Minister of State. I am sure the MST is right, and that you should use the 13.2% figure for the current rate of inflation, this being the annualised rate of the past 6 months, excluding seasonal foods. On innumerable occasions in the past, both implicitly in the Treasury's Economic Progress Report, and explicitly in Written Answers by the previous Chief Secretary, the Treasury has insisted that this concept is the best available indicator of the current rate of inflation. It may not be perfect for the reason Mr Unwin states, but it is less imperfect than the annual figure, which goes back over too long a period. It is also worth pointing out that the figure for the six months to April is less 'distorted' this year than it would normally be, since it excludes the 'standard' Budget revalorisation of the specific duties & the consequent RPI effect of this.

17

CONFIDENTIAL

20 MAY 1979

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LONDON S.W.1.A. 0.A.A.

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18

CONFIDENTIAL

HOUSE OF COMMONS
LONDON S.W.1.A. 0.A.A.

Finally, Mr Unwin is of course right in saying that UK inflation is not at the top of the OECD range. It is equally true, however, that - taking th latest UK figures into account - UK inflation is nearer the top of the OECD range than it is to the bottom, and is rising. There is also the important "inheritance" point about the very substantial nationalised industry price rises in the pipeline, which had been deliberately held back by the previous Government until after the election.

Yours ever
Nigel

NIGEL LAWSON

Postscript6 In general, the draft could do with a somewhat sharper political cutting edge. At this stage, the simplest way of achieving this would probably be to insert one or two telling quotations from your predecessor, which CRD could readily supply. An apposite quotation (one of many) is also to be found in Edmund Dell's excellent LSE lecture of 10 May, in which - reflecting on the Labour Cabinet in which he served - he said:

> "The structure of Government in this country reinforces pressure for high public expenditure and the lack of any constitutional limit on borrowing reduces the pressure on a Government to face up at once to the ~~XXXXXXXXXX~~ tax consequences of its profligacy."

NL.

N.L.

18

CONFIDENTIAL

HOUSE OF COMMONS
LONDON S.W.1.A. 0.A.A.

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NIGEL LAWSON

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N.L.

√ ASP 19

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

CHANCELLOR

INDEPENDENT TAXATION OF HUSBAND AND WIFE

Sir William Pile's letter of 15th May 1979

I have only so far been able to glance through the Inland Revenue's note accompanying Sir William's letter, but it is clear that an early decision is sought on Green Paper publication.

2. Sir William sees this as one of those changes in the Inland Revenue system where the switch could be made in any year up to 1983/84 on a manual basis; but where if that dateline is missed there will then be a closed season until computerisation is completed in "the late 80s".

3. If the target were to be implementation in financial year 1983/84, then the timetable would become:

Green Paper publication	October 1979
Select Committee set up	December 1979
Select Committee reporting	December 1980
Legislation	1981

4. Sir William asks four questions in paragraph 2 of his letter of 15th May, to which I suggest you could answer:

a. Please continue work on examining options.

b. We do wish a Green Paper; indeed we are committed to publishing one.

20

c. The Green Paper should go wider than husband and wife, covering in particular the widow, the single parent and child care expenses.

d. We can only discuss the timing of implementation in the context of a wider discussion on computerisation. But meantime the consultation must go ahead.

As regards c. above, I note that Sir William Pile hopes for a more restrictive approach, concentrating on just the taxation of husband and wife. After all our trouble in Opposition with widows and single parents I imagine you would prefer a wider reference.

PJC.

P J CROPPER

21st May 1979

C PY. 21

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

CHANCELLOR

HEALTH SERVICE CHARGES

A message from Charles Bellairs recommends very strongly that if it is proposed to raise NHS charges (and he is fully in favour of doing so) it would be most unwise to do it in the Budget, where the linkage with tax cuts for the rich would be too easy for the Labour Party to latch on to. Charles suggests doing it in early September when people are not, by and large, thinking about illness. One might add: an early September announcement could be synchronised with big income tax repayments.

P J CROPPER

21 May 1979

PM. C 22

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

CHANCELLOR

MR DELL'S LSE LECTURE 10TH MAY 1979

Full of good quotes against his wilder colleagues, Mr Dell's lecture makes two crucial points:

1. Governments in the UK are too large (ie Cabinets) and they take on themselves for political reasons responsibilities that they would be better without.

2. The Treasury is too weak, not too strong. "There are some key economic decisions which it is right for the Chancellor of the Exchequer to take in agreement with the Prime Minister alone, and the level of public expenditure and of public borrowing are among these."

P J CROPPER

22 May 1979

11 23

2

CHANCELLOR OF THE EXCHEQUER

LUNCH WITH SAM BRITTAN

I had an enjoyable and somewhat discursive lunch with Sam Brittan, in the course of which a number of issues emerged in a rather disorganised way. As far as I can see, he has a generalised anxiety about RPI increases which might disturb inflationary expectations. But he could not be pinned down in any way on figures! I think that to some extent this anxiety is no more than the rationalisation of his view that there is relatively little case for a reduction in the standard rate of income tax. In his view what matters is to reduce the other rates and to raise thresholds. I think his judgment arises from a feeling that all that is at stake is a cut of a point or two, at considerable expense in revenue. I emphasised to him on several occasions that we were not talking about small cuts, but of a programme of large cuts extending over several years, on a scale which he had probably not contemplated.

2. He also expressed great interest and anxiety about the suppression of energy prices. I should not be surprised if he turned his attention to the case for higher duties and prices in the relevant energi~~es.~~y industries.

AN

A N RIDLEY

23rd May 1979

24

cc Chief Secretary
Financial Secretary

CHANCELLOR OF THE EXCHEQUER

ABOLITION OF THE EARNINGS RULE

You will recently have received two notes on this subject, one from Mr Kemp, dated May 21st, and another from Sir Anthony Rawlinson. My own, purely political, advice would be that, whatever the eccentricity of the reluctance of Patrick Jenkin to ask for a move towards abolition in this financial year, it is politically a most desirable thing to do. Why he did not advocate it this year, having championed it for so long in Opposition, is beyond comprehension! Furthermore, it is a valuable, if not very large step towards reducing the disincentives which clutter the tax field wherever one looks. While it may be odd for the Treasury to apparently gratuitously volunteer extra expenditure, there is nothing to suggest that it is wrong, let alone that it would be unpopular with colleagues.

2. There is, then, the question of cost. While we are operating with a ceiling on growth of public expenditure, it is obviously the case that the gross increase in government expenditure attributable to relieving the earnings rule would require net reductions elsewhere. Hence it is inevitable that offsetting savings would have to be found elsewhere if this expenditure is not to be allowed to cut back the Contingency Reserve. However the costings which the Treasury have, in the past, produced for the net impact of reducing the earnings rule on overall public finances have never been persuasive. I think we should be cautious about disowning our own work in Opposition without having a fairly careful critique done of the Mockler-Clarke paper. Would you agree to this work being put in hand?

AR

A N RIDLEY
23rd May 1979

PM 25

CHIEF SECRETARY TO THE TREASURY

CHANCELLOR OF THE EXCHEQUER

cc. Financial Secretary
Mr Ridley

?

ABOLITION OF THE EARNINGS RULE

The Chief Secretary has seen Mr Ridley's minute of 23 May and has commented:-

> "Please - let the Secretary of State for Social Services be responsible for his political timing!"

R. Watts

pp A C PIRIE
29th May 1979

26

DRAFT

MINISTERS OF STATE (COMMONS AND LORDS)

EXPERT TAX ADVISERS

1. During the five years of Opposition, the Conservative Party finance team received invaluable assistance from a team of outside tax experts - principally from Keith Carmichael, John Avery Jones, Bruce Sutherland, John Chown and Milo Kerr. Others helped from time to time.

2. The view has been expressed that:

i. we owe it to that group to involve them in some way in the activities of the Party now that it in office, and

ii. more positively, we would be foolish to cut ourselves off from their advice, even though we do now have the Civil Service at our disposal.

3. The present Chancellor has already committed himself to open government in the field of taxation (see the Addington Society lecture of February 1977). The first motto of any Chancellor should be, he said, "consult now and draft later".

4. Sir Geoffrey Howe has ruled out the idea of a Royal Commission on tax reform because of the time lag involved; furthermore it is only certain parts of the tax system that are felt to be in need of major overhaul, eg capital taxation, company taxation and family taxation.

5. The main consultative device is seen as the Green or White Paper, or draft Bill - with sometimes a reference to a Select Committee of the House of Commons. This process provides ample scope for the government of the day to set out its own approach

on a major tax problem, to hear the views of the public, the experts and the parliamentarians, and then to legislate accordingly The advice of our Finance Bill team could well be useful at the stage when a Green Paper is being planned and drafted, as well as at the consultative stage.

6. The Addington Society lecture raised the possibility of a regular separation of the present Finance Bill into two parts - a Finance Bill containing major general tax changes (rates and thresholds in particular) and a Tax Management Bill dealing with technicalities, anti-avoidance measures, and administrative rules. Items proposed for the Tax Management Bill would not, by their nature, need to be subject to strict rules of Budget secrecy; hence it would be possible to subject them to careful consideration not only by the House of Commons but also by experts and interested parties over a period of time.

7. The lecture also explored the possibility of a regularly appointed Select Committee, with special and continuous responsibility for the tax system. This body might conceivably include some non-parliamentary members or assessors; our expert advisers would make good candidates.

8. Thirdly, where ongoing administrative problems are concerned, involving the tone and style of the Inland Revenue and Customs & Excise, the practical experience of our Finance Bill team (gained in their every-day professional work) could be invaluable.

9. It is tempting to suggest that our existing team of five advisers should simply be converted into a formal advisory committee, to whom Green Paper drafts might be referred in course of preparation, and who would be integrally involved in the preparation of Tax Management legislation. However this might raise constitutional problems; it could be argued that any such formal body should be representative of various interests. Indeed

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it might even end up with its statutory trade unions. This would be to destroy the instrument that we actually find in our hands - a compact group of practitioners who have worked together over a lengthy period, who know each other's minds and who know the minds of the ministerial team.

10. The preferable answer is almost certainly to retain an informal structure for the group. My suggestion would be that, if ministerial time could be found for a regular commitment, the advisers should be brought together, say, three times a year - either at the Treasury or over dinner - to discuss with Ministers the progress and development of the ideas which were set going during Opposition. The timing of these meetings might be

i. September/October, when the new year's policy work is being launched in the Departments.

ii. February, when legislation is beginning to take formal shape.

iii. June, when the Finance Bill has just been published.

It could be one of my responsibilities, to organise and minute the business of these meetings, and I could provide the channel through which the advisers might be consulted on an ad hoc basis in between meetings.

11. I am not certain whether the group ought to be recompensed financially, or whether the members would find their relationship with Whitehall would bring its own reward in professional kudos. (Our thanks might find occasional expression at New Year.) Neither am I sure whether the goup would need an official title or status. At an earlier stage I was arguing for establishment of a "Conservative Tax Committee" which I might have run as secretary

from a base in the Research Department. The same title could be adopted now, but even that might leave us open to pressure from the Party organisation to include other experts who might not fit in personal terms.

12. In short, best results would probably be achieved by simply leaving things as they are - a group of enthusiasts who are invited to come together regularly for a good dinner and who can be informally consulted from time to time. This would need the minimum of planning and a start could be made with a dinner meeting some time before the summer recess.

P J CROPPER

29th May 1979

CONFIDENTIAL

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MR CROPPER
EXPERT TAX ADVISERS

cc Minister of State (Lords)

I have seen your draft paper of 29 May embodying proposals for keeping in contact with those who were so helpful to us in tax matters in Opposition. I have little to add to the draft which seems to me to cover the ground excellently. I am sure it is right that we should not cut ourselves off from the advice of these people and that the best results would be achieved by ensuring that we are available for informal discussions from time to time. My own feeling is that a suitable time for the first of these discussions would be after the Budget but before the Committee Stage of the Finance Bill.

In addition, some early form of hospitality seems to be indicated - possibly at No 11?

PR.

PETER REES
30 May, 1979

CONFIDENTIAL

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MR CROPPER

cc Mr Peter Rees

Expert Tax Advisers

1. I agree we should - and ought - to keep in touch.

2. I agree that a formalized arrangement will lead to difficulties.

3. The proposal for informal but fairly regular meetings seems to me to be a good one.

Arthur Cockfield

LORD COCKFIELD
30 May 1979

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CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir Douglas Wass
Sir Lawrence Airey
Mr Littler
Mr Bridgeman
Mr Unwin
Mr Ridley

BRIEFING ON MR HEALEY'S POINTS ON "WORLD AT ONE"

I attach briefing, for use in the House this afternoon if the arguments put forward in Mr Healey's interview on 12 November are repeated in questions after the statement. Such briefing was commissioned in Mr Hall's minute of yesterday.

M T FOLGER
15 November 1979

62.15.1

Government should make good "a shortfall in demand"

This suggestion demonstrates that, like the Bourbons, the RHG has learned nothing. Governments worldwide now see that inflation is the number one enemy and that attempts to manage demand, whilst they may give politically attractive results in the short run, make it much harder to bring inflation down. This government certainly has no intention of pursuing the soft option of an "expansionary" fiscal policy with all that would imply for monetary growth and the long term health of the economy.

Government should have "some sort of policy for incomes"

We have a policy for incomes: free bargaining by employers and unions on the basis of what the firm can afford in its own circumstances. We want sense and reason in the way people bargain on pay and our monetary policy provides the right framework for that. We do not intend to embark on the road of institutionalised "incomes policy". I am surprised that Members opposite would have us go down that road after the country's disastrous experience with the 5% regime last winter.

The Government's Expenditure Plans 1980-81

NOT FOR PUBLICATION BROADCAST OR
USE ON CLUB TAPES BEFORE 1530 HOURS THURSDAY 1 NOV 1979
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Presented to Parliament by the Chancellor of the Exchequer
by Command of Her Majesty
November 1979

LONDON
HER MAJESTY'S STATIONERY OFFICE
70p net

Cmnd. 7746

ISBN 0 10 177460 5

THE GOVERNMENT'S EXPENDITURE PLANS 1980–81

1. Public expenditure is at the heart of Britain's present economic difficulties.

2. For a long time now the performance of the British economy has been deteriorating. Over the past five years output has grown less than half as fast as it did over the previous 20 years, and little over a third as fast as in other industrialised countries. Without the contribution of North Sea oil there would have been scarcely any growth in output or productivity at all. Inflation has been at record levels, and has acquired strong momentum.

3. Over the years public spending has been increased on assumptions about economic growth which have not been achieved. The inevitable result has been a growing burden of taxes and borrowing.

—Increases in taxes have made inflationary pressures worse and reduced incentives.

—High Government borrowing has fuelled inflation, complicated the task of controlling the money supply, raised interest rates and thus denied the wealth-creating sectors some of the external finance they need for expansion.

—High inflation has increased the risks and uncertainty faced by both employer and employee and gravely damaged investment, production and jobs.

If this continued, our economy would be threatened with endemic inflation and economic decline.

4. In deciding their spending plans for 1980–81 the Government have had in mind three central objectives:

—First, to bring down the rate of inflation. To achieve this it is essential to contain and reduce progressively the growth of the money supply. This means that Government borrowing must in turn be firmly controlled. It is a main determinant of monetary growth.

—Second, to restore incentives. This means that the Government must hold down and if possible reduce taxes, particularly on incomes.

—Third, to plan for spending which is not only compatible with the necessary objectives for taxation and borrowing, but is also based on a realistic assessment of the prospects for economic growth.

5. The immediate prospects for output are poor both in this country and in the rest of the world. The growth of world trade is low. The recent increase in the oil price has made matters worse.

6. The Government's economic strategy must be to stabilise public spending for the time being. Unless this is done there can be no possibility of lower taxes, lower borrowing or lower interest rates.

7. For 1980–81 the previous Government's plans involved a level of expenditure which could not be sustained. Even leaving out of account the likely cost of "catching-up" pay settlements in the public services, their published plans were £3½ billion higher than the spending now planned

for 1979–80[1]. To pay for this increase would have required sharply higher taxes or borrowing on a scale which, if possible at all, would mean higher interest rates or an excessive growth of the money supply and more inflation. (The increase in the basic rate of income tax required to raise an additional £3½ billion of revenue is about 8p.) Any of these would damage our growth prospects still further—and, in so doing, the prospects for higher spending on our public services in future.

8. To limit severely the resources devoted to our public services for the time being is not to deny that many of them need improvement. It is rather to recognise that the only way in which that improvement can be secured is to earn the money and resources by higher output. But higher output can only come from lower taxes, lower interest rates and less Government borrowing, and better use of investment. To plan more public expenditure before the required output is available to support it would ensure that, in the event, that growth of output does not take place. Higher public expenditure cannot any longer be allowed to precede, and thus prevent, growth in the private sector.

9. Total expenditure now planned for 1980–81 is shown in Table 1. The Government have provided for growth in some programmes, particularly defence, law and order, and social security (reflecting among other things this year's record pensions uprating). Within the total, reductions have therefore been made in other services. The plans for later years will be published in a later White Paper.

10. The figures in Table 1 for 1979–80 include the public expenditure reductions announced in the Budget. The outturn is still uncertain, particularly on local authority expenditure which the Government do not directly control. The present estimate is that the planning total of public expenditure after shortfall will be about the same as in 1978–79.

11. Figures for the main programmes are set out in Table 2. Brief comments on the individual programmes follow in paragraphs 16–42. Where appropriate, the Ministers concerned will be announcing further details. Capital expenditure on construction, including expenditure by the nationalised industries, is likely to be rather less than £7 billion in each of the last three years shown.

Local authorities

12. The broad breakdown of local authority current expenditure between services, incorporated in Table 2, is consistent with the pattern of individual programmes discussed in paragraphs 16 to 42, which reflect the Government's view of national priorities between and within services in 1980–81. However, the figures are necessarily tentative since it is for individual local authorities to decide the eventual distribution in the light of local needs and conditions. The distribution which has been assumed is set out in Table 3. The planned levels for capital expenditure in 1980–81 are some 8 per cent lower than in 1978–79, and 9 per cent less than the outturn at present estimated for the current year.

13. The outturn of local authority current expenditure in 1979–80 cannot yet be estimated. The figures for current expenditure in 1979–80 therefore

[1] At 1979 survey prices.

still reflect the levels of expenditure planned at the time of the Rate Support Grant settlement in November 1978. But local authorities have been asked to achieve economies which would result in a lower outturn for 1979–80; for England and Wales the Secretaries of State asked authorities to reduce their expenditure to 3 per cent below the previously planned level.

Special sales of assets

14. As announced in the Budget speech, the Government is intending to raise some £1 billion from sale of assets owned by the public sector in the current year, as a contribution to reducing the public sector borrowing requirement. Measures for raising this sum are in hand. The target for the corresponding reduction in the public sector borrowing requirement in 1980–81 is £½ billion.

Civil service staff costs

15. The civil service staff costs included in the 1980–81 programme take account of the revised manpower levels resulting from the adjustment to the current year's cash limits and the changes in public expenditure programmes both in 1979–80 and 1980–81. They do not, however, allow for additional savings resulting from the review of the size and cost of the civil service announced by the Minister of State, Civil Service Department, on 11 June; these will be announced in due course.

The individual programmes

All expenditure figures in the following paragraphs are at constant, 1979 survey prices.

Defence

16. The defence programme figure of £8062 million represents a 3 per cent increase over estimated outturn for the current year; this estimated outturn is in line with the cash limit. The figure for 1980–81 reflects the Government's determination to give priority to strengthening the nation's defences, within the framework of the NATO Alliance, and at the same time to achieve maximum value for money within the resources available.

Overseas aid and other overseas services

17. Overseas aid will be at about the same level in 1980–81 as in the current year. Similarly, the provision for other overseas services is planned to continue at much the present level (except that the current year includes contingent provision for UN peace-keeping operations, and once-for-all grants of military aid to two Commonwealth countries). In order to tailor activities to this level of expenditure, 23 overseas posts will be closed or reduced in size and other FCO services curtailed.

18. The provision for net contributions to the European Communities and to the European Investment Bank rises from about £920 million in 1979–80 to about £1000 million in 1980–81, representing the full estimated net cost to the United Kingdom under present arrangements; it demonstrates the strength of the Government's case in pressing our Community partners to accept without delay a fundamental change in these arrangements.

Agriculture, fisheries, food and forestry

19. The provision made for expenditure on EEC-financed market support policies allows for an increase of £84 million compared with 1979–80. In the rest of the programme there is a net reduction of £77 million as a result of sales of land and changes in various services and their uptake, partly offset by provision for some increase in expenditure on fisheries. (The forecasts for expenditure for 1979–80, however, on which these comparisons are based, include payments due in 1978–79 but delayed by industrial action; if allowance is made for these the £77 million reduction becomes £40 million. Similar delays affected some other programmes, but not to the same extent.)

Industry, energy, trade and employment

20. Expenditure by the Department of Industry in 1980–81 on industrial support will be slightly below the level now planned for 1979–80. The policy changes announced by the Government on regional and selective assistance, and on the National Enterprise Board, affect both of these years but the full savings will be achieved after 1980–81.

21. Selective assistance by the Department of Energy to certain industries under Section 8 of the Industry Act 1972 and assistance to the nationalised industries, mainly coal, will continue to be provided. This programme also provides for the United Kingdom Atomic Energy Authority's research and development work in the nuclear field and for the Department of Energy's expenditure on energy conservation, research and development activities.

22. ECGD expenditure is expected to increase by £156 million which reflects the once-for-all reduction achieved in 1979–80 by the Trustee Savings Banks taking over some £200 million of outstanding refinance.

23. The abolition of the Price Commission, which is expected to save £3 million in 1979–80, should produce a full year's saving of £7 million in 1980–81.

24. The provision for 1980–81 for measures operated by the Manpower Services Commission is held broadly at the reduced level for 1979–80. No provision is made for the extension of the Small Firms Employment Subsidy, the Job Release Scheme, or the Temporary Short-Time Working Scheme which are due to close for applications in March 1980. The statutory short-time working scheme proposed by the previous Government has been dropped.

Nationalised industries

25. The public expenditure planning total includes the industries' borrowing from all sources (line 9 of table 1 as well as Government lending in table 2). The level planned for 1980–81 represents a reduction of £450 million on the expected figure for the current year (though a substantial part of the reduction results from the delay from the current year in payment of telephone bills as a result of the recent strike of computer operators in the Post Office). No allowance is made in these figures for the Government's plans for special sales of assets, the proceeds of which are included separately in line 10 of table 1 (see paragraph 14 above).

Roads and transport

26. The roads and transport programme will be reduced by some £200 million compared with 1979–80 and the reductions will be spread widely across the programme. Local transport expenditure accounts for just over half the programme and it is the Government's intention that about half the total reduction should come from this. There will be a reduction in central government expenditure on the motorway and trunk roads programme from the level previously planned, but there will be a switch within this programme to permit increased expenditure on motorway maintenance. Roughly half of the overall change will result from a reduction in central government subsidies to transport industries, the bulk of which will reflect changes in the arrangements for the funding of British Rail and National Freight Corporation pension schemes. There will also be small reductions in new bus grants, ports investment and transport research.

Housing

27. Public expenditure on housing is expected to increase between 1978–79 and 1979–80 by about £150 million. It will then fall in 1980–81 by about £300 million to about £5,080 million. *Capital* expenditure will be broadly unchanged between 1978–79 and 1979–80 but will fall in 1980–81 by some £280 million. The reduction compared with 1978–79 reflects the expected decline in local authority new housebuilding which will result from a change in local authorities' priorities.

28. *Current* expenditure, chiefly subsidies to public sector housing, is expected to show a small decrease in 1980–81, following an increase of about £150 million in 1979–80 which is partly attributable to a rise in interest rates since 1978–79. Over a period of years the Government intend to reduce further the level of housing subsidies, which at present cost taxpayers and ratepayers £1·5 billion—nearly a third of all public expenditure on housing. This will be assisted by the new subsidy system for England and Wales, which will start in 1981–82 and relate subsidies more directly to need.

Other environmental services

29. The amount included for 1980–81 for this miscellaneous group of services, mainly provided by local authorities, takes account of savings arising from the Government's decision to abolish the Community Land Scheme. Legislation will be introduced to enable local authorities to reduce their net expenditure on local environmental services by charging for planning applications and for the enforcement of building regulations. Capital investment on water and sewerage services is planned to continue at broadly the same level as in 1979–80. Expenditure on the Urban Programme will be at a higher level than is now expected in 1979–80. Capital expenditure on local environmental services is less than the prospective outturn for 1979–80. Expenditure on the Thames Barrier will increase by £28 million with a view to completing the project in 1982.

Law, order and protective services

30. Planned expenditure on this programme will increase to reflect the Government's decision to give priority to law and order. Total provision

in 1980–81 will thus be £2,542 million, £23 million higher than the provision for that year planned by the previous Government and £88 million higher than expected expenditure in 1979–80. This does not however include any net expenditure which may arise from the recommendations of the inquiry into the United Kingdom prison services or from the Royal Commission on Legal Services. Included in the total is provision for additional central government expenditure on court services and other legal services, including legal aid, and on prisons. In England and Wales expenditure on the police will be increased to allow an increase in strength to 115,500 officers by March 1981 with increases in supporting staff and services both locally and centrally. If this estimate for numbers of police officers is exceeded, further provision will be made from the contingency reserve. The planned expenditure will also enable local authorities to increase their provision for the probation and after-care service and magistrates' courts; and, in the fire service, will enable existing standards of fire cover to be maintained. In Scotland, additions for these services will be made commensurate with the totals in England and Wales.

Education and science, arts and libraries

Education and science

31. The Government are committed to promoting higher standards of achievement. The number of pupils in schools will be falling but account has been taken, both in teaching and in non-teaching expenditure, of the inescapable diseconomies of smaller scale. The figures in the programme provide for the employment of some 505,000 teachers in 1980–81 (compared with about 526,000 in 1978–79), sufficient for the present level of induction and in-service training to be maintained. It will be necessary to step up the rate at which surplus school places are taken out of use. It should be possible to maintain expenditure on the under-fives at about the present level.

32. The Government expect expenditure savings of some £240 million to be made on school meals, milk and transport. Parliament will be asked to give local authorities greater discretion in the nature of and charges for these services.

33. Some modest expansion of non-advanced further education, especially vocational courses, should be possible to meet rising numbers aged 16 to 18. The resources available for home students in higher education will be about the same as in 1979–80. New overseas students or their sponsors will be expected in future to meet the full cost of their tuition.

34. There will be no reduction in the provision for capital expenditure on school basic need but building programmes for school improvements, under-fives and further and higher education will be reduced by about half.

35. Provision for science at just over £300 million will be slightly less than in 1979–80.

Arts and libraries

36. Direct central government expenditure in support of museums, libraries and the live arts in 1980–81 should allow a continuation of activities at a level broadly comparable to what has been possible in the current year. Planned expenditure includes the contribution of the Office of Arts and Libraries to the £15·5 million to be provided for the new National Heritage Fund and for acceptances of works of art in lieu of tax. Local authority expenditure on libraries, museums and art galleries will fall to the extent that local authorities' provision for these services reflects the reductions in planned local authority expenditure in general.

Health and personal social services

37. The Government plans to maintain spending on the National Health Service in 1980–81 at the level proposed by the last Administration. However, the net cost to the taxpayer will be reduced by increased recovery under the Road Traffic Act 1972 of the cost of treating the victims of road accidents, by increasing prescription charges to 70p from April 1980, by revising dental charges so as to maintain their 1979–80 level in real terms, and by limited changes in the welfare milk scheme. Gross expenditure will be about 3 per cent above the 1978–79 outturn. Measures which are being taken to eliminate waste and to simplify administration in the National Health Service will enable the available resources to be channelled more into direct patient care.

38. Spending on the local authority personal social services is likely to be reduced. The Government expect that savings will as far as possible be made by further increases in efficiency, by reducing or eliminating low priority provision, by developing policies designed to help people to help themselves and others, and by promoting collaboration with the voluntary sector. Where reductions in standards of provision prove necessary, authorities will be relied upon to implement these in ways which protect the most vulnerable. Authorities have also been asked to give priority as far as possible to those services for children which are concerned with the prevention and treatment of delinquency. Joint finance will continue at the level planned.

Social security

39. Expenditure on social security reflects the numbers who qualify for and claim the benefits, which are in turn influenced by the course of the economy and demographic variations. The figures reflect the Government's intention to intensify efforts against fraud and abuse of the social security system.

Other public services

40. The principal expenditure in this programme is on revenue collection by Inland Revenue and Customs and Excise, and is mainly related to staff. In 1979–80 the programme included £26 million for the cost of the Parliamentary and European elections. For 1980–81 there are small increases for financial administration and population surveys (preparation for 1981 census).

Common services

41. The provision for civil service superannuation, which is £28 million higher than for 1979–80, assumes some increase in the number of pensions in payment and their average level. Expenditure by the Property Services Agency on the Government office estate in the UK will be reduced by cuts in expenditure on major new works (mainly on new offices following the decision to reduce the dispersal of Government work from south-east England) and also by reductions in minor works, furniture, rent, maintenance and running costs.

Northern Ireland

42. The Northern Ireland total for 1980–81 reflects, among other changes, the consequences of decisions taken on public expenditure in 1979–80, including the application to Northern Ireland of measures such as the increase in health charges. Expenditure on law and order in Northern Ireland will rise to ensure that the necessary resources are available to combat terrorism.

PUBLIC EXPENDITURE 1974–75 TO 1980–81

Table 1 — £ million at 1979 survey prices

	1974–75 Outturn	1975–76 Outturn	1976–77 Outturn	1977–78 Outturn	1978–79 Provisional outturn	1979–80 Expected outturn	1980–81 Plans
1. Central government	48,139	49,016	47,700	46,080	49,882	51,985	51,857
2. Local authorities	20,662	20,576	19,463	18,373	18,427	18,693	17,850
3. Certain public corporations	1,401	1,460	1,328	1,083	1,012	1,098	1,022
4. Expenditure on programmes	70,202	71,052	68,490	65,536	69,321	71,776	70,729
5. Contingency reserve	—	—	—	—	—	271(*a*)	750
6. Debt interest	1,298	1,569	2,041	2,375	2,921	3,100	3,200
7. Total public expenditure before shortfall and special sales of assets	71,500	72,621	70,531	67,911	72,242	75,147	74,679
8. Expenditure on programmes and contingency reserve (4 + 5)	70,202	71,052	68,490	65,536	69,321	72,047	71,479
9. Net overseas and market borrowing of nationalised industries(*b*)	1,388	770	1,567	1,009	446	–500	–150
10. Special sales of assets(*c*)	—	—	—	–697	—	–1,000	–500
11. Planning total(*d*)	—	—	—	—	—	70,547	70,829
12. General allowance for shortfall	—	—	—	—	—	–750	–1,000
13. Outturn (actual or projected)	71,590	71,822	70,057	65,848	69,767	69,797	69,829
Percentage change on previous year	—	*+0·3*	*–2·5*	*–6·0*	*+6·0*	*0·0*	*0·0*

(*a*) Balance remaining at 31 October 1979 in the contingency reserve for the current year.

(*b*) Includes short-term borrowing and capital value of leased assets, which were not included in the planning totals in Cmnd. 7439.

(*c*) See paragraph 14. The precise treatment of the sales in relation to public expenditure and the public sector borrowing requirement depends on the exact nature of the transactions.

(*d*) The planning total (line 11) differs from total public expenditure (line 7) by excluding debt interest (line 6) but including all net borrowing by the nationalised industries (*i.e.* including line 9 as well as Government lending to nationalised industries in line 1) and special sales of assets (line 10).

PUBLIC EXPENDITURE BY PROGRAMME: 1974–75 TO 1980–81

Table 2 £ million at 1979 survey figures

	1974–75 Outturn	1975–76 Outturn	1976–77 Outturn	1977–78 Outturn	1978–79 Provisional outturn	1979–80 Expected outturn	1980–81 Plans
1. Defence	7,462	7,830	7,721	7,550	7,509	7,824	8,062
2. Overseas aid and other overseas services:							
Overseas aid...	628	699	671	718	786	790	782
EEC contributions	−13	16	281	632	774	919	1,000
Other overseas services	699	412	393	486	400	426	409
3. Agriculture, fisheries, food and forestry ...	2,454	2,210	1,394	1,068	896	986	993
4. Industry, energy, trade and employment(*a*) ...	5,213	4,300	3,886	2,461	3,267	2,753	2,870
5. Government lending to NIs	1,187	1,450	351	−238	693	1,700	900
6. Roads and transport	3,820	3,913	3,505	3,023	2,980	3,118	2,914
7. Housing	7,141	6,293	6,253	5,507	5,226	5,380	5,078
8. Other environmental services	3,541	3,703	3,344	3,262	3,330	3,303	3,213
9. Law, order and protective services	2,172	2,311	2,352	2,284	2,370	2,454	2,542
10. Education and science, arts and libraries ...	9,584	9,756	9,722	9,362	9,567	9,657	9,246
11. Health and personal social services	8,326	8,634	8,713	8,776	9,055	9,109	9,194
12. Social security	14,146	15,333	15,774	16,595	18,213	19,058	19,289
13. Other public services	949	1,078	1,012	975	973	1,010	997
14. Common services	965	1,060	1,054	1,022	1,048	1,073	1,088
15. Northern Ireland	1,928	2,057	2,064	2,054	2,232	2,215	2,150
Total programmes (see Table 1, line 4) ...	70,202	71,052	68,490	65,536	69,321	71,776	70,729

(*a*) Includes purchase of British Petroleum shares in 1974–75 but excludes sales of British Petroleum shares in 1977–78 and 1979–80 (see line 10 of Table 1).

PUBLIC EXPENDITURE BY LOCAL AUTHORITIES IN GREAT BRITAIN (a)

Table 3 — £ million at 1979 survey prices

	1978–79 Provisional outturn	1979–80 Expected outturn	1980–81 Plans
Current expenditure			
Education, libraries and arts	7,664	7,754	7,396
Local environmental services	1,698	1,697	1,627
Law, order and protective services	1,764	1,817	1,858
Personal social services	1,263	1,292	1,204
Transport	1,182	1,149	1,110
Housing	544	617	647
Other programmes	226	239	238
Total (current)	14,340	14,565	14,080
Capital expenditure			
Education, libraries and arts	418	384	350
Local environmental services	641	621	616
Law, order and protective services	68	58	66
Personal social services	64	75	72
Transport	567	613	549
Housing	1,822	1,865	1,623
Other programmes	4	7	9
Total (capital)	3,585	3,623	3,285
Total (capital + current)	17,925	18,188	17,365

(*a*) The totals differ from those in line 2 of Table 1, which cover the UK and include VAT paid by local authorities.

Explanatory and technical notes were included as Part 6 in the public expenditure White Paper published in January 1979 (Cmnd. 7439). The following notes supplement that description.

The definition of public expenditure in this White Paper

2. In general, the same definitions are used in this White Paper as in Cmnd. 7439. The two principal changes are:

(*a*) Family benefits. The change from child tax allowances and family allowances (including child interim benefit payable during 1976–77) to child benefit was spread over a period of years. During the transitional period the total for the social security programme included only the net Exchequer cost of the change; this treatment was reflected also in public expenditure totals. The gross cost of child benefit was shown in the main table for the social security programme together with tax revenue flowing from reductions in child tax allowances. Now that the transition to child benefit has been completed by the general withdrawal of child tax allowances, the social security programme and public expenditure totals include the gross cost of child benefit (up to 1976–77 family allowances including child interim benefit).

(*b*) Net overseas and market borrowing of nationalised industries. The definition has been broadened to include short-term borrowing and the capital value of leased assets. Net short-term borrowing is defined to include the industries' transactions in other public sector debt. The definition of the industries' external financing requirement used in the public expenditure planning total (including borrowing and grants) is thus now aligned with that used for their cash limits.

Main classification changes since Cmnd. 7439

3. The following are the principal transfers between main programmes that have been made to reflect new arrangements:

(*a*) Expenditure on computer requirements supplied to central government departments by the Central Computer Agency and formerly included in the common services programme has been distributed to the appropriate functional programmes, reflecting the change to provision against repayment by the user department from 1 April 1980. The other programmes principally affected are defence; industry, energy, trade and employment; roads and transport; other environmental services; law, order and protective services; health and personal social services; and other public services.

(*b*) Some further expenditure on the urban programme in England and Wales has been re-allocated from other environmental services to housing, roads and transport, education, and health and personal social services.

(*c*) To improve functional control it has been decided to confine the programme for Northern Ireland to expenditure within the responsibility of the Secretary of State for Northern Ireland. Thus expenditure by the Ministry of Agriculture in that area is now classified to agriculture, fisheries, food and forestry; and expenditure on the court service to law, order and protective services.

The price basis of this White Paper

4. Money figures in this White Paper are presented at constant prices (described as 1979 survey prices) to allow comparisons from one year to another of the quantity (' volume ') of goods and services used, either directly or indirectly, by the programmes. For most expenditure on goods and services 1979 survey prices are prices as they were in the autumn of 1978 (for most local authority current expenditure the date is, more precisely, November 1978). For most transfer payments, 1979 survey prices are assumed average prices of 1979–80.

5. The average increase from 1978 survey prices (the price basis of Cmnd. 7439) to 1979 survey prices is $11\frac{1}{2}$ per cent. The price basis for borrowing by nationalised industries has been changed from estimated prices for the financial year in which the White Paper is published to prices for the preceding financial year (1978–79 for this White Paper).

Debt interest

6. Total public sector interest payments, corresponding to the estimates in table 1, line 6, on the " public expenditure " definition of debt interest, are as follows:

£ million at 1979 survey prices

1978–79	*1979–80*	*1980–81*
9,900	9,900	9,800

Printed in England by Her Majesty's Stationery Office

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Southey House, Wine Street, Bristol BS1 2BQ
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There have been a number of suggestions of alternative techniques of monetary control. We have, of course, been looking at these. I have been pressed to make an early decision. But consultation is essential; these are highly technical and complicated matters and could have wide ranging institutional implications. It would not be sensible to introduce a new system, of any sort, before we were sure it would achieve what it was intended to do. The Bank and the Treasury will, however, be issuing quite shortly, a consultation paper discussing schemes of monetary base control.

/I should emphasise

I should emphasise that none of the alternative monetary control techniques that have been suggested will avoid the need to get the fundamentals right, in other words to keep down the level of public sector borrowing and thus to ensure that interest rates are at the right level. Indeed, one possible benefit of a monetary base control is that it would help to bring about a quicker response of interest rates to changes in monetary conditions. In this respect it has a rather different role to play than the SSD scheme, and a monetary base system should not therefore be seen as a replacement to that scheme.

/Many people

36 C.A.P.

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THE ECONOMY OF THE UNITED KINGDOM - PROBLEMS, CONSTRAINTS, OPPORTUNITIES - PAPER BY THE CPRS

The Chancellor has asked me to circulate this paper because of its interest in presenting a general diagnosis of the UK's difficult position.

AR

ADAM RIDLEY
30 May 1979

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cc → ADAM RIDLEY / POLICY UNIT

Prime Minister.

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You are having a general talk with Cabinet colleagues on Tuesday at 1430. This is helpful background reading. Do you wish to circulate it to colleagues for Tuesday?

K.R.S.

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Qa 04092

To: PRIME MINISTER

From: SIR KENNETH BERRILL

The Economy of the United Kingdom - Problems, Constraints, Opportunities

1. An important part of the remit of the Central Policy Review Staff is to advise Ministers collectively on major strategic issues. I attach a note by the CPRS on the problems and prospects for the United Kingdom economy in the medium term which you may like to see. The intention would be to circulate it to your colleagues.

2. I am sending a copy of this minute and the enclosure to Sir John Hunt.

KB

4 May 1979

Att

THE ECONOMY OF THE UNITED KINGDOM - PROBLEMS, CONSTRAINTS, OPPORTUNITIES

Note by the Central Policy Review Staff

Introduction

1. This paper reviews in brief the main problems, constraints and opportunities facing the economy of the United Kingdom over the next 4/5 years. It concentrates almost exclusively on domestic economic issues; foreign policy, defence and constitutional matters are raised incidentally, if at all.

Problems

2. The main problems of the economy are deep-seated and now widely recognised. We are rich in natural and human resources. Other industrial countries envy our self-sufficiency in North Sea oil and gas. But our industrial performance has been so poor for so long that in Western industrial terms we have now become a low productivity, cheap labour, country - see Annex A.

3. The main problems remain the same as they were pre-1974, only more so: inflation, industrial performance, unemployment (in that order). The Government's strategy is to break into the vicious circle by reviving personal initiative. Public expenditure and personal taxation are to be reduced; and strict monetary discipline observed. The aim is to revive investment, increase productivity and thus substitute improved growth and competitiveness for "stagflation" and relative decline. None of this can be instantaneous. During the first year or two, while inflation is wrung out, the disciplines may be painful in terms of growth and unemployment. It may well be the second half of this Parliament before the benefits begin to accrue. It will be important meanwhile both to stick to the strategy and to keep the longer term goals in the public eye.

Inflation, Industrial Performance, Unemployment

4. The Government is fortunate in having a national consensus that the order of priorities is inflation, industrial performance, unemployment. There is general agreement that high rates of inflation harm us as a trading nation, discourage investment, slow down growth, increase unemployment. There is a widespread fear of the social dissatisfaction and unrest which inflation brings.

5. There is also growing, if belated, understanding of where Britain has slid to as a trading nation; and how our living standards depend, long term, on the productivity of our manufacturing and service sectors.

6. The United Kingdom growth rate has been considerably below that of our major competitors. Our service industries have generally performed as well as their counterparts but British manufacturing industry, both in the private and the public sector, has not. Too often the story is one of low profits, low productivity, bad management/ labour relations, outdated machinery; and of products that fail to compete in price, quality, delivery time, and after-sales service. This is true not only of declining industries such as steel and shipbuilding, which are facing problems throughout the Western world. It is true also of industries whose products are still in demand (cars and the mechanical and electrical engineering industries generally) and even some of the industries of the future. If profits are adjusted for inflation, the position looks even worse.

7. Unemployment by postwar standards is very high. At present this is accepted with surprising equanimity. But there are problems ahead if new jobs do not emerge. Like many other industrial countries, our labour supply is expected to increase (by about 1 million over the next five years). In part this is due to the bulge of school leavers and the small numbers due to retire over the period; in part to the strong trend for more married women to go out to work. At the same time, we have the further

decline of some manufacturing sectors (e.g. shipbuilding) and the need to reduce labour in others (e.g. motor cars, steel, coal, railways). The effect on employment of rapid technological change (in particular the widespread use of microprocessors) is uncertain: everything depends on whether new opportunities are grasped. If unemployment were to increase sharply, the present equable acceptance might break down, especially in the Inner Cities, with large numbers of young coloureds unable to find jobs.

External Constraints

World Trade

8. There are major external constraints which the Government can do little to ease. First, the rate of growth of world trade. By the standards of the late 1960s and early 1970s, the prospects are not encouraging. Over the next five years, world trade may grow rather faster than in the depths of the recent depression but the situation is fragile. The outlook has been weakened by the Iranian revolution and the possibility that other OPEC suppliers may become more cautious in raising their oil output and exports.

9. The growth in world trade depends largely on the internal growth rates of the major industrial countries. There is every sign that output will remain well below productive potential. Oil supplies apart, expansion in key economies is constrained by fears of increased inflation, balance of payments problems, or both. The pace is set by the strong, surplus countries who are reluctant to raise their growth rates for fear of inflation. Countries in deficit cannot reflate or they will make the distribution of surpluses and deficits still more uneven and place their own currencies in jeopardy. The centre of the world economy, the United States, is inhibited through fears both of inflation and the possible effects on the dollar. These problems will be for discussion at the Tokyo Summit, but an early solution is not in sight.

Protection

10. The United Kingdom cannot escape by opting for widespread protection. Other countries do not see us as a 'special case' and would certainly retaliate. The industrialised world has agreed that there is a place for selective tariffs and quotas (particularly to smooth the run-down of declining industries) and for some use of non-tariff barriers (as in public sector purchasing). But a surge towards protectionism by the trading world generally or by the United Kingdom alone, would not be at all in our interests. It would mean reduced markets for our exports, the risk that the inefficient parts of British industry would relax behind the new tariff wall and the certainty that our standard of living would drop as the range of imports available was reduced.

Exchange Rate.

11. The United Kingdom is now exposed to the 'Dutch disease' - the tendency for oil and gas revenues to raise the exchange rate and so, in the short term at least, to lower competitiveness. The Government's commitment to a strict monetary and fiscal stance will reinforce the strength of sterling. If our inflation rate remains higher than that of our competitors, the exchange rate must eventually weaken - but not necessarily enough to restore competitiveness. The extra oil revenues will play a major part in determining market expectations and the prospects are for world oil prices to rise quite markedly.

12. There are, of course, compensations. A higher exchange rate would lower inflationary pressures; and greater overseas confidence in sterling would make it easier to refinance part of the large volume of overseas debt which falls due for payment in the next few years. But, on balance, there is probably a case for trying to reduce the upward pressure on sterling by leaving more of the oil in the ground (depletion

policy); by investing more abroad (exchange control policy); and by reviewing the case for the the United Kingdom joining the European Monetary System as a third way of helping prevent sterling drifting too high.

Balance of Payments

13. Paradoxically, while North Sea oil and gas (plus strict monetary and fiscal policies) are liable to keep sterling high, the balance of payments remains fundamentally weak and a real constraint on faster growth. This is because of our very high (and rising) propensity to import, especially to import manufactures. Until we have improved the attractiveness and competitiveness of British goods, reflation flows disproportionately into imports (creating jobs abroad instead of at home) and pushes the balance of payments into deficit. A serious balance of payments deficit would reduce the level of sterling and solve, temporarily, the 'Dutch disease' problem. But it is impossible to 'fine tune' the extent to which sterling would weaken and a plunging exchange rate would mean that the brakes have to be put on hard. Back to the familiar stop/go cycle which benefits no one - certainly not British industry.

The EEC

14. The Government's political commitment to the EEC is firm and more fundamental than any economic assessment. However, in financial contributions, the United Kingdom is a heavy net contributor rather than a beneficiary. It must be a prime aim to reduce this net contribution (by adjusting the CAP and the EEC budgetary system). A Government which is known to be fully committed to the European ideal may find it easier to influence Community rules in the United Kingdom's interest.

Opportunities

15. We have listed above the well known problems and constraints which face the United Kingdom economy. They are formidable. Yet the next decade remains a period of real opportunity. This is in part because of

North Sea oil and gas (though that brings its difficulties) and in part because the British people have, belatedly, come to recognise how far we have slid and what is needed to begin to restore the position. Ten years ago that was not the case - the view was that full employment and ever-expanding social services could and should be provided by increased public expenditure. That has now changed; new opportunities present themselves and they must be grasped.

Incentives

16. Central to the Government's strategy is a substantial reduction in personal direct taxation. It is now widely believed that present income tax rates act as an important disincentive to effort and there is a lot of (anecdotal) evidence to support that belief. Even the previous Administration accepted that United Kingdom tax rates, particularly at the upper and lower ends of the income spectrum, were too high. There are direct disincentive effects, a distortion of the systems for rewarding skills and effort (special perks and benefits in kind), and evidence of an insidious growth in the 'hidden economy'.

17. The first priority must be at least to index for inflation. (Statutory indexation at present applies only to the basic tax threshold.) After that, priorities should be -

(a) lift the tax threshold in real terms (to reduce the overlap with social security benefits, to improve the advantages of working over not working, and to ease the 'poverty trap';

(b) reduce the burden of the higher rates of tax;

(c) increase the threshold (or reduce the rates) of investment income surcharge, particularly for the elderly and retired.

18. (b) and (c) are not expensive, but should be related to some progress on (a). On (b), the CPRS view is that pulling out the higher rate bands (so that they apply to real levels of income comparable to those of five years ago) merits higher priority than reduction of the top rates. But there is a case on psychological grounds for an early reduction in the top rate.

19. Reductions in direct taxation have to be paid for. In the longer term, this may come from increased growth. But in the next year or two, assuming restraints on money supply and the PSBR, it will be necessary both to increase indirect taxation (and nationalised industry prices) and reduce public expenditure. Counter-inflation policy is a constraint on raising indirect taxation and nationalised industry prices and large savings in public expenditure take time to achieve (see paragraphs 22-28 below). This points to the Government putting before the public a medium term tax strategy explaining where they aim to get to in two or three years.

Industrial Performance

20. The Government's general stance is to create an overall economic climate which is conducive to greater industrial profitability and higher investment; and to remove barriers to industrial expansion. Its policies on fiscal incentives, the reduction of inflation, labour relations, employment protection legislation and unfair trade practices are all designed to contribute to these objectives.

(a) Fiscal incentives. The tax burden on manufacturing industry generally is not a problem at present, given generous investment reliefs and relief for inflationary pressures through stock relief. But the position of small firms will continue to require special attention. It has been improved recently, but there may still be scope for additional concessions to help small firms and those who invest in them.

(b) Industrial Financing. Over the past few years, lack of finance has not been a constraint on industrial investment, except perhaps for new small firms based on technological innovation. But this has been against the background of low growth. Industrial investment needs to return to comparable international levels, and to make good the years of low investment. This could put a much greater strain on the supply of available funds. There is room for action, both by the Government and the City (including the Clearing Banks) to encourage investment in industry. There is also a case for a more active involvement by the investing institutions in the companies to which the savings of their policy holders and pensioners are committed. A greater exchange of views and information between Government and the City institutions is desirable, given that they have so many objectives in common.

(c) NEDO and the Industrial Strategy. The work of NEDO's sector working parties is recognised by industry (CBI and unions alike) to have achieved some useful results. The value should grow in the years ahead. It is proving possible to assess past industrial performance and weaknesses; to share information on markets, export and import substitution opportunities; and to provide a channel of communication to Government on an industry basis with the joint involvement of employers and unions. It would seem right to build on this machinery.

(d) Support for Industry. Ministers should consider specific cases on their merits. Cost-effectiveness is important and market disciplines should never be ignored. But the implications for employment and the balance of payments of failure to provide transitional support in some cases could be very serious (e. g. ship-building). Similarly, in reviewing general and selective programmes of investment incentives Ministers will wish to take into account industry's repeated pleas for stability of policy.

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Public Sector

Nationalised Industries

21. Nationalised industries are, in principle, expected to adopt a commercial approach but, as a group, are a long way from this at present. Economic pricing should be pursued wherever possible despite short-term effects on the price level. Derogations from this are damaging to the morale of the industry and store up problems for the future. There are, in practice, limitations on this policy since the public sector embraces many of the industries which are in trouble throughout Europe. Change is necessary, but there are real social constraints on its speed and direction. It is desirable, wherever practicable, that the costs incurred by such constraints are clearly identified (e.g. through the negotiation of a separate 'social responsibility' grant as with the railways and airways). Social constraints on the speed of adjustment should not be allowed to inhibit adequate investment or necessary technological change in those parts of the industry which are running efficiently.

Public Expenditure

22. Present plans, which were based on the assumption of a higher growth of GDP than now seems likely, provide for total public expenditure programmes to grow by about 2 per cent a year in volume terms over the next four years.

23. Substantial expenditure savings will be required to meet the Government's commitments on personal taxation and the present year's PSBR. (Most forecasts put the latter at about £10 bn. for 1979/80.) The extent of these savings will depend on the scale of sales of public assets (e.g. British Petroleum shares) which is decided upon.

24. Some savings were identified in the Election Manifesto (e.g. the Community Land Act, local authority direct labour, and an attack on waste).

But these, and other, savings will take time to come through. Capital expenditure is already largely committed for the current financial year. Staff cuts will clearly be needed - in local government as well as central. But in the short run redundancies can involve heavy offsetting costs. On transfer payments there are potentially large savings, but some of these would require contentious legislation (e.g. indexing benefits for prices alone rather than for the better of prices or earnings).

25. To achieve large public expenditure savings, the Government will need to consider urgently both a rigorous application of cash limits and policy changes on individual programmes.

Cash Limits

26. The present cash limits for 1979/80 allow for retail prices to rise by only $8\frac{1}{2}$ per cent in the year to the fourth quarter of 1979; and for pay to be in accordance with the guideline of 5 per cent plus £3.50p. under-pinning. On reasonable assumptions about inflation and public sector pay settlements, these arrangements could imply a volume squeeze on public expenditure of about £500 m. in 1979/80. The Government will wish to consider whether it can go further than this. Cash limits are a good way of persuading spending authorities to test the cost-effectiveness of their programmes, and their use of staff. But they have their limitations particularly where staff cuts would be unacceptable (e.g. defence or police) or difficult to achieve without prior structural change (e.g. revenue and social security administration).

Specific policy issues

27. The following are among the major policy issues which will need urgent attention. (The list is not exhaustive.)

(a) Housing investment. There is still scope for switching from house construction to renovation and improvement.

(b) Economic pricing for nationalised industries. Further moves towards full economic pricing could substantially increase the revenue of

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these industries (particularly gas, electricity and telecommunications) and so reduce their net borrowing. Regard would need to be paid to economic effects, e.g. on exports, and on subsidy practices in competitor countries.

(c) Uprating of social security benefits. Long term benefits might be indexed to prices only in line with the present arrangements for basic rate personal tax allowances. This could be combined with similar indexation for higher rate thresholds and specific duties.

(d) Housing subsidies. The present system for subsidising housing is expensive, capricious and wasteful. The gradual elimination of housing subsidies could release substantial resources for reductions in personal taxation. The balance between the public sector (subsidised rents) and the private sector (tax relief for mortgages) would need to take account of the Government's policies for encouraging more home ownership.

28. Three general points:

(a) Expenditure commitments. The Government is committed to increased expenditure on defence, law and order and the health service. The need to ensure that resources are used effectively should apply to these services as to others. Some increases are built into existing plans. It will be important to consider the extent to which further expenditure is really required.

(b) Local authority expenditure. Control in this area raises the issue of relations between central and local Government. One approach would be to give local authorities greater discretion on the direction of their spending, but within tighter overall limits.

(c) Policy review. The machinery for the systematic and radical review of existing programmes, as opposed to proposals for incremental change, needs attention. Also the question of what other machinery, or systems, are required for eliminating waste.

Employment measures/regional policy

29. Employment measures. The present package is aimed at what was thought to be a particularly severe but short to medium-term recession. But cyclical unemployment has been overlaid by a growing 'structural' element. When vacancies increase this is having relatively little effect on depressed regions or on the numbers of unskilled adult males who are unemployed. It tends to benefit already prosperous regions and to draw new workers into the labour force. A review should identify the most intractable structural problems and, subject to EEC constraints, should channel training and incentives more selectively towards them.

Regional Policy. Over the past decades successive regional policies have been of doubtful value. The depressed regions of the United Kingdom are, if anything, becoming relatively less attractive to investors while their problems intensify as a result of shifts in the industrial structure of the economy. But the high value placed by industry on continuity in the structure of incentives, provide strong arguments for leaving regional policy relatively undisturbed.

Energy

30. Britain is fortunate among OECD countries in being virtually self-sufficient in energy. We shall for a time be a net exporter. But, despite this, our interests as a major trading nation coincide much more closely with the OECD than with OPEC countries. We have more interest in the expansion of world trade than in a high price for oil which harms world trade. Our hope must be that OPEC producers, particularly Saudi Arabia, will use their power over the price and supply of oil moderately and not hold back world economic activity or spur inflation. But this hope may not be fulfilled.

31. Investment in the energy industries has long lead times. Important decisions will soon need to be taken which will significantly affect the balance

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of our energy supplies in the 1980s and 1990s. The main areas for review are -

(a) North Sea oil. Decisions need to be reached on the rate at which we choose to deplete our North Sea oil and gas resources. National priorities will not always coincide with the wishes of the oil companies. The Government is committed to an early review of the future role of BNOC. It will also need to take early decisions on North Sea oil taxation. This is important because it can both increase the scope for cuts in personal direct taxation, and maximise the balance of payments advantages from our oil.

(b) Coal industry. A healthy coal industry is vital to the long term security of our energy supplies. But the immediate financial position of the National Coal Board presents a depressing picture - a forecast loss in 1979/80 of some £300 million despite the benefit of recent oil price increases and the decision to increase power station coal-burn. A review of the long term strategy for coal is urgently needed.

(c) Coalburn and coalstocks. Our International Energy Authority commitment to a 5 per cent reduction in oil use will require the use of more coal at power stations. Ministers will wish to assure themselves that this will not reduce coal stocks to levels which might leave the Government vulnerable to threats of industrial disruptions (particularly next winter).

(d) Nuclear programme. Given the likely supply of coal, oil and gas, commitment to a nuclear programme is inescapable. But extremely delicate handling is required if this country is to avoid the opposition to nuclear power, which has so much embarrassed others. The Government will have to decide whether to proceed with the Pressurised Water Reactor, for which design work has already been authorised; the extent and timing of our commitment to the Fast Reactor; and the most suitable forum for public discussion of these sensitive issues.

(e) Nuclear industry. The nuclear industry is disorganised and demoralised through continuing uncertainty about its future. Its role and its relationship with the generating boards, and indeed the structure of the electricity industry as a whole, needs to be resolved as soon as possible.

Pay Bargaining and labour relations

32. Pay bargaining in the private sector is to be left to the companies and workers concerned, with the understanding that the Government will not rescue companies who run into trouble. This policy is to be buttressed by 'more open and informed discussion of the Government's economic objectives'. The 'national assessment' this spring was largely ineffectual. But it would be possible to build on the general concept, which was welcomed both by the CBI and the TUC. The aim of such a national forum would be to reach a broad consensus about the size of the pay increases which the country can afford, without endorsing a 'pay norm'. Discussions could perhaps be based, as they are in Germany, on an input of statistics and forecasts from one or more of the main independent economic institutes.

33. It will be worth trying to build on the TUC's earlier commitment to the target of an inflation reate of 5 per cent by 1982 (in practice they will find it difficult to disown it), and to develop the implication of this target for wage increases, possibly by adopting a three-year rolling approach. (This would, for example, make it clear that for one year at least earnings would need to grow more slowly than prices.)

34. In principle much the same considerations apply to the public trading sector. But in practice the Government cannot help being more directly involved. It will need to apply the additional discipline of cash limits on the sector's financing requirements. And it will want to prevent nationalised industries from financing large pay settlements from monopoly price increases

35. In the rest of the public sector the Government, as paymaster, will have to take a view about the appropriate level of wage settlements. The following points are relevant to the approach to public sector pay in the medium term -

(a) It is not practicable for public and private sector pay to diverge for any length of time. All experience suggests that if one sector is deliberately held back problems are compounded elsewhere. Large catching-up awards are then taken as a reference point by other groups.

(b) This points to the continuing need for 'comparability' studies by some such body as the recently established Standing Commission. It is important that any such reviews should be conducted on the basis of genuine job-for-job comparisons with full account being taken of conditions of service other than pay and the demand and supply position for those skills in the labour market. Above, all, the reviewing body must not be allowed to identify itself with the cause of particular 'client' groups. This may be better achieved through a single review body with some continuity, than through a series of ad hoc reviews.

(c) There is some merit in seeking to synchronise public sector settlements towards the end of the pay round, when the 'going rate' for the private sector is established.

36. While this offers an approach to public sector pay in the medium term, the short-term problems are acute, largely because the large catching-up awards which are likely to come out of the present round of comparability studies will overstrain existing cash limits.

Summary of some main points

37. (a) There is a general consensus that the main problems facing the United Kingdom over the next 4/5 years are inflation, industrial performance, and unemployment, in that order.

(b) We must expect a relatively slow growth in world trade. Upward pressure on sterling could worsen our industrial competitiveness, though it also has compensations.

(c) The problem in the short term is to reconcile objectives on restoration of incentives through tax cuts, and reductions in the PSBR. A medium-term tax strategy is required.

(d) In the private sector of industry greater profitability is essential. Government should aim to foster a climate favourable to technological change, support this through fiscal incentives, and remove obstacles to adequate financing, particularly for smaller, innovative firms. There is scope for building on the existing NEDO tripartite machinery.

(e) In the public sector, economic pricing should be pursued, and 'social' costs separately identified. There is a limited role, albeit in a recast form, for a body like the National Enterprise Board.

(f) Public expenditure cuts on the scale required will require urgent consideration of how much can be achieved through cash limits, and how much will need to come from policy changes in individual programmes.

(g) In energy, important decisions are needed on North Sea oil (depletion, taxation and BNOC), the coal industry (particularly its uneconomic parts), the nuclear programme and industry.

(h) Pay bargaining and labour relations is a critical area. A national 'forum' could help to encourage consensus and responsible bargaining in the private sector and public trading sector. For the non-trading public sector, 'comparability' in some form still seems the best approach.

Conclusion

38. It will take time to win the battle against inflation, to reduce public expenditure, to lower direct taxation, to stimulate investment and improve competitiveness. During that time, all Government decisions should be related to the central strategy and the Government will need to watch carefully that it does not drift off course. It will need to keep the ultimate goal firmly in front of itself and the public and ensure that progress towards that goal is continuously monitored.

4 May 1979

SOME ECONOMIC INDICATORS FOR SEVEN MAJOR OECD COUNTRIES

	Real GDP in 1977 (1953 = 100)	Productivity Growth (average annual % increase) (a)		Consumer Prices (average annual% increase)		Unemployment (% of labour force) (b)	
		1964-73	1974-78	1964-73	1974-78	1970	1978
UK	184	3.2	0.8	5.8	16.1	2.6	5.8
Canada	304	2.4	0.6	4.1	8.8	5.7	8.4
France	314	4.5	3.0	4.8	10.0	1.7	6.2
Germany	314	4.7	3.2	3.8	4.2	0.7	4.4
Italy	301	5.4	1.1	4.4	16.0	3.2[c]	7.2[c]
Japan	717	8.9	3.4	6.3	8.2	1.2	2.2
USA	212	1.8	0.1	4.0	7.3	4.9	6.0

Source: OECD

Notes: (a) Average annual percentage growth rates of GNP/GDP per employee.

(b) The figures are not comparable between countries owing to differences in definition.

(c) Italian unemployment rates for 1970 and for 1978 are not comparable owing to changes in definition.

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PwP. 56

cc Chief Secretary
Financial Secretary
Mr Battishill
Mr Ridley

for information:

Minister of State (C)
Minister of State (L)

CHANCELLOR

EXPERT ADVISERS

At your request I prepared a draft on this subject for the Ministers of State (C) and (L). They have each agreed my analysis in principle. Therefore at this stage I am circulating to you, to the Chief Secretary and the Financial Secretary, copies of my paper and their comments on it.

2. For consideration, whether you would wish to invite the advisers for a drink at No 11 one evening before Budget Day.

PETER CROPPER

31st May 1979

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cc Mr. Ridley

MR. CROPPER

OUTSIDE ENQUIRIES

The Chancellor has seen your minute of 30th May, and agrees that you should issue an instructions on the lines of your paragraph 4.

MAH

(M. A. HALL)
31st May, 1979

58

cc Mr Ridley

CHANCELLOR

OUTSIDE ENQUIRIES

A trivial matter, but one on which it may be wise to lay down the law at the outset.

2. I have just been rung by a stockbroker who had been referred by Central Office press department first to Anne Bulloch (on holiday) and then to me, with an aggressive enquiry about the Party's posture and past statements on Exchange Control.

3. During Opposition this sort of thing was happening all the time because press department was not technically up to its job and simply off-loaded it.

4. Would I be right in issuing a firm instruction that my name (nor Adam's) are not to be given to outside enquirers and that, where necessary, this sort of enquiry must be intermediated by a member of Central Office press department himself speaking to me or to our Press Office here and relaying the answer back.

5. I see dangers in allowing stockbrokers to think they can ring in here with their enquiries on Exchange Control policy.

Yes

PC.
PETER CROPPER
30th May 1979

So far as the Treasury is concerned I v. much support this and believe it would wholeheartedly commend itself to Peter Davis and his team.

AB
30/5

C

59

CHANCELLOR

c Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Mr Couzens
Sir Lawrence Airey

A WAGES AND PRICES FREEZE?

You may be interested to learn about some points which were passed on to me by Rob Shepherd, our political adviser in the Department of Employment. He was simply reporting on one or two conversations he had had with industrial and labour correspondents in the City. According to these journalists, there is a very widespread feeling in the City that the Government will be forced back on to a wage or price freeze before very long. A number of "books" are being kept and the betting makes November the favourite month, while a few optimists are holding out for July next year! Apparently there are no significant members of this, admittedly rather specialised, community of journalists who think that some kind of direct action on wages and prices is unlikely.

2. The argument on which they are said to base this pessimistic expectation runs as follows. Prices are rising quickly, the Budget will make them somewhat worse, and there could well be further difficulties with commodities such as oil. Looking at the timing of the next pay round, the announcement of the results of the early Comparability Commission references will come at a very unfortunate period, and will stimulate considerably higher private sector wage claims than might otherwise have been the case. It is felt that employers will pay out the extra money, and will not wish to fight excessive wage claims. In addition, the industrial relations reforms which the new Government is intending to introduce are not rated as

likely to make much difference to the outcome. These points I should stress, are what the journalists themselves are said to attach emphasis to.

3. When cross-checked against the attitude at union conferences, it appears, according to Rob Shepherd, that there is no great evidence of absurd claims being formulated. Furthermore, a number of unions are in a position of considerable financial difficulty after the heavy cost of industrial action in recent months, and this must be an important factor favouring a stern and effective line by employers in the coming wage round. I gather that the Department of Employment will be looking more carefully into some of these questions in due course.

4. Regardless of what one thinks of the views of the journalists, it is interesting that their attitude is so unanimous and apparently deep-seated.

AR

ADAM RIDLEY
31 May 1979

TOTAL COPIES 4

COPY No. 1

CCE

Gist of Chancellor's comments passed to Sir K's office. 5/6

C

61

PERSONAL AND SECRET

Secretary of State for Industry

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

CH/EXCHEQUER
REC. 1 JUN 1979
ACTION

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Whitehall
London SW1

31 May 1979

Oh, ok! But (1) it is a highly complex industry, with numerous sub. industries + sub. cases (2) Also very volatile: punters' money is very foot. loose + tax. sensitive — + much of it can v. quickly move abroad (3) For this reason neither we in opposition — nor officials + Lord Rothschild came near to clear conclusions + it would be wrong to act unilaterally this year

Dear Geoffrey,

We had a word the other night about the betting and gaming duties, which you said could not yield more than about £40 million increase in the forthcoming budget. This is not a subject in which I have either Departmental or personal expertise, but as I understand it there are three main objections to raising very large amounts of money by this means:

(a) the duty on the pools is already at 40% of stake money and could not be increased significantly without affecting business.

(b) Significant increases in the betting duty itself would drive the business underground, and hence be self-defeating.

(c) In any case, decisions have yet to be taken on the various taxation recommendations of the Royal Commission on Gambling, and substantial increases in the rates of the existing duties would preempt those structural decisions.

I understand the force of (a), and am not competent to judge the significance of (b). On (c), however, I feel most strongly that the structure and interests of the betting industry should not be subordinated to the vastly more important interests of industry at large and manufacturing industry in particular. I have myself put forward in the wider interest of the economy substantial proposals which run counter to the interests of industry - cuts in direct assistance and regional support, increases in VAT and specific duties, and my proposal for an ACT surcharge. I should feel badly if industry in general had to bear these heavy burdens merely in order to protect the betting industry or to avoid the minor embarrassment of pre-empting decisions on the Royal Commission.

I am copying this letter to the Prime Minister.

Yours, Keith

62 C – to go with PCs minute

cc Mr Ridley

PJ

To

CHANCELLOR

BACKBENCH FINANCE COMMITTEE

Would it be right for me to write to Bill Clark congratulating him on his chairmanship and asking if I might attend the Committee regularly as heretofore? Would this cut across Ian Stewart's function? I don't think Anne would mind.

2. If I go regularly I am unobtrusive. If I go occasionally they may feel they are being snooped.

3. On the other hand, if I went regularly would there be any risk of evil spirits suggesting that the members of the Finance Committee were getting improper briefing, even if I in fact sat there with my mouth shut?

4. Where does the balance lie?

I would also like to be able to attend occasionally....

AR 1/6/79.

PETER CROPPER

1 June 1979

163/6.

63

cc Mr Ridley

PR.

CHANCELLOR

BACKBENCH FINANCE COMMITTEE

Would it be right for me to write to Bill Clark congratulating him on his chairmanship and asking if I might attend the Committee regularly as heretofore? Would this cut across Ian Stewart's function? I don't think Anne would mind.

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4. Where does the balance lie?

PETER CROPPER

1 June 1979

CONFIDENTIAL

64

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Minister of State - Commons
Minister of State - Lords
Mr Ridley
Mr Cropper

BUDGET SPEECH

I have given you most of my comments on your draft Budget Statement but there is one point I omitted.

I think it would be a very good idea, when covering the public expenditure cuts, to express these as, inter alia, percentage cuts in current and capital expenditure respectively. I have not done the sums myself, but I suspect that this will prove to be the first package within living memory that has not taken the soft option of clobbering capital expenditure. At the very least, this should earn you the plaudits of the Expenditure Committee which has been harping on this for years. But the point is of wider importance than this.

I also commend to you Victor Keegan's piece in today's Guardian on the failings of the RPI as a measure of inflation.

FACTS TO BE
CHECKED BSE

NIGEL LAWSON
4 June 1979

65

CHANCELLOR

BSP

BUDGET BROADCAST

Following on the meeting with Anthony Jay which you asked Peter Cropper and me to arrange, Jay has come up with an idea for an approach to the broadcast. It is in essence:

a. an introduction designed to attract and hold attention, and to create a sense/awareness of your strategic purpose;

b. a series of metaphors making it clear how your actions are means to your end;

c. something far less tediously political than anything which your predecessor ever undertook.

2. If you could give us some reactions, however preliminary, overnight, we could then feed them in to Jay and/or the official draftsman working to Mr Unwin - and, of course, keep Peter Davies posted.

AR

ADAM RIDLEY
6 June 1979

66

C

cc Chancellor

2

MR P G DAVIES

BUDGET WEEK HOSPITALITY

I am holding myself free for any sort of engagement in Budget week, so await your instructions for press lunches, etc.

2. Meanwhile I will be happy to attend lunch on 13th June (Economist) and drinks at No 11 that evening. I will also be at the disposal of the Observer Profile team

PETER CROPPER

6th June 1979

67

C

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

CHANCELLOR

COMPANY SCHOLARSHIP SCHEMES

1. This problem, which blew up in the middle of last year's Finance Bill debates as a result of an Inland Revenue Notice, is still alive.

2. The secretary of BP's scheme rang me to say that one of his Trustees has just been asked for a return of all payments made under the scheme since June 14th 1978.

3. It is a matter whereon we will need to seek clarification, and which could arise from our own backbenchers this year.

Yes

L

PC.

PETER CROPPER

6th June 1979

68 C

M

CHANCELLOR

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

CPRS, JOHN HOSKYNS AND WORK ON COMPARABILITY

At your morning meeting on June 4, you asked me to find out what role these two bodies will be playing in future work on comparability etc. Mr Littler and I have discussed the matter, and he reports that there appears to be no further work which CPRS expect to be undertaking in this area, now that their paper on pay has been circulated to Ministers.

AR

ADAM RIDLEY
7 June 1979

69

CHANCELLOR OF THE EXCHEQUER

JOHN HOSKYNS AND THE BUDGET SPEECH

I have tried to locate JH, but he is away from the office today. If you would still like his views, I will 'phone him again tomorrow when he is due to be back.

2. We have already spoken about Budget Presentation, and John sent me a note of his thoughts afterwards, of which I attach a copy.

AR

ADAM RIDLEY
7 June 1979

CONFIDENTIAL

70 [illegible] (2)

10 DOWNING STREET

Adam Ridley Esq
HM Treasury
Parliament Street
LONDON SW1

31 May 1979

Dear Adam,

You asked me to let you have any thoughts on Budget presentation etc. There isn't much I can say, because in a sense I feel that policy measures are themselves messages and they themselves will constitute a strong statement about values, priorities and political direction. However, one or two thoughts:

1. It should be stressed that any apparent step increase in the RPI, following VAT changes, are once-for-all. We have to assume that many people have great difficulty in understanding that there is a large element of zero sum transfer between direct and indirect; and even greater difficulty in recognising that any immediate increase is not simply an acceleration in the inflation rate. *

2. The greater the extent of any transfer between direct and indirect the greater the help we are giving to the lower paid, a large percentage of whose budget presumably goes on VAT exempt items. Perhaps I am wrong, but if I am right, it should certainly be stressed. In a sense, therefore, the higher the VAT rate, the more it can be presented as a "luxury tax" on the affluent which now in fact means the great majority of the working population as distinct from the relatively small genuinely low earners, poverty line etc.

3. I had a long session with Leslie Murphy at NEB yesterday who very much hopes that he will not be directed to divest himself of specific holdings but rather given a target figure and it's up to him how to arrange it. I don't happen to be anti-NEB in principle. I believe we have to think very hard about the true implications of a low risk, low effort, low confidence economic culture, before concluding that NEB does not have a role to play. That brings us back to the fundamental question; not the question of what sort of destination (healthy social market economy etc, pluralism and enterprise etc) we are heading for, but how on earth we bootstrap ourselves from our present boxed-in and demoralised position to that desirable destination.

136/5

More generally, I feel that we have to start thinking, very purposefully, very soon after the Budget, about the economic buffeting we can expect over the next 12 months - double-digit inflation and rising, pay rises in the pipeline, anomalies and differentials still unresolved especially in the public sector, likely increases in oil prices. By the time the true impact of all this is obvious - say October - it will be too late to intercept the problem and we will be back to chasing after it. Perhaps we can talk about this when we have lunch.

* Also remind people that we're bringing VAT & income tax into line with the pattern of ~~economies~~ successful o'seas

CONFIDENTIAL

31 May 1979

71

Incidentally, on the subject of the Council of Economic Advisers, I was talking through some names of likely academic advisers with Ralph Harris at IEA yesterday and several potential heavyweights for the Council were mentioned. Most of them will be well known to you, some of them to her. Let me know if you want details.

JOHN HOSKYNS

72

CHANCELLOR

c Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Mr Unwin
Mr Davies
Mr Locke
Mr Cropper

YOUR BUDGET BROADCAST

After his recent discussion with Mr Davies, colleagues in IDT, Mr Jay and Mr Cropper and myself, Mr Jay volunteered some preliminary ideas for its presentation. You asked me to discuss them with the Financial Secretary, and we agreed on the following points:

i. The introduction needs shortening.

ii. One needs to stress

a. cutting public spending and borrowing (p3) will help reduce inflation;

b. the take-home pay argument

iii. One should <u>end</u> the exposition of policy with income tax cuts, not have it coming second in the sequence;

iv. One might want to close, not with the thought of a change of direction, but that we shall be carrying on a lot further down this path.

2. I am copying the Jay draft and these comments to the Central Unit so that they can absorb both in the preparation of a first full draft which they are already undertaking for you. I shall also let Mr Jay know where things stand.

AR

ADAM RIDLEY
7 June 1979

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THE CHANCELLOR OF THE EXCHEQUER'S

BUDGET BROADCAST June 12th 1979

First draft introduction Antony Jay

June 6th 1979

<u>SIR GEOFFREY HOWE</u> Someone once said that taking over the government was like moving into a house that someone else had been living in for five years. You knew roughly the sort of state it was in, but it was only when you actually moved in that you realised just what had to be done. Well, I know what he meant, but it isn't quite true. And the reason it's not true is that you can put a house right pretty quickly. If you've got the time and the skill and the energy you can start painting and papering, you can put up shelves and cupboards, alter the carpets and curtains, move in your own furniture, and in really quite a short time you can transform the whole place. But the country's economy just isn't like that. New businesses don't grow overnight. Companies don't embark on new investment programmes at the drop of a tax. So it's not like taking over someone else's house. (160 words)

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What it's much more like is taking over someone else's garden. With a garden, you can't get quick results. You know it's going to be years before it's right. That's why we stressed before the election that we weren't going to produce any instant solutions. All the same, there are some things you can get down to straight away. In fact you have to. You can prune back things that are wildly overgrown and are taking too much goodness from the soil. You can pull up the weeds that are stifling the growth of the plants you want to encourage. And you can water and nourish some of the plants that have been choked and starved.

And those, really, are the three things I've tried to do in this first budget: some urgent pruning, some urgent weeding, and a little bit of watering. (300 words)

To take the pruning first. The plant that is in danger of taking over the whole garden is public expenditure. Even as recently as 1966 we had nearly five people working in productive industry for every one on the government payroll.

P.S. [illegible]
They grow on

75

Today it is only 2.9 to I, and falling. And public expenditure is the principal reason for our present intolerable rate of inflation. So I have .... (measures)

[illegible]

You can't prune too hard or fast

So that's the main area of pruning. Then the weeding. The really awful weeds are the high taxes which for years have been holding back the really fruitful growth of successful enterprises. We in Britain pay more tax than ...... (example). So I have .... (measures).

[illegible]

And finally the watering. It's the wealth creating, profit earning businesses of this country that need the mose urgent nourishment and encouragement, especially the smaller ones that haven't got deep financial roots. Small businesses already employ % of the work force, and they are even more important in providing the new jobs that we have to create to attack the appalling rate of unemployment. So I have ....
(measures)

So that is the underlying strategy behind this first conservative budget. I haven't tried to do everything at once, because it has to be a slow and careful business. And there won't be any sudden dramatic results, either, because growing always takes fime. But I do believe that today's measures will clear the ground - I believe they will cut out the waste and extravagance, remove the restrictions and

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blockages, and encourage the growth of the money-making enterprises rather than the money-spending ones. And that I think is the beginning of the change of direction that all of us want. Goodnight.

We shall carry on in this
Dir, which e. one wants.

S E C R E T

78

CHANCELLOR

You asked about the sentence (paragraph M11) which talks of getting down to a 25 per cent basic rate. I have discussed this with Mr. Unwin.

2. As a long-term aim it is difficult to challenge - though inevitably something of a sword of Damocles hanging over you until achieved.

3. With the information available on Saturday we cannot really look beyond 1980/81. But the picture is not an optimistic one. It will be an extremely difficult task to make further reductions in income tax, whilst keeping to your other fiscal and monetary objectives next year. On quite stringent assumptions the forecast PSBR for 1980/81 comes out at £10.2 billion. This assumes revalorisation of the personal allowances and higher rate bands; and similar revalorisation of the specific duties. Public expenditure is kept constant in volume terms between this year and next, with specific cuts of £1.5 billion assumed. Another 1 billion asset sales has also been included.

4. 5p off the basic rate will cost around £2 billion. To get the PSBR down to £8 billion, therefore, implies finding another £4 billion beyond the assumptions mentioned. You might get another £½ billion by going for a 2-year revalorisation of the specific duties; and more money perhaps from PRT. But the gap still looks a formidable one. The medium term forecasts, for whatever they are worth, show the PSBR track getting no better - but they can no doubt be taken with a very large pinch of salt!

5. To conclude, a cautious approach would suggest no mention of 25 per cent. At the end of the day, it rather depends on how "long" is "long-term". My preference, I think, will be to err on the side of caution and leave it out.

(A.M.W.B.)
8th June, 1979

RESTRICTED

PWP 79 11 C

2

CHANCELLOR

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

THE NI LINK : LABOUR IN 1976

I have done a little research into what was proposed, but not acted on, at the time of the discussions of the IMF Cuts which took place in late 1975. I have not yet managed to locate one or two written sources which could be of help, but until that can be done and unless they reveal something fresh, the sum of what I can learn is as follows:

> The discussion focused both on public sector pensions (those which are inflation-proofed), and on National Insurance and other benefits. On the former, it appears simply that breaking pure protection was considered seriously. Whether the break was temporary or permanent is not clear.
>
> On the NI side there was:
>
> i. recognition of the case for modifying the treatment of short and long-term benefits in different ways;
>
> ii. consideration of suspending part (or all?) of the uprating provisions for two years but not, one presumes, indefinitely.

2. No doubt these and other distasteful possibilities were rejected not so much because they were thought inappropriate as because the Parliamentary Labour Party was certain not to support the necessary legislation.

AR

A RIDLEY
11 June 1979

80

CHANCELLOR

LCC SPEECH - JUNE 15

Since you are off so soon to OECD, I attach my very first, unreconstructed draft. It is an attempt to point out to the private sector their very real responsibilities. I think that "opportunity" is important, but the obligations that go with it can do with much more emphasis.

2. The order and language need, of course, wholesale improvement, assuming, that is, that the general theme is of some use to you! Any reactions you can leave with me before you go would be most valuable.

3. I am arranging for material to be gathered in parallel on reactions to the Budget, so that you can include a suitable passage. It would, I imagine, go best at the front of the speech.

4. The final question is whether you would rather have a Treasury or CUCO Press Release. The present text is more suited to the former, with the exception of the last sentence.

Surely?

AR

ADAM RIDLEY
12 June 1979

81

MR BATTISHILL + 1

c Chief Secretary
Financial Secretary
Minister of State (L)
Minister of State (C)
Sir Douglas Wass
Mr Littler
Mr F Jones

ECONOMIC ADVISERS' COUNCIL

As agreed, I attach a copy of my paper for you to send to No 10, and a spare copy for the Chancellor. I will speak to you separately to mention one or two ideas which you might like to incorporate in the covering note.

AR

ADAM RIDLEY
15 June 1979

82

AN ECONOMIC ADVISERS' COUNCIL (EAC)

The purpose of this paper is principally to set out the most important practical questions about how an Economic Advisers' Council (EAC) might operate and be organised. Wider issues such as how it might relate to other bodies such as NEDC or Parliament are only touched on in passing.

2. An EAC would be intended to serve several objectives:

a. to provide an authoritative and independent opinion on issues of economic policy both to the Government, to Parliament and to the public generally;

b. to promote a wider and deeper understanding of some of the most important topical economic issues of the day; and

c. in particular, perhaps, to help in creating wider understanding and acceptance of the need to overcome inflation, and of the policies that requires.

It could be introduced on its own, or as part of wider moves to set in motion the process of economic education and information associated with the "Forum" idea. The issues explored below are consistent with either alternative.

TERMS OF REFERENCE AND AGENDA

3. It would be natural to expect the EAC to undertake two kinds of work, and for them to be reflected in its terms of reference: first, regular reports on the central issues of economic policy; and second, a number of ad hoc reports on important issues of the day.

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i. The regular reports could be once or twice yearly, but probably not more frequent. Their form and timing would depend on a variety of matters, many of which can only be resolved at a later stage. Relevant factors include whether or not there is a Forum, the timing of the Budget, the timetables for setting monetary targets, and the annual pattern of the wage round.

ii. Subject to these reservations and assuming two regular reports a year, it would be natural to produce one shortly after the New Year in time to catch the Budget making season, and one in the late Summer as a background to the resumption of pay-bargaining in the Autumn.

iii. The ground to be covered in a regular report would include an appraisal of the economic prospect and the various forecasts and judgement made about it by others. The real purpose would be to focus implicitly or explicitly on policy issues. The reports might spell out the constraints imposed by economic reality, the implications of Government policy or of important policy proposals of general interest and, perhaps, shed light on more particular economic problems.

iv. Special studies could be initiated in a variety of ways. They could be commissioned or requested by Ministers, Parliament or the participants in the Forum, or started by the EAC itself without outside pressure; or both could be permitted. Examples of issues which might, in the past, have benefited from such treatment include: the adjustment to the 1973/74 oil crisis; use of North Sea Oil; the collapse of profits; public and private sector pay; the "case for shorter working hours" and so on.

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v. All these reports would ideally be written with more than usual emphasis on presentation. The reticence of some official prose and the somewhat academic style used by most economists, by the German Wise Men or the American CEA must be avoided as far as possible.

vi. Past experience suggests that the EAC will be most likely to establish itself firmly if it has a well defined destination to which it must report. This point is made more fully in a brief note by Treasury officials which is annexed to this paper.

4. To fulfil the education task properly, the EAC Members - and particularly its chairman - would have to present their views to the outside world from time to time both in public and in private: on television and radio; before select committees; at occasional conferences and seminars; and probably play a central role in the Forum. This would have to be clearly understood from the start and should either be a feature of the terms of reference, or of any letter of guidance given by Ministers at the outset.

LOCATION AND STATUS

5. Where the EAC is based has a considerable bearing on its status, how its work would be regarded by the outside world and how its members are appointed. Given a particular location, its relationship with its parent body could be close, involving for example shared staff; or it could be distant, involving little more than "pay and rations" in common. In weighing up these alternatives, it has to be borne in mind that there are many cheaper and simpler ways of increasing the range of economic advice available internally to Ministers than creating an EAC. However, much of the purpose of an EAC is to have a public impact. To do that requires a genuinely independent body, which is seen to be and believed to be "free standing", and not merely a stalking horse of the authorities.

85

6.

i. It could be based in some way in the Treasury. To some extent this might help access to data and the Treasury's own model.

ii. Another range of alternatives would be attachment to No 10, the CPRS, or the Cabinet Office. This kind of location has a number of precedents. It would crudely parallel the American CEA, which reports direct to the President.

iii. It could be created as an adjunct to a Parliamentary body, for example an Economic or Treasury Select Committee if one were ever created. However, such a formal link might make it more awkward to get the right members and staff, at least until Select Committees have become more stable and consistent bodies. Furthermore, it is in no way necessary if one wants an EAC with a Parliamentary link, which could be assured almost regardless of location. Were there to be direction or control by a Select Committee the EAC could well become seriously constrained in unpredictable ways.

iv. It could be related - loosely or closely - to the NEDC and NEDO. There would be a certain logic in this if an enlarged NED Council were to be the nucleus for the "Forum", since the EAC would presumably provide important input into the Council, but the same kinds of argument would point the other way if the Forum were to be located elsewhere. The EAC's activities would not fit in very naturally with the normal work of the NEDO organisation, and there might be awkward questions about separating its role and management from that of NEDO. Furthermore, its part in the activities of the Forum could be supported almost equally well from the other locations, regardless of where the Forum is based.

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v. Finally it could be formally quite "independent" like a Standing Royal Commission or Quango. This could have some disadvantages. But it is the only arrangement which seems to be fully consistent with the EAC's basic objectives. All the other alternatives discussed above are difficult to reconcile fully with the appearance or reality of independence, though not always seriously so.

POLITICS AND DOCTRINES

7. The political and doctrinal balance to be sought in setting up an EAC are important issues. While it would be unrealistic to expect that the EAC should be totally apolitical, it would, equally, be ineffective if it were seen as in essence a politically partisan organisation. How to find the "juste milieu" is something to be worked out in practice rather than defined in principle. But it would clearly be reasonable to envisage an EAC one or two of whose members were known to be sympathetic to the Government*.

8. A somewhat similar issue arises over what breadth of economic philosophy and doctrine the membership should embrace. Were it only to include one narrow school of thought, whether monetarist, Keynesian or any other, the EAC's authority and credibility would not be very great. At the other extreme, a membership embracing both a near Marxist member of the "New Cambridge" Group and a pure Friedmanite would make it unlikely that the EAC could agree about anything of interest.

9. The means by which the key members of the EAC are selected has a bearing on both issues. If nomination is in the hands of Ministers, then a coherent body can be constituted, though at the

* The "five wise men" in the German Advisers Council (known as the Sachverständigenrat)are all independents politically, while the more senior members of the American CEA are normally well-known Democrats or Republicans. This difference in composition reflects a difference in roles. The CEA is geared above all to advising the President, hence the unavoidably political nature of its membership. The German Council is intended to educate the public, for which purpose the less political colouring the better.

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risk of their being swept away and replaced "en masse" whenever the Government changes. Were there to be seats effectively in the gift of the CBI and TUC or a Select Committee, then striking a proper political or doctrinal balance would be much more a matter of chance. And the effects of elections might not be that different.

MEMBERSHIP

10.

i. In practice the EAC would inevitably have as its kernel a small number of key figures. It would have to have some staff backing, though not necessarily much or entirely full time.

ii. There would be room for choice in drawing the dividing line between "members" and "staff". The Germans have five "members" and a small anonymous supporting staff, which is based on the Bundesamt für Statistik, for whose role there is no exact British analogue. The American CEA consists of more than a dozen economists, of whom the chairman and his two deputies are public figures of some real weight.

iii. Assuming there are to be "members" and "staff", the obvious alternatives would be three or five members, including the chairman. More would be unwieldy. The question of staff numbers cannot be determined so simply. For it will depend on the term and reference, working methods and decisions on a number of other practical issues, some of which are discussed elsewhere.

iv. The Chairman would obviously have to be a person of some weight, and a good organiser of work; on top of recent economic developments, both in policy and analysis; and, importantly, a competent public performer.

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v. The members could be full-time, a mixture, or entirely part-time with, perhaps, only the head putting in more than two or three days a week on average throughout the year. On any plausible assumptions, the pattern of work is likely to be fairly seasonal. This could matter a lot, particularly if university posts are at stake, or members (and staff) have outside occupations, whether teaching, research or consultancy, which they cannot or would not wish to abandon.

vi. The members should not be solely professional economists or academics, though they should, perhaps, be regarded as economists in the widest sense of the word. One might also aim to include some of the following occupations: financial journalist; City person; ex-economist politician; management consultant; or economically literate businessman.

STAFF AND METHOD OF WORK

11.

i. The supporting staff would best be drawn partly from University or private sector circles, partly from Government statisticians and economists on secondment. Probably only three or four full time graduates would be needed. It would, in any case, be desirable to define firmly in advance the limits of staff and funding within which the organisation was to operate.

ii. The EAC must be expected to draw on work and ideas from a variety of outside sources, whether institutions or individuals, and whether in the UK or elsewhere.

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This might not be very expensive particularly if such studies were as a rule published, as would in any case be desirable for some routine work. Access to the forecasting models of the Treasury and London Business School - and, no doubt, of other bodies if need be - could doubtless be arranged without difficulty. The EAC should, as a rule, be able to obtain basic statistics and material from the official machine at negligible cost whether in terms of money or the workload of officials.

iii. A decision would have to be made about whether the EAC was to hold hearings or publish evidence, particularly if it is to be set up on lines not unlike those of a Royal Commission. There seems to be little point, and some danger, in requiring it to do so. But equally there would be no reason for ruling out either course of action in the terms of reference or guidance.

STARTING UP

12. There are a number of unrelated but important points worth stressing:

i. to secure members or staff in time to begin work by this Autumn and, therefore, to be in time to publish next Spring would, if it is possible at all, require fairly swift action;

ii. some of the details of the EAC's shape and modus operandi may in practice have to be a matter for negotiation with the chairman designate. So, a fortiori, may the staff.

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iii. Decisions about an EAC would have implications for the way in which the Treasury undertakes and publishes its own forecasts, for the evolution of Parliamentary Committees, and for moves towards the Forum idea.

iv. This note deliberately does not go into questions of personalities. But a little thought makes it quite clear that there is not a very wide range of suitable candidates from which to chose members or a chairman.

CONCLUSIONS AND RECOMMENDATIONS

13. To sum up the key recommendations of this paper, if an EAC is set up it should:

- be independent

- have 3 or 5 members and a small supporting staff

- prepare one or two regular reports a year, and do some ad hoc studies either at the request of others or on its own initiative; and

- the final details should not be fixed without consulting the chairman designate, or ensuring consistency with other related plans.

ADAM RIDLEY
15 June 1979

ECONOMIC ADVISERS' COUNCIL - PAST EXPERIENCE

Note by Treasury Officials

1. There have been other attempts by Conservative administrations to set up advisory bodies which would encourage an understanding of the economic problems facing the country. But they have foundered or proved short-lived usually because of opposition from the trade unions.

2. The closest parallel to what we now have in mind was the Council on Prices, Productivity and Incomes (COPPI) set up in 1958 - "to keep under review changes in prices and productivity and the level of incomes" while "having regard to the desirability of full employment and increasing standards of life based on expanding production and reasonable stability of prices". Its first two reports, strongly influenced by Sir Dennis Robertson, aroused a storm of protest from the trade unions. Its third and fourth reports, reflecting the views of a labour market economist, Professor Henry Phelps Brown, were less unpalatable to the unions but had little impact generally. The Council was wound up in 1961 when it had become clear that it had no further useful life.

3. Two lessons can be drawn from this experience: first, that the membership of the council needs to embrace the main stream of economic thinking while avoiding the extremes at either end of the spectrum if it is to avoid the charge of being partisan; second, to make a widespread public impact the reports need to be presented and discussed in a wider economic forum, which includes both employer and employee representation.

M 92

MR. CROPPER

You sent a minute to the Chancellor on 19th June seeking his instructions on the circulation of information which came your way. He prefers your option ii. He has however commented that official advice should be sought on the attachment to your minute, on the discussion of pensions at the centre for policy studies. He thinks that the question of inflation proofing for public sector pensions will become increasingly pressing this winter, but beyond that, does not relish another upheaval.

MAH

(M.A. HALL)
20th June, 1979

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CHANCELLOR

For general guidance, where I come up with intelligences of more or less value, would you wish me to circulate:-

i. to you

ii. to you and Ministers

iii. to you and Ministers and certain officials.

The third course will present some difficulty for me until I know more about the structure of the machine. In any case you may prefer to stick to ii. and give specific instructions where you want a particular note to be given wider circulation.

But we shd seen official advice re [illegible]
—
The pub. sec. [illegible] pref. qn will become increasingly pressing this winter: but, [illegible], do not [illegible] and [illegible]

PETER CROPPER

19th June 1979

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CHANCELLOR

THE FUTURE OF PENSIONS

Last night I attended a discussion at the Centre for Policy Studies with Nigel Vinson, Alfred Sherman, Raymond Nottage and Mr Furse (of Mold).

2. The group were rather disconcerted by their own conclusions, which I think worth recording. They seemed to involve major recasting of pensions legislation and a substantial increase in the role of the State.

1. The starting point was a basic concern with the unfairness now existing between public servants, enjoying their inflation-proofed pensions, and the rest of the population. This had to be put right.

2. This unfairness could only be put right by:
either taking inflation proofing away from public servants (impossible)
or forcing private employers to guarantee their employees' full inflation proofing (impossible).

3. So a new start would be inevitable.

4. At present everybody (subject to niggling requirements on years of contribution etc) was eligible for a rather meagre inflation-proofed State pension. People then fell into four categories:-

i. State servants (civil service, local authority and nationalised industry employees) who enjoy a further layer of inflation proofed provision.

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ii. Employees of companies, who enjoy additional pensions, some inflation proofed to various degrees, but seldom completely.

iii. The self-employed, who only enjoy as much inflation proofing as equity share and property purchases will accord.

iv. The unprovided, who will have to make do on the basic state pension.

5. Since the public servants could not in practice be totally deprived of their privileged position and since the rest of the population could not be given a comparable system of benefits, a compromise would have to be reached.

6. This compromise would involve:

a. substantially increasing the basic inflation-proofed State provision, maybe on an earnings-related basis;

b. rendering any additional provision a matter for personal decision, to be effected through private institutions with no State inflation guarantee of any sort.

7. The implications of that compromise would be that:

i. existing funded pension funds would be closed down and the capital disbursed. (Difficult, but becoming more difficult still if not dealt with soon.)

ii. public servants would be obliged to accept the new situation in respect of their upper layer of pension;

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iii. people would need to be educated to make their own decisions in respect of the upper layer of their pension provision.

8. It was difficult to avoid the conclusion that the Pensions Act of 1975 had already lost its validity. This was what disconcerted the CPS group, since it pointed to the onset of another period of turmoil in the area of State pensions just as we thought we had reached a position of bipartisan agreement. Equally disconcerting was the feeling that the size of the State pensions operation would be substantially increased; this was to some extent balanced by the expectation that the upper layer of personal pensions would be managed entirely in the market sector of the economy.

Conclusion

3. If this compromise is seen as the only solution to the running irritation caused by present public sector privilege, then the question becomes simply whether:-

i. to proceed forthwith

ii. to brush the problem under the carpet for a few years on the grounds that another major upheaval in pensions is unthinkable.

PETER CROPPER

19 June 1979

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M C

CHANCELLOR

EXECUTIVE EMIGRATION

1. John Page has now obtained the Korn Ferry stuff. It seems to be a sizeable organisation: its blurb states:

> "Korn/Ferry International is the world's largest executive search consultancy firm specialising in management recruiting with highly skilled professionals in 18 offices worldwide serving over 800 corporate, institutional and governmental clients."

2. Their February 1979 Survey concludes, on overseas executive movements:

> "The number of those stating they only wished to relocate overseas fell to its lowest recorded level. By contrast those returning to the UK on terminating overseas appointments maintained the high level recorded in the previous Survey. In addition, those stating they were unwilling to go overseas rose from 41.66% to 45.88%. Thus a sharp decline in the executive brain drain has been substantially confirmed."

3. Attached is a "Times" article discussing the Healey claim.

PC.

PETER CROPPER

21st June 1979

A brake on the executive brain-drain

Those who for business or pleasure pay attention to the speeches of Chancellor Denis Healey would have heard him state twice in public, during TUC-week and the run-up to the election announcement that didn't come, that twice as many senior executives now want to return to work in the United Kingdom as want to leave for highly-paid jobs abroad.

In fact Mr Healey was paying a compliment to the work being done by the country's management consultants and headhunters in preparing accurate statistics of senior management movement.

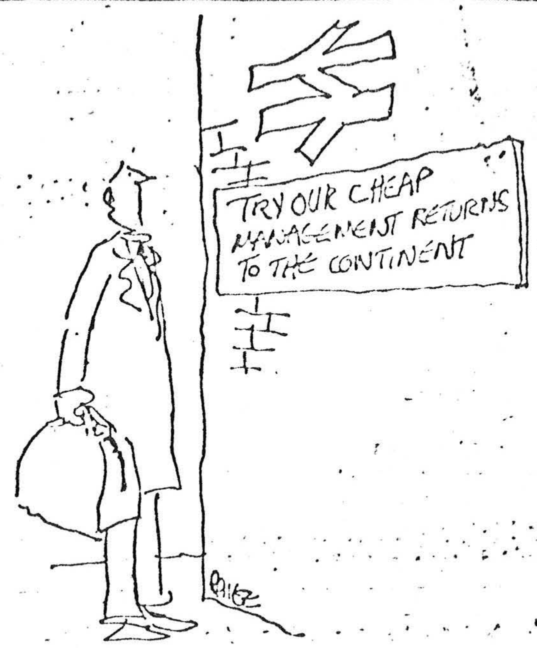
He had based his remarks on a recent survey carried out by Korn-Ferry International. Mr David Munns the company's managing director reported: "This survey confirms the general observations of the last, although certain new trends have emerged. The economic upturn has stabilized and this has created greater confidence amongst companies. As a result this has led to a marked increase in executive vacancies over the past eighteen months. At the same time, a greater number of executives, aware of the expansion of opportunities, are seeking to relocate. As before, their prime reason is to gain higher financial reward.

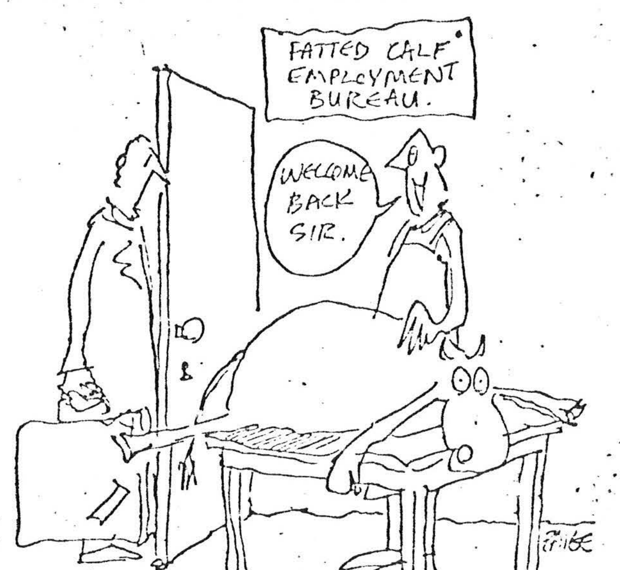
"However, the number of executives wishing to relocate overseas fell to its lowest level since January, 1976. The numbers returning to the United Kingdom were double those expressing a desire to leave. This trend indicates an end to a seriously detrimental loss of talented and able individuals overseas."

Mr Munns adds that his company's survey has found the general economic outlook to be better than it was six months ago and the number of senior management made redundant or wishing to find new jobs because of their firm's financial problems has fallen to its lowest rate since January, 1976.

"Within terms of the job market we are beginning to see a real revival which in turn has brought about greater executive mobility. Many companies will unfortunately continue to lose key individuals from their management teams, but hopefully, fewer and fewer executives will go overseas."

It is as difficult to estimate the numbers of management personnel returning to the United Kingdom in search of jobs as it is to discover the reason for their return. Many give their reason for returning as "missing the quality of life in Britain" while others point to the cost of maintaining a base in the United Kingdom and the cost of living overseas outweighing the increased salary and lower taxation.





The majority point to the increased cost of living abroad, particularly housing. While the cost of certain household purchase in western European countries is cheaper than in Britain the whole household budget can be more than treble. A three-bedroomed house in Holland can cost over £130,000, in Germany £98,000 and in Italy over £600 a square metre of floorspace. Clothing and transport costs are on average 20 per cent more than in Britain, but education, entertainment, and sports club subscriptions, and telephone costs can be high.

One young manager who recently returned from Scandinavia found that although his salary was almost three times that in Britain his standard of living hardly progressed and another who went to a senior marketing job in Holland found that even after doubling his salary and being allowed generous expenses he was marginally worse off than he had been on Humberside.

A further indication of the falling popularity of overseas jobs among senior management—those earning over £12,000 in the United Kingdom—is an authoritative estimate from a specialist recruiter in this field. He found that in the first six months of this year the proportion of his clients who categorically state that they will not consider overseas jobs is 43 per cent, compared with 35 per cent at the turn of the year and 30 per cent last autumn.

The reasons given by the executives involved are that they feel the economic climate has now improved so much that they can see an assured future with their present company or that more attractive jobs are becoming available in the United Kingdom.

One company which specializes in recruiting senior management recently found that out of 400 individuals handled that only 15 of them specified that they specifically wanted to work overseas while 175 said that on no account would they leave Britain. In previous years management consultants have found that the majority of executives they dealt with would at least consider an overseas post with very few stating quite categorically that they would not go abroad.

The statistics of those executives returning to the United Kingdom are, admittedly, misleading. Many of them went abroad for fixed periods knowing that they would eventually return and many others only went abroad because of in-company transfers and promotion.

It is the number of executives who go abroad to work for British companies engaged in overseas contracts who officially remain as United Kingdom employees that clouds the picture. Their companies still list them on head-office payrolls and company schemes insulate them from the increased cost of living abroad. Therefore, on return they are able to paint an unreal picture of life and costs abroad which has led others to try a foreign job without the back-up of a United Kingdom-based company.

There are those within the management consultancy and management training worlds who suggest that the management "brain drain" never happened and stories about brief-case-clutching executives jamming the departure lounges of airports were put about by those consultancies which had vested interests in making the overseas job much more attractive than it was.

However, the specialist recruitment agencies can provide statistics to show that many managers did go abroad in 1976 and 1977 and it is possible that what Korn Ferry International's figures suggest is the start of a trend that will become more apparent in the coming months.

David Young

Spl. Mr. St. Clair

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pwp.

CHANCELLOR

c Financial Secretary
Mr Littler

NO STRIKE AGREEMENTS AND "THE APPROACH TO INDUSTRIAL RELATIONS" (E(79)11)

I notice in the minutes of the meeting of the Ministerial Committee on Economic Strategy of June 19, which took the Secretary of State for Employment's paper with the above title, an interesting point on the question of no strike agreements. The minutes record that "the whole of no strike agreements should be further examined by ..." and then follows a whole list of Departments which exclude the Treasury. It would seem reasonable that, if no strike agreements are to be negotiated (and I do not attempt at this point to consider whether or not it is either right or reasonable to do so), then they are likely to be intimately bound up with the future of comparability and the general structure of pay bargaining in the public sector. This must, surely, relate very closely to the future of the Clegg Commission, the impact of cash limits on pay and much else. The underlying logic of the bargaining position must surely be that no Government would wish to endorse on a permanent basis the continuation of the system of comparability without a substantial quid pro quo such as no strike agreements.

A.B.:
This seems right: Sh[?]. we not [?] to be included?

ADAM RIDLEY
22 June 1979

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CHANCELLOR OF THE EXCHEQUER

Legit to him to work out

Chancellor

Herewith Special Advisers' leave requests.

As for Private Secretaries, would you be content for Tony & I to Sax & Cox from end July → 7 Sept?

MMA
2/7.

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CHANCELLOR

HOLIDAYS

1. This matter seems to have occurred to Adam and me simultaneously at the weekend.

2. I do not expect I am alone in feeling that a proper break would be beneficial this year and was going to open the bidding for August 8th to September 5th. Only the fourth of those weeks is a firm request - the rest is negotiable.

PETER CROPPER

25th June 1979

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C – Could we also ask please?

Chancellor

Holidays

I should like to take a single day's leave on Friday, July 6th to attend family festivities in the North Country.

Looking ahead it would be helpful for Peter and me to know a bit about the times it would suit best and worst for us to be on leave. For example

(1) will we be wanted for the Party Conference?

(2) will you be around for periods in August and September when our presence would be helpful? Ditto early October?

Obviously you may not want to comment yourself yet. But to the extent you can, it would be very helpful.

AR

ADAM RIDLEY

25 June 1979

Chancellor

Martin and I were proposing to box and cox through August & early September if that is OK with you

JBY

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The Chancellor has seen.

CHANCELLOR

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

MINFORD ON THE BUDGET STRATEGY

I attach an advance text of an interesting article by Patrick Minford, which is one to be published in the July issue of the Banker.

The simulations reported on p.10, which were provoked by some discussions Patrick and I had in opposition, offer an intriguing view of the possible longer run effects of the policies you are committed to.

I believe that the LBS will be publishing somewhat similar results in July.

AR

A N RIDLEY
28 June 1979

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FROM THE DEPARTMENTS OF ECONOMICS AND COMMERCE

ELEANOR RATHBONE BUILDING MYRTLE STREET P.O. BOX 147 LIVERPOOL L69 3BX TEL: 051 – 709 - 6022

The University of Liverpool

APLM/JF 21st June 1979

A. N. Ridley, Esq.,
The Chancellor's Office,
H. M. Treasury,
Parliament Street,
LONDON
SW1

Dear Adam,

I enclose an advance copy of an article for the next Banker (due out in early July). It has some simulation figures in which I have finally put together to my partial satisfaction.

I thought you'd like to see these in the light of our previous discussions. I'll let you have other figures as they become available; I have not done any forecasts yet.

All the best,

~~Yours sincerely,~~

Patrick

(Patrick Minford)

Encl.

Reply on Tape

The First Tory Budget : a return to sound money?

I welcome this Budget enthusiastically for the change of direction that it indicates. Not only are the changes implemented this year - with which I assume the reader is familiar - bold and appropriate, but explicit commitments have been made in the Budget speech to these future actions:

1) Progressive reduction of the rate of growth of the money supply and of the Public Sector Borrowing Requirement (PSBR).

2) Further reductions of public spending to achieve this.

3) The progressive dismantling of exchange controls.

4) A review of the investment income surcharge ('justification ... debatable'), of Capital Gains Tax and Corporate Tax on paper gains, and of the Capital Transfer Tax.

Some have commented that it is 'dangerous' to switch from direct to indirect taxes, because of the effect on the retail price index ($3\frac{1}{2}$%) and the supposed 'knock-on' effect on wages. No doubt there are some officials who hope that wages will react in this way and cause an early 'u-turn' towards incomes policy. The Treasury's forecast of accelerating prices seems to reflect some such reaction. These views illustrate a deep-seated unwillingness to apply straightforward economic analysis. Clever officials suppose somehow that working people are stupid and incapable of

recognising their own economic interests; they and union leaders will not realise they are enjoying a rise in real post-tax wages, being misled by the drop in real pre-tax wages! Yet one only has to state this to expose its utter absurdity; needless to say, there is not a shred of evidence for it.

My only regret about this budget is that the forward commitments on the money supply and the PSBR are not made in explicit arithmetic form, year-by-year, for the next four years. It has been suggested that the Treasury opposed this, on the grounds that circumstances might change - and lead to a more inflationary ('expansionary') policy. But this is precisely why we need this total commitment and the implied total commitment to the elimination of inflation from our society by the next election. It is the absence of total commitment that allows inflation to run out of control, as I shall explain in the rest of this article.

My hope - and indeed my belief - is that the Treasury Ministers ~~Treasury team of Ministers~~ acquiesced in the omission of such detailed commitments only because of the speed with which the budget had to be put together. It follows that they should soon announce them. The sooner that commitment is made, the sooner will the beneficial effects of these policies be felt on interest rates, wages, and prices.

The case for the Tories' monetary and fiscal strategy

This is the first budget in this country drawn up explicitly according to monetarist principles. Previously in the budgets of Denis Healey from late 1976 onwards we have had half-hearted compromises designed to placate the 'irrational financial markets'. Targets were enunciated for money supply growth and the PSBR, and were in practice broadly followed. But they were not at the heart of the strategy, and were not paraded in the general exposition of policy that Ministers adopted to the people at large; Mr. Joel Barnett was occasionally allowed to make a few nasty arithmetic points but they were not allowed to obscure the main strategy. This was to increase public spending as soon as a social contract on wages could be 'delivered' by the unions. This contract would reduce inflation and so allow those Ministers to 'expand the economy' without fear of upsetting the City.

Such policies have throughout the post-war period been dear to the hearts of senior civil servants. Indeed it is they that have been largely responsible for selling them to our political masters. They have succeeded to the extent that few politicians have been able to avoid paying lipservice to 'responsible wage bargaining', private sector profiteering', 'joint consultation with unions and industry', 'investment-led growth', 'increasing industrial efficiency' and so on. With the advent of the new government, the

predictable and cunning barrage by senior officials has begun, to 'educate' them and bring them back to the complacent ways of previous macroeconomic failure. However, since these efforts were totally predictable, Ministers should be quite able to use these officials constructively to carry out their strategies, largely because these strategies have been carefully worked out outside Whitehall; the academic opposition has a strong academic and research base and within the economics profession at large the tide has turned strongly in the direction of the policies this government is adopting. The evidence is now overwhelmingly seen to favour the view that markets work and that macroeconomic policies can have a major impact on inflation with at most a modestly stabilising effect on output.

It is by now familiar that the central assertion, common to 'monetarists' (who are nevertheless a very diverse lot in their detailed support for this assertion), is that growth of the money supply must be controlled. The simplest level of exposition defends this reference to 'too much money changing too few goods'. This expression is useful because it has immediate intelligibility to ordinary people but its obvious over-simplicity has led to much misunderstanding among sophisticated laymen and economists brought up on Keynesian economics. The true reasons for the necessity to control the money supply are deeper and hard to grasp, being in fact rather technical. They involve us deeply in

the area of expectations formation.

The standard textbook view - vintage 1970 - of how the economy works went something like this. Imagine the economy starts off with full employment and an inflation rate of say 5%. Now let there be some expansion in demand such as a stimulatory budget. This raises output and employment. The resulting pressure of demand causes inflation to rise; initially not by much because people only gradually realise that prices are rising faster. However, as their expectations catch up with the faster rise, inflation rises more rapidly. If the growth in money supply is held constant (ie. the budget deficit is financed by borrowing outside the banking system), then this higher inflation causes a tightening in financial markets; this, if allowed to continue, will contract ('crowd-out') demand and cause the inflation to fall back. The higher deficit will cause a higher price level and higher interest rates in the long run but not a higher inflation rate, because the money supply growth has been held under control.

By contrast were the authorities to have allowed the money supply to expand so as to prevent any tightening in financial markets (a view associated with the 'real bills' doctrine that money should accomodate the needs of trade at constant interest rates), then no limit would intervene to prevent inflation rising. Strictly speaking, an economy with these policies would in time inevitably move onto

hyperinflation; in practice monetary policy would at some point have to tighten in the face of this worsening inflation. The basic point is that the absence of control over the money supply makes the economy exceedingly vulnerable to inflation; formally, without such control the economy both has an 'indeterminate' price level and is very likely to exhibit unstable behaviour.

This standard textbook model has been challenged from two main viewpoints in recent years. First, the link between budget deficit and money supply growth is closer than this model says because in the long run the extra bonds created by the deficit if money supply growth is held constant have to be absorbed by the private sector; to do this interest rates would have to <u>keep on</u> rising to induce them to hold an ever rising proportion of bonds in their portfolio. In the long run this would have to stop; therefore a higher budget deficit <u>must</u> in the long run be financed by equi-proportionate expansion of money and bonds. The moral is: you cannot in the long run have an independent monetary and fiscal policy.

Second, the 'rational expectations' controversy has questioned the plausibility of the slow process by which agents in the standard model change their inflation expectations. Are they not as well able as the government to perceive the long run implications of the change in policies? If so why should they delay in changing their expectations?

Whatever view one takes as to the realism of 'fully rational' expectations, this line of thought must lead to severe modification of the basic textbook process. In particular, it speeds it up sharply.

The overall effect of these two developments is to make monetary <u>and</u> fiscal control even more urgent - a short run matter in fact. In the text book model there is room for the authorities to 'wait and see', 'keep options open' and so on - the familiar Whitehall lobby material and the essence of 'fine-tuning'. Alas in the new view, lax policies today get translated into their corresponding long run realities and before the authorities know what, they have lost control of inflation - <u>today</u>.

This is in essence the rationale for control of the PSBR and growth in the monetary aggregates. It has little to do with the simple Quantity Theory of money but emerges rather from a fully articulated view of how the economy is likely to work.

But in these terms, it should be apparent why it is insufficient merely to cut the PSBR and money supply growth <u>this</u> year, in the pursuit of lower inflation. These cuts must be part of a medium term programme of sustained and cumulative reductions in the PSBR and monetary growth. The final year of this programme must, if the ultimate objective is a stable currency envisage a PSBR compatible with the private sector's normal rate of acquisition of bonds and

money (or 'net aquisition of financial assets' as this is sometimes called); the evidence for the UK suggests that this is very low in noninflationary conditions, which suggests a PSBR target of zero as the desirable long term aim. The equivalent rate of growth of the money supply compatible with zero inflation will be in the region of 3%, the normal growth of real output; but it may vary somewhat between definitions of money, within a range perhaps of 2-5%.

The issue that is repeatedly raised in opposition to this strategy is unemployment. It is suggested that it will raise unemployment considerably for some length of time; even if it is conceded that this would eventually reduce inflation, this unemployment cost, though temporary, is too large to tolerate, it is argued.

This argument is rooted in the textbook model I described earlier; for in that model the cut in money supply growth works to reduce inflation <u>through</u> the induced rise in unemployment. Yet, as I argued earlier, this fails to take into account the possibility that economic agents will change their inflation expectations 'rationally' in line with the change in policies. If <u>any</u> group of agents in the economy - be it financial agents, or firms, or trade unions - act in this way, the whole process is sharply speeded up, and the output effects along the path become hard to predict but in any case are likely <u>not</u> to be the recession of the textbook model; they could in principle go either way, depending on the

interaction of a variety of shockwaves evoked by the change in policies. In the unusual - but desirable - event that the policy change is announced well in advance of implementation, the output effects are kept to a minimum and the economy moves smoothly to the lower inflation rate.

I have seen at different times simulations of versions of two 'big' models (the London Business School's and the Treasury's) under the assumption that agents in the foreign exchange market have rational expectations. These have tended to suggest that policies of permanently cutting the PSBR and money supply growth in parallel would have small output effects but would rapidly reduce inflation. The reason for the reduction in inflation is clear; it is the anticipation of the long run effects of the policies acting on immediate contracting behaviour. The reason for the modest output effect is roughly speaking that the direct cut in demand arising from the PSBR cut (ie. lower public spending or higher taxes) is offset by higher private spending from (a) the cut in inflation, which directly raises consumption spending (largely an asset effect, but also due to the reduction in uncertainty that lower inflation brings) and (b) the cut in interest rates, which raises the capital value of financial assets and so leads to a diversification into goods.

The numbers in such simulations should not be taken seriously; but they make the point which is that the output

effects will probably not be seriously negative for any period of time. In the same spirit, I set out below simulations from the UK model we have developed at Liverpool in which all agents are assumed to have rational expectations.

The simulations assume for illustration that the strategy over the coming five years is as follows:

	79/80	80/81	81/82	82/83	83/84 and after
PSBR as % of GDP at factor cost	5.3 (£8.25billn.)	4.5	3.8	3.2	2.5
Money supply growth (£M3) % p.a.	13½	12	11	9½	8

The strategy with which they are compared assumes the PSBR would have been held at about 6% of GDP and money supply growth at about 15% per annum. This would have implied inflation running at around 12% p.a. on average over the next five years.

The effects simulated (ie. the differences from what is simulated on the alternative) are:

	79/80	80/81	81/82	82/83	83/84	84/85	Long term effect
Inflation (% p.a.)	-1.0	-3.0	-9.4	-10.4	-9.0	-6.3	-7.0
Short term interest rates (% p.a.)	-3.1	-8.8	-10.4	.9.8	.6.4	-6.2	-7.0
Output level	+1.9	-0.3	-0.4	+1.6	+1.4	-0.1	0

The broad simulation results are that in the long term

inflation and interest rates would be some 7% p.a. lower with these policies than the 12%p.a. that would have otherwise occurred. There is some 'overshooting' of the path in 1981-1983 and this should be ignored as unlikely. The level of output would be quite unaffected by 1984/5; meanwhile there would be minor blips (of ±1% or so) to it reflecting interacting effects of asset changes and the net balance of public demand. These blips should also probably be largely discounted.

The bolder strategy - which it is to be hoped the Tories would choose - of cutting the PSBR to zero (and money supply growth correspondingly) would thus bring the prize of a stable currency within the grasp of this government by the end of its five-year term.

I stress again that importance should not be attached to the detail of such numbers. But the policy point is: the gain in lower inflation from such a strategy is very likely to be large in the long run and to come through rapidly, while any temporary loss of output is likely at worst to be of modest significance. Looked at in this light this Budget heralds the start of a strategy which if persisted in with determination and commitment offers the promise of a return to a sound currency at a cost that we should be well willing to bear.

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CHANCELLOR
FINANCIAL SECRETARY
MR RIDLEY

REAL ESTATE AND EXCHANGE CONTROL

The attached cutting illustrates a dimension in the ending of Exchange Control which may be overlooked. Freedom of portfolio investment may not only mean investment in DOW Chemicals or Quaker Oats. It may mean real estate.

I am not intending to discourage, only to suggest that the ever-enthusiastic nationalised industry pension funds may be found blazing the trail into some pretty risky jungles.

The investment trusts did this a hundred years ago of course. Hence "Scottish Mortgage and Trust Ltd" and "English and New York". And I believe the Dundee investment trust industry originated as a channel for Indian Empire projects (jute etc) flowing west to the real estate markets of New York and the Middle West.

P CROPPER
2 July 1979

Financial Times Friday June 29 1979

Foreign investors eye the U.S. market

THE GREAT American Real Estate Rush is apparently gathering pace, despite mounting controversy within the U.S. over the growing numbers of foreign investors who are buying up property from Long Island to Los Angeles.

But as everyone from the U.S. Congress down watches the spread of overseas participation in American real estate, over 100 potential major investors from throughout Europe and the Middle East have this week been meeting in London to see what America has to offer.

A two-day conference at the Cafe Royal has, in the week in which the National Coal Board's pension funds succeeded in its £67m bid for Continental Illinois Properties of California, provided other would-be investors with an opportunity to hear from leading U.S. real estate specialists what prospects are like across the Atlantic.

The location and evaluation of suitable investment opportunities, the legal aspects of U.S. real estate, tax liabilities and financing procedures have all figured prominently in the type of seminar which is hardly likely to allay American fears that a sizeable chunk of the country's best real estate is due to fall into foreign hands.

According to Mr. Ben Lambert, conference chairman and chief executive of the property division of U.S. broking giant Blyth Eastman Dillon, foreign purchases of American property are increasing, with virtually every type of property being considered for acquisition.

Historically, overseas institutional and individual investors have concentrated primarily on income-producing properties—including offices, shops, hotels and agricultural land. Now they are moving into development transactions, unimproved land, part-interest purchases and buying property companies outright.

With anticipated returns often better than in their own country, overseas investors have also been quick to appreciate that the declining value of the dollar is creating significant foreign exchange bargains. They can frequently achieve tax benefits through real estate purchase in a country where taxation policies are not in any case onerous and are most unlikely to be discriminatory.

Foreign buyers are sometimes drawn to the U.S. by the accepted use of leverage, in contrast to the situation usually found in other markets where long-term mortgage financing can seldom be found for real estate deals.

With the trend towards more planning controls and restrictions (you can still build virtually what you like where you like in major cities like Houston) implying fewer development opportunities and higher rental growth for prime properties, the attractions of the U.S. market seem clear.

Underneath all these considerations lies the implicit belief that the U.S. has come to represent the last bastion of social, political and economic freedom, as well as the best place to invest safely.

Mr. Lambert's assertion at the Cafe Royal that the U.S. also appears to be less vulnerable than other nations to major economic disruptions may, however, have touched on the biggest single imponderable now hovering over the American market.

Whether or not the U.S.—which is now as jittery about inflation as it is enraged about the long petrol queues—can avoid a recession is still anybody's guess. There are many differing opinions on what is in store.

Mr. Lambert says that there is a widespread perception among foreign investors that, in the longer run, the U.S. is still probably more determined and better equipped than most to bring inflation under control, a view which some potential investors might not so readily accept. The U.S. property market has, after all, had its share of slumps in the past.

There is also the question of the likely extent of future opposition to the spread of foreign investment in real estate—a concern which has already led to new legislation covering the purchase of agricultural land by overseas buyers.

The recently enacted Agricultural Foreign Investment Disclosure Act was a direct result of mounting criticism of foreign investment in farmland and it requires any foreign citizen, government or company—or any U.S. company in which an overseas investor holds more than a 5 per cent interest—to disclose full details of their holdings. In this way the Government hopes to determine the full extent of foreign penetration in the market. Whether any further action is then taken remains to be seen.

Supporters of the move claimed that foreign investment in land had created an artificially high market in which American investors could not compete. Overseas buyers, they suggested, could pay premiums over normal market values because of favourable tax treatment offered to non-residents and that the process could eventually permit foreign dominance or control of U.S. food supplies. In a small but growing number of states, foreigners are precluded by law from owning farms.

No one is suggesting that similar legislation is about to hit other forms of real estate investment in the U.S., although it is accepted that by bidding up prices in many prime properties foreign investors are raising the costs for U.S. buyers. A close eye on their future activities is likely to be kept by a fairly vociferous and potentially powerful lobby.

The view of many observers, however, is that despite all the publicity surrounding the influx of foreign money, overseas ownership of U.S. real estate remains extremely small. Neither does it seem ever likely to dominate—if for no other reason than the enormous real estate investment appetite of U.S. individuals and, more recently, of institutions which in many cases have been slow to enter the property investment market.

What is clear is that U.S. real estate is not necessarily an easy option for the foreign investor and that the market, which is largely unregulated and offers little governmental protection to buyers, can throw up a range of complexities quite capable of exposing the newcomers' inexperience in the most painful of ways.

As Mr. Donald Bodel, of Richard Ellis, said in Atlanta last week: "We have shown streams of would-be investors around the market and a lot of them go home shaking their heads, amazed at the fundamental differences which exist here and which have to be thoroughly understood before one penny is spent." That, at least, should be good news to those Americans opposed to foreign investment in their country.

CONFIDENTIAL

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11

Chancellor

MR BATTISHILL

c Mr Patterson
PS/CST
PS/FST
PS/MST(C)
PS/MST(L)
Sir D Wass
Sir L Airey
Mr F Jones
Mr Lavelle
Mr Lovell
Mr Corlett
Mr Griffiths
PS/IR
PS/C&E

Agree - but argument did not prevail in Cabinet

REGIONAL INDUSTRIAL POLICY

May I offer a brief comment on the DofI proposals on Regional Policy which are set out, as a basis for a compromise agreement with other Cabinet colleagues, in Andrew Duguid's letter to you of July 4. It is a well known cliché, and none the worse for that, that Regional Policy must have a reasonably stable framework, and be believed to be reasonably stable, for it to have any effectiveness. Since major changes in the coverage of the assisted areas and in the rates of assistance are already in prospect this year, one wonders whether it is really sensible to envisage a further review of both the minimum limits of RDG and the rate in DAs in as little as two years time. The changes this year will be unpopular enough as it is. Further changes later would certainly excite a good deal of irritation. So on the face of it, the promise to review included in the Secretary of State's compromise proposals is not an entirely welcome feature from an objective point of view. I fully appreciate that, given the tensions and problems involved in reaching any kind of settlement, such unpalatable proposals may have to be entertained. But, in presenting the difficult changes that are to be announced shortly, it would greatly strengthen the Government's difficult position if it were possible now to say that there was no intention, at the very least, to alter the rates and limits for RDGs now to be enforced for the rest of the

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lifetime of this Parliament, except in the most exceptional circumstances.

AR

ADAM RIDLEY
5 July 1979

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C

PM

CHANCELLOR

c Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)

BUILDING SOCIETIES

I spoke today to Ian Gow about the strength of backbench feeling against any intervention in determination of the building societies' lending rates. He reported that he had already drawn this demonstration of commitment to monetary rectitude to the attention of the Prime Minister.

AR

ADAM RIDLEY
7 July 1979

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PWP.

CHANCELLOR OF THE EXCHEQUER
HONI SOIT QUI MAL Y PENSE

2

Chancellor

Please see Adam's note below. As I explained to him (and he notes) the public expenditure side have this problem on board. It is mentioned in para. 4 of the (monster) brief for Cabinet on Thursday below. (I have included this now as you might like the extra time to glance through it).

I also understand that the FST has been discussing the same issue with officials, and may suggest an early discussion with you. He will be sending you a note.

JB 10/7

ey 122

CHANCELLOR

c Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Mr Cropper
Mr Cardona
Sir A Rawlinson
Mr F E R Butler

PRESENTATION OF PUBLIC EXPENDITURE DECISIONS

Mr Cardona and I have been talking to Mr Butler about a very awkward problem which you might like to discuss at the next Ministerial meeting.

2. The Local Authority Associations need, apparently, to know as soon as possible what cuts they are expected to make in 1980/81. If they are to be told formally, then it would be difficult and unwise not to announce the cuts for the other Departments at the same time. Should the final Treasury proposals to Cabinet on July 26 go through, it might just be possible to get in a Statement on it all to Parliament before the recess.

3. There is a fundamental problem about all this however. The 1980/81 cuts, and those for subsequent years should be launched in public only after the "softening-up" exercise which it was recently decided should be undertaken by publishing some kind of document about the medium-term prospect, and by suitable accompanying speeches and so on. A late July announcement date instead of the normal PEWP would make that kind of sequence of events impossible. It is almost impossible to see how one could increase the medium-term problem properly before the end of July. And even if that could be done, it would not be possible to bring in the wider "stabilisation programme" issues which it was agreed belonged in the same document.

4. So there is a great deal to be said for finding ways of satisfying

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the need to give the LA's the early guidance they need without a formal announcement before the normal White Paper.

AR

ADAM RIDLEY
10 July 1979

Since writing this I have learnt that Mr Battishill has been in touch with Sir A. Rawlinson about the matter, & that he will be advising before long.

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PWP

CHANCELLOR

I was asked to speak to Tim Lankester to find out who was going to be responsible for centralising the Ministerial briefing on the pay posture. Mr Lankester indicates that no decision was reached and his view is that it should be for the Chancellor to raise this question in E Committee.

PJC

P CROPPER

11 July 1979

PS.

Tim comes on to say that the minutes of E Committee have made clear that Sir Keith Joseph has been made responsible for coordination.

PJC

AB:

Odd? Maybe not, since he is in chair of the other which has most of the detail?

11 Deputy odd.

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

MR. CROPPER

PROFIT SHARING

The Chancellor has seen your minute of 16 July. He agrees with your second paragraph, i.e. that we should opt for one alternative or the other as soon as we are able to form our view.

M. A. HALL
17 July 1979

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C

cc Chief Secretary
Financial Secretary
Minister of State - Commons
Minister of State - Lords
Mr Ridley
Mr Cardona

CHANCELLOR

PROFIT SHARING

1. John Franklin (director of Morgan Grenfell) who helped in our Wider Ownership policy committee passes the message that:-

1. A lot of companies want to go ahead with new profit sharing/share ownership schemes.

2. They are holding their horses pending guidance from government; legal fees and so on are very costly and there would be no point in instituting a 1978 type or an SAYE style scheme just ahead of a revision of the legal framework.

2. This suggests that we should either say we are going to legislate next April, or indicate broadly what we intend to change and what we intend not to change.

CLEARLY, ASSUMING
WE R ABLE TO
FORM OUR VIEW

PETER CROPPER

16th July 1979

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cc: Mr. Hancock

MR. RIDLEY

FURTHER PRESSURE ON THE US ABOUT
PRICES OF HYDROCARBONS

The Chancellor has seen your minute of 17th July. At yesterday's Royal Garden Party, he asked the American Ambassador whether in fact he was conscious of significant criticism of the statement on grounds that there was no reference to price. Mr. Brewster unhesitatingly identified this as one of the main criticisms of President Carter's statement. He argued however that the huge boost which an increase in price would have given to inflation overshadowed the modest, shortlived, and even doubtful limiting effect on consumption which an increase in price would have had.

MAH

(M.A. HALL
18th July, 1979

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P.W.F.

CHANCELLOR

c Financial Secretary

THE PUBLIC EXPENDITURE WHITE PAPER, AND THE PUBLICATION OF THE MTA

I shall be seeing Frank Cassell tomorrow (Tuesday) for an informal discussion about the kinds of ground which the proposed White Paper might cover. Obviously it will, at this stage, be no more than an exploratory exchange of views. I shall report to you both afterwards to let you know what general conclusions we can both agree on, and any important points of difference.

2. If, however, there are any important points either of you would like me to bear in mind before the meeting, a little guidance, however brief, would help a great deal.

AR

ADAM RIDLEY
23 July 1979

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CHANCELLOR OF THE EXCHEQUER

Chief Secretary
Minister of State (C)
Minister of State (L)
Sir D Wass
Sir A Rawlinson
Mr Anson
Mr F E R Butler
Mr Cardona

PUBLIC SPENDING WHITE PAPER - TREATMENT OF THE LATER YEARS

In his note dated July 30th the FS/T once again argues for the "discontinuance of the publication of the figures for the later years" in the PEWP (my underlining).

It is important to be clear just what the FS/T wants. First, there is the distinction between what is published and what is negotiated in private and agreed with Cabinet colleagues. The FS/T's proposal implies continuing with a review covering the full quinquennium much as now but is quite consistent with its being dropped. I would strongly urge that some kind of internal review be continued to cover years 3-5. Without it there will surely be grave problems of control in later years, of just the kind experienced in Pre-Plowden days.

ON ZERO GROWTH ASSUMPTIONS?

Second, there is surely nothing to be lost from publishing some broad totals for years 3-5, at least down to the level of the major programmes, even if the final stage of disaggregation is abandoned as being meaninglessly precise. It must surely make both for more effective control of the colleagues and for wider public understanding of the changes in public attitudes now required, the latter particularly in circumstances such as those which face us now. To put it another way, I cannot see any hope of explaining to people the consequences of the low growth "worst case" in the medium term without a few broad figures for ceilings for expenditure over the relevant period.

Third, one must ask oneself how well a curtailment of the period covered by the PEWP fits in with the concept of the published medium-term stabilisation plan. To the naive observer - and to many experienced ones too - a continuing commitment to the effective control of expenditure is needed to buttress the PSBR/ M3 targets/framework/guidelines. For a new Government to drop from the PEWP the broader brush figures for years 3-5 (recommended for retention above) would be rather odd. Would it not be an essential part of such a framework of objectives?

Fourth, is there not something to be said for covering years 3-5 in proper detail at least once early on during this Parliament to indicate major changes of direction within programmes?

AR.

ADAM RIDLEY
30 July 1979

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Ix: each of the 3 points in § 8 deserves to be taken v. seriously (& the parenthesis in § 4).

CHANCELLOR OF THE EXCHEQUER

cc Minister of State (C)
Minister of State (L)
Sir L Airey
Sir F Atkinson
Sir K Couzens
Sir A Rawlinson
Mr Bailey
Mr Unwin
Mr Cardona
Mr Byatt
Miss M P Brown
Mr F E R Butler

Provisionally, I c[?] find much in the broad option [?]. But it wd. be helpful if - after I come back, or tomorrow - FST + A.R cd react fully to § 5 + § 8 (3)

AUTUMN WHITE PAPER, TIMETABLES ETC

Sir D Wass and the FS/T here already commented to you (on July the 27th and 30th respectively) on Mr Unwin's paper of July 27th, so the following comments are offered in reaction to all three minutes.

The fundamental choice

2. Like the FS/T I have, as you know, always felt that longer run expenditure decisions should be presented against the context of their economic justification. However unlike him, my first preference would not be for attempting to do so in the early Autumn as he suggests. The best course of action seems to me to be variant (c) as outlined in paragraph 15 of Mr Unwin's paper, whose first stage is an early, but restricted announcement to Parliament of 1980/81 decisions, followed some weeks later by a considered White Paper. My reasons are as follows.

This is my view too, for just the same reasons. PB

3. The general pattern of economies proposed for 1980/81 is already entering public consciousness through leaks. Much more will do so before long when the guidance to Local Authorities has been undertaken. A formal statement to Parliament and the accompanying detail will necessarily provoke some hysteria whatever the circumstances. But most of it will be fairly synthetic, and

almost all of it unavoidable. The problem that some of the figures will be provisional and subject to later revision (Mr Unwin's paragraph 15) is surely not insuperable. The figures could be presented in that light and the revised ones published later in the full PEWP.

4. I fear that it would not be possible to prepare the kind of really full White Paper which is required in time to meet a late October publication date, albeit while doubting whether the timetable need be quite as slow as Mr Unwin's minute suggests (there is a case for looking very carefully at it to see if it cannot be speeded up). This is because

(a) The document ought at least to include firm outline figures for expenditure in the later years, for the reasons set out in my minute on the coverage of the PEWP of July 30th. Since it seems very unlikely that firm decisions can be reached about them so early on, an early date becomes impractical unless the PEWP is only to cover years 1 and 2.

(b) I would not go as far as the FS/T, and would want to use some MTA figures as one element in the economic analysis.

(c) Your own plans are difficult to fit in with this timetable, given the Party Conference, your absence in the latter part of September, and the need to allow, say, a full week between completing the draft (by October 15th?) and publication (October 22nd?).

(d) I suspect that the analytical work which ought to be done before one can be really confident that the medium-term objectives are well founded could well be pretty complex, and would merit something of an iterative dialogue between yourself and your colleagues, and those doing the background work and drafting.

CONFIDENTIAL

(e) The case for tying in the Bray amendment projection and the folling-forward of the monetary target is very strong, though not of course overwhelming. But neither could be dealt with in an October White Paper.

5. Comparing my views with the FS/T's suggests to me that both he and I ought to commit to paper a slightly clearer indication of what we imagine the new PEWP should tackle and how. I suspect our objectives are very similar, but the means we might choose are rather different.

6. Lurking in the background are differences of view both about the MTA, and how one might present public expenditure decisions or aspirations in the longer-run. The issue of the vices and virtues of the MTA and similar devices is too big a topic for discussion in this note. Suffice it to say at this point that at the very least I would not discard its output as a way of building up our worst case. I do not see how a Treasury can confidently plan and control expenditure or educate the public without any illustrative figuring to hand. There are undoubtedly shortcomings in what the MTA is and does. But the best way to deal with that problem is by including other projections as well which, whatever their defects, go some way to making good the weaknesses of the MTA. The MTA report has gone a little way down this route with its variants already, and there is nothing in principle to prevent one from developing that kind of alternative view further. [The "angst" one faces when offered more than one variant springs, I suspect, from recent experience, in which all variants were grotesquely over-optimistic, and the one taken to justify spending plans was often at the absurder end of the spectrum. We, however, are proposing the opposite.]

7. All this said, the FS/T's proposal is obviously not to be ruled out of court. It would certainly be possible to write something which justified holding expenditure constant for a long

time ahead, outlined an approach to monetary targets in the longer-term (and the PSBR or PSD) and perhaps say something about tax policy. But I fear it would be a rather limited document, and suitably scarcely easier to defend before the new Select Committee than one based on the MTA. After all a great deal of it would consist of declarations of faith and intent. While it might turn out, after sketching out such a document, that it had a certain intangible quality which both lent it conviction and rendered it immune from criticism, I should need to have looked much more carefully at a skeleton or draft before I could be convinced!

8. Finally a few practical points, some of which have been made already:

(1) The case for expediting further expenditure decisions in Cabinet is strong (cf Mr Unwin's paragraph 4).

(2) The timetable constraints identified by Mr Unwin for the normal MTA exercise merit probing. Does it really need to take so much time? Do DHSS need 3 weeks to re-calculate their Social Security figures?

(3) Some preliminary sketching out of the coverage of the White Paper should be undertaken by enthusiasts for it such as the FS/T and myself.

AM

ADAM RIDLEY
31 July 1979

PS
In the interests of economy I am not sending this to all recipients of earlier correspondence on this subject!

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CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

Chancellor

Lambeth etc.

I've spoken to Gordon Reece and he will try & get some investigations & a story going. I mentioned Sir J.P. as a contact but no one else. If you knew of any others it wd. help, I suspect.

AR 31/7

?

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CHANCELLOR OF THE EXCHEQUER

28TH MEETING

NOTE FOR THE RECORD

CHANCELLOR'S MORNING MEETING 31ST JULY 1979

Present:
Chancellor
Chief Secretary
Minister of State (L)
Mr. Cardona
Mr. Cropper
Mr. Ridley

Lambeth Health Authority

1. Ministers should look for ways of backing up the Secretary of State for Social Services in correcting the misleading impression given by the Authority.

National Savings

2. The Chancellor would discuss with officials the possibility of making a statement denying the Government's intention to close down any of the major National Savings services.

CTT

3. The Minister of State (Lords) sought guidance on the minimum figure it would be reasonable to aim at as the yield of a reformed Capital Transfer Tax. The Chancellor felt that this question had to be seen in the context of the planned yield from capital taxes as a whole, but he felt £150-£200 million was the minimum yield that should be budgeted for and the Chief Secretary endorsed this.

4. It was felt that there would be no time for a formal round of consultation on CTT reform given the intention of legislating in April 1980, but that the Inland Revenue should be encouraged to put informal enquiries to certain of the representative and professional bodies.

Tax Exiles

5. Mr. Cropper was asked to seek information on returning tax exiles, eg from the CBI.

/Tax Consultations

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Tax Consultations

6. Mr. Cropper would speak to Private Secretary, Inland Revenue, to enquire whether all the necessary guidance had been given in order that the requisite "Green" or Consultative Papers relating to topics for 1980 legislation might be prepared ready for submission to Ministers in September.

Cuts in Civil Service Expenditure

7. The Minister of State (Lords) would represent the Treasury on the Lord President's exercise identifying options for further cuts in administrative expenditure. The first meeting would be on 13th September.

Public Attitudes on Pay

8. Financial Secretary would represent the Treasury on the new committee that had been set up to publicise the Government's philosophy on pay determination. This committee was intended by the Prime Minister to be led by the Treasury; its members would include the Paymaster General and Mr. Henry James.

COP

9. Ministers discussed the Inland Revenue minute of 27th July setting out progress on plans for computerisation of PAYE and putting forward names of advisory consultants. Advice on how to react to the submission would be sought from Mr. Hoskyns and others. Mr. Ridley undertook to suggest further names.

Meetings to Review Economic Economic Position

11. It was important that these meetings, with officials, should if possible be held before departure of the Chief Secretary.

PC

(PETER CROPPER)

31st July, 1979.

Circulation: Those present
Financial Secretary
Minister of State (C)
Mr. Battishill
Sir Douglas Wass
Sir Anthony Rawlinson
Sir Lawrence Airey
Sir Kenneth Couzens Sir Fred Atkinson

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C

FINANCIAL SECRETARY TO THE TREASURY

17

CHANCELLOR OF THE EXCHEQUER

IMMIGRATION POLICY AND SEX DISCRIMINATION

You asked for the papers on this. I understand from Home Office officials that Mr Whitelaw was given a substantial paper last weekend for his approval, but that he does not appear to have finished considering it. The CRD desk officer is on leave so I can learn nothing from him. As soon as papers become available I shall be able to forward them to you.

La.

GC

GEORGE CARDONA

19 Sept 1979

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Floating round - by mistake? - in UNEMB Brief file

Chancellor of the Exchequer

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

MICRO-ECONOMIC ADVICE

I have seen Peter Cropper's note of 13 September. I am much in agreement with his analysis.

Peter Rees

PETER REES
3 October 1979

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CONFIDENTIAL

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

CHANCELLOR

MICRO-ECONOMIC ADVICE

1. You have asked for comments on the Wass/Byatt papers on Micro-Economic Advice. In case it arises at the 5.15 pm Ministers' meeting tonight, herewith a few notes. I shall have to leave the meeting early to go and hear the Stock Exchange lecture on the French experiment in tax encouragement of investors.

2. You may or may not wish me to copy these notes to Sir Douglas.

PJC.

PETER CROPPER

13th September 1979

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MICRO-ECONOMIC ADVICE

Comments on the papers by
Sir Douglas Wass and Mr Byatt

1. I can see plenty of good reasons for increasing still further the amount of economic work done inside Government, and of micro-economic work in particular. But before addressing ourselves to that, I suggest we need to look at the broader balance of our establishments.

2. I do not lack for understanding of what applied economists can do. I was one myself and, as membership secretary of the Business Economists Group for most of its first ten years, I can take some credit for the growth of the profession. But 63 economists in the Treasury and 398 in the GES as a whole is an awful lot of economists, and I think we ought to apply a bit of marginal analysis to these figures themselves. Compare, for example, the marginal utility of one fewer economist giving advice and one extra person on the Chancellor's private office and its environs. Or indeed, 20 and 20.

3. Our problem is not shortage of advice. It is shortage of time and resources for considering and acting on that advice. On the strength of my admittedly brief experience in Government, my overwhelming impression is of a small and grossly overloaded decision-making summit sitting atop a vast and smooth-running civil service machine. Ministers, the ultimate decision-takers, are swamped, deluged with work of every conceivable variety. They can barely pick and choose between the policy papers before rushing back to the next heap of letters to sign, the next speech draft, the next constituency or party engagement, the next staff side meeting or pressure group conference.

4. The private office (using the term in a very broad sense) would be transformed by the injection of twenty good economists, who would write speeches, invent jokes, augment the two private secretaries, assess and pre-digest policy papers for Ministers, liaise with the media, etc, etc. All the things, readers will no doubt remark, that Special Advisers are meant to do.

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5. It may be that I should not be applying my marginal analysis to economists. Maybe I should be questioning the balance between the size of the private office and the size of the government corps of ratcatchers. But I have a special reason for raising this issue in the present context because:-

i. Economists are versatile characters and can therefore be regarded as particularly eligible for a marginal switch from back room analysis to a place at the political coalface. (By politics I mean the interface between the governors and the governed; Party politics are only a small part of this.)

ii. It is in any case frustrating to economists if they feel that the products of all their hard work are barely looked at by the decision makers as they rush from one meeting to the next - if indeed they are seen at all.

6. In my own field of taxation, to which Sir Douglas and Mr Byatt refer particularly, I would certainly apply the above arguments. There is good work being done by the Institute for Fiscal Studies, Bath University, York - and all the Brookings and similar work in the USA, much of which is applicable to countries in general not just the States. The problem is not one of scarcity; it is largely a problem of finding the right people to read the stuff and the right format in which it can (after digestion and assessment) be fed into the top decision making process.

7. I suppose what I am saying is that we need a complete re-think of the relationship between politics and administration (again meaning politics in its broadest sense, not just in the Party sense). And, more particularly, of the allocation of scarce resources between political and administrative functions.

PJ.

13th September 1979

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FINANCIAL SECRETARY TO THE TREASURY

CHANCELLOR OF THE EXCHEQUER

Chief Secretary
Minister of State C
Minister of State L
Mr Ridley
Mr Cardona

MICRO-ECONOMIC ADVICE

I have seen Peter Cropper's note of 13 September.

Not surprisingly, Mr Cropper has hit a most important nail bang on the head.

NL

NIGEL LAWSON
13 September 1979

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CHANCELLOR

PARAGRAPHS 12 and 16 OF ANNEX 2

I gather that the run of assumed exchange rates in paragraph 12 derived from information which the Bank of England gave to Rolls Royce in July. The Treasury first heard of them when they were quoted at a meeting of officials in August. Given their provenance those concerned saw no reason to take issue with the figures.

2. Mr. Hancock's present view is that there is quite a good chance that the dollar will strengthen next year and an equally good one that it will then fall back again.

3. But he is mainly concerned to ensure that important financial decisions do not depend critically on <u>any</u> central estimate of the rate over the next five years, given the known difficulty of making any very sound predictions in this field. Rather, his approach would be that decisions should be tested against a range of plausible exchange rate movements, showing worst and best cases. Because of dollar pricing, the worst case for Rolls Royce would be one in which sterling either continued to appreciate or at least did not depreciate against the dollar. Over a five year span the first seems pretty unlikely, but the second can by no means be dismissed as implausible. Our advice, therefore, would be to test the cash flow requirement for Rolls Royce against an assumption of an unchanged $2.10 throughout the period.

AMB

A. M. BATTISHILL
8th October 1979

(i) a reduction in the number of additional staff posts for the Commission to 183 (including 41 temporary) from the 717 (including 100 temporary) requested; also a reduction to 151 from 200 in the number of temporary staff attributable to Greek Accession;

(ii) reductions of 180 MEUA in commitment appropriations and 85 MEUA in payment appropriations for the industrial and energy sectors; reductions of 58.8 MEUA in commitment appropriations and 31.9 MEUA in payment appropriations for the research and investment sector; moreover, several items with token entries in the Preliminary Draft Budget were deleted as no proposals from the Commission had yet been received by the Council;

(iii) reductions in commitment appropriations for the Social Fund from 1000 MEUA to 826 MEUA and in payment appropriations from 550 MEUA to 350 MEUA;

(iv) reductions in commitment appropriations for the Regional Development Fund from 1200 MEUA to 850 MEUA and in payment appropriations from 610 MEUA to 527 MEUA;

(v) transfer back to Title 6 (EAGGF Guarantee Section) of provision for food aid refunds and ACP sugar included in Title 9 in the Preliminary Draft Budget;

(vi) deletion of the overall operational reserve included by the Commission in Title 10.

Further details of changes agreed by the Council can be found in Volume 7 of the Draft Budget.

16. The Council also decided that the presentation in the Draft Budget of borrowing and lending operations should accord with the Financial Regulation of 21 December 1977 and appear as an annex to the Commission Section.

THE COMMUNITY BUDGET - BACKGROUND NOTE

The following paragraphs outline the procedures which apply to the adoption of the Budget of the European Communities.

2. Under Article 203 of the Treaty of Rome, as amended by the Treaty of 22 July 1975, each Community Institution is required to forward to the Commission by 1 July each year estimates of its expenditure in the following year. The Commission then consolidates these along with the estimates of its own expenditure and forwards the consolidated Preliminary Draft ("avant-projet") Budget (PDB) to the Council by 1 September.

3. The general sequence of events provided for in the Treaty is then as follows:-

i. The Council refers the PDB for examination to the Budget Committee (comprising officials of the Member States and the Commission). Unresolved matters are then discussed in the more senior Committee of Permanent Representatives.

ii. A meeting of the Council of Ministers, normally attended by Ministers from Finance Departments, takes place, and, acting by a qualified majority (see below), "establishes" (ie approves) the Draft Budget, which is then forwarded to the European Parliament by 5 October.

iii. The Parliament may, acting by a majority of the votes cast, propose modifications to items in the Draft Budget "relating to expenditure necessarily resulting from this Treaty /of Rome/ or from acts adopted in accordance therewith". In addition, the Parliament may, acting by a majority of its members, make amendments to the Draft Budget in respect of "expenditure other than that necessarily resulting from this Treaty /of Rome/ or from acts adopted in accordance therewith". The Parliament has 45 days in which to complete its deliberations.

iv. The Council, acting by a qualified majority, then rejects, accepts or alters the Parliament's modifications; and may propose changes in the Parliament's amendments. The Council has 15 days in which to do this.

v. If the Council seeks to modify the Parliament's amendments, the Budget is returned once more to the Parliament. Within 15 days the Parliament then has to decide, by a majority of its membership and a three-fifths majority of the votes cast, on the Council's proposed modifications.

vi. The President of the Parliament then declares the Budget finally adopted. However, the Parliament may, if there are important reasons, reject the Draft Budget and ask for a new draft to be submitted to it.

4. By informal agreement of the Institutions, the timetable has been advanced in recent years in order to provide more time for consideration at each of the various stages. However, because of the postponement of the First Budget Council from 23 July to 11 September, the timetable this year has had to be further modified and at present can only be roughly estimated as follows:

i.	Commission PDB to Council	15 June
ii.	Budget Council meeting of Ministers to establish Draft Budget	11 September
iii.	Proposed modifications and amendments to the Draft Budget to be forwarded by the European Parliament to the Council	(17 November)
iv.	Budget Council meeting of Ministers to decide on the Parliament's proposed modifications and amendments	(23 November)
v.	Further consideration and adoption of Draft Budget by the Parliament	14 December

5. The Council acts in relation to the Budget by a qualified majority. Under Article 148 of the Treaty, as amended, member States have the following votes:

Belgium	5	
Denmark	3	
France	10	
Germany	10	
Ireland	3	
Italy	10	
Luxembourg	2	
Netherlands	5	
United Kingdom	10	Total 58

Forty-one votes cast by at least six Member States constitute a qualified majority.

6. The Budget of each Institution is divided into Titles, Chapters, Articles and finally into Items. These are numbered in a decimal system; thus item 1140 is part of Article 114 of Chapter 11 in Title 1.

ANNEX B

BUDGETARY POWERS OF THE EUROPEAN PARLIAMENT AND THE COUNCIL

Article 203 of the Treaty of Rome, as amended by the Treaty of 22 July 1975, gives the European Parliament two sets of powers over Community Budget expenditure:

i. A power to propose modifications to the Draft Budget appropriations relating to expenditure "necessarily resulting from this Treaty or from Acts adopted in accordance therewith" (ie. obligatory expenditure*). Such proposals for modifications are subject to an overriding veto of the Council of Ministers, acting by qualified majority. Where a modification would increase overall expenditure it is not included in the Budget unless the Council approves it, acting by qualified majority. Where a modification would not increase overall expenditure, it is included in the Budget unless rejected by the Council, acting by qualified majority.

ii. A power to make amendments to the Draft Budget appropriations relating to expenditure "other than that necessarily resulting from this Treaty or from Acts adopted in accordance therewith". (ie. non-obligatory expenditure*). The Council has a power to alter the Parliament's amendments but this power is subject to a further overriding power of the Parliament to reject by a majority of its members and three-fifths of the votes cast, the Council's suggestions.

2. The two categories of expenditure referred to at (i) and (ii) above are not defined in the Treaties. The Council of Ministers and the Parliament therefore had to agree during their consideration of the 1975 Community Budget on how the distinction between the two categories of expenditure should be drawn. Agreement was reached on the basis of a working classification prepared by the Commission;

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* The terms "obligatory" and "non-obligatory" expenditure are used for convenience; they do not appear in the Treaty. (The terms "compulsory" and "non-compulsory" are also used).

under this, expenditure for programmes laid down by the Treaties (eg. the EAGGF) or arising from firm international agreements (eg. aid) were classified as obligatory while all other expenditure (eg. staff pay, administration, research and the Social Fund) were classified as non-obligatory. Agreement on the principles has not yet been reached but it has proved possible in practice for the Budget to be considered and adopted without formal agreement.

THE MAXIMUM RATE

3. Article 203(9) of the Treaty of Rome, as amended by the Treaty of 22 July 1975, provides for a limit to be set each year on the increase in the total appropriations for non-obligatory expenditure compared to the previous year. Although there is no reference in the Treaties to separate commitment and payment appropriations, the Council and the European Parliament have agreed informally that the maximum rate should be applied separately to each total. The first stage in this procedure involves the calculation of the maximum rate by the Commission on the basis of trends in the preceding year of Member States' real GNP, public expenditure and cost of living indices. In accordance with this procedure, the Commission declared a maximum rate of 13.3% for the 1980 Budget. The Council and the Parliament hold differing interpretations of the provisions governing the precise operation of the maximum rate, but in general terms their effect is as follows:

i. If at any stage of the budgetary procedure the Parliament, Council or Commission considers that non-obligatory expenditure should be increased beyond the limit allowed by the maximum rate calculated by the Commission, a higher rate may be fixed by agreement between the Council, acting by a qualified majority, and the Parliament, acting by a majority of its members and 3-5ths of the votes cast. In the absence of such an agreement, the maximum rate limits the increase in non-obligatory appropriations in the following way.

ii. If the rate of increase in non-obligatory expenditure in the Draft Budget (ie. that established by the Council of Ministers and sent to the Parliament) is less than half of the maximum rate, then the Parliament may increase the total of non-obligatory expenditure up to the maximum rate.

iii. If the rate of increase of non-obligatory expenditure in the Draft Budget is more than half of the maximum rate, the Parliament can further increase the total of non-obligatory expenditure by an amount not exceeding half the maximum rate, (eg. if the Commission declared a maximum rate of increase of 10%, and the Council's Draft Budget provided for an increase in non-obligatory expenditure of 6% compared to last year, the Parliament could put forward amendments adding a further increase of 5%, making an increase of 11% in all).

4. For non-obligatory expenditure, the Draft Budget provides for an increase of 145,988,426 EUA (4.84%) in commitment appropriations for non-obligatory expenditure, but a decrease in payment appropriations of 37,819,529 EUA (-1.67%). As a result, the margin of manoeuvre available to the Parliament is 255,254,262 EUA on commitments and 338,925,181 EUA on payments.

5. At the 570th meeting of the Council of Ministers (Budgets) in Brussels on 22 March 1979 the Council had a thorough exchange of views on the internal procedure it was to follow when considering the Draft Budget and when fixing the Maximum Rate. At the close of the discussion eight delegations undertook to apply the following in connection with the budgetary procedure:-

(a) If the Draft Budget as established by the Council after its first reading exceeds the maximum rate, the Council will vote on the new rate thereby produced before forwarding the draft to the European Parliament.

(b) During its discussion on the amended Draft Budget, the Council will make a preliminary examination of all amendments. At the end of this examination it will vote on the amendments which it has ascertained it is able to reject.

If the total of the unrejected amendments would involve exceeding the maximum rate established, the Council will examine whether there is a qualified majority among its members in favour of increasing that rate accordingly, having regard, where appropriate, to the 4th subparagraph of Article 203(9).

If the rate which it chooses is incompatible with the total of the unrejected amendments, the Council will, by determining its priorities, where possible, among these amendments, endeavour to reconcile its positions on the individual amendments with the maximum rate on which it can agree.

In this endeavour, the Council will take account of the need for the Community to play a supporting role, as part of increased solidarity, in order to achieve better convergence and a harmonious development of the economies.

Within the 15-day period laid down in Article 203(5) of the Treaty, the Council will reject or modify those amendments which it cannot bring within the limits of the maximum rate on which it agrees at the end of the examination, where necessary and as a last resort by making a proportional reduction in each of the amendments still under discussion.

(c) If the maximum rate which the Council has chosen exceeds the maximum rate established, the Council will propose this new rate to the European Parliament, thus initiating the procedure provided for in the last subparagraph of Article 203(9).

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(Not included in the document series)

EXPLANATORY MEMORANDUM ON THE DRAFT OF THE GENERAL BUDGET OF THE EUROPEAN COMMUNITIES FOR 1980

Submitted by H.M. Treasury 12 October 1979

SUBJECT MATTER

This explanatory memorandum concerns the Draft Budget of the European Communities for 1980. It reflects the changes agreed by the Council of Ministers to the proposals submitted by the Commission in the Preliminary Draft Budget for 1980. An explanatory memorandum on that document (7633/79) was provided on 27 June.

2. The Draft Budget consists of seven volumes:-

Volume 1: Statement of the estimated revenue of the European Communities together with a summary of the expenditure of each of the Community Institutions (the Council, the European Parliament, the Commission and the Court of Justice) and the Court of Auditors.

Volume 2: Draft Budget of the European Parliament.

Volume 3: Draft Budget of the Council of Ministers, including the Economic and Social Committee.

Volume 4: Draft Budget of the Commission, including the Office for Official Publications.

Volume 5: Draft Budget of the Court of Justice.

Volume 6: Draft Budget of the Court of Auditors.

Volume 7: Explanatory Memorandum of the Council on the Draft Budget.

3. The Draft Budget has been established in European Units of Account (EUA). The EUA is made up of a basket of national currencies

and its value, in relation to national currency, is calculated each day. It thus accurately reflects the value of national currencies in relation to one another. In preparing the estimates for 1980 the value of the EUA at 1 February 1979 has been used. The conversion rate in relation to Sterling is therefore £1 = 1.4813 EUA.

4. The appropriations included in the Draft Budget cover both commitments and payments. Commitment appropriations lay down the limit within which action may be undertaken during a year; payment appropriations lay down the limit on expenditure which may occur during the year. Where it is expected that actions initiated during the year cannot be completed within that year (eg Social Fund, Regional Development Fund, EAGGF Guidance Section), the budget appropriation is divided between separate commitment appropriations and payment appropriations. Where action can be completed within the year (eg staff pay, administrative expenditure, EAGGF Guarantee Section) the appropriation is not divided but serves as the limit on both commitments and payments.

TIMETABLE

5. The Draft Budget will be discussed by the European Parliament in the week commencing 5 November. Any amendments and proposed modifications which it adopts will then be forwarded to the Council, which is expected to decide on them at a Second Budget Council on 23 November. Its decisions will then be communicated to the Parliament, which, in the week commencing 10 December, will decide what action to take on the changes proposed by the Council to its amendments. When this procedure has been completed, the European Parliament finally adopts, or rejects, the Budget. (Background material on the Community Budget and on the European Parliament's powers in relation to it is given in Annexes A and B.)

MINISTERIAL RESPONSIBILITY

6. Treasury Ministers are responsible for the Community Budget generally, but other Ministers are concerned with the parts of the Budget which concern their own departmental interests.

IMPACT ON UK LAW

7. The Community Budget does not affect UK law.

POLICY IMPLICATIONS

8. The Draft Budget reflects the decisions taken by the Council of Ministers (Budgets) on 11/12 September and will now be considered by the European Parliament. The Council will then consider the European Parliament's proposed modifications and amendments which are likely to be available in early November.

9. Total expenditure of 14,907,479,241 European Units of Account is proposed in the Draft Budget for 1980. A comparison between the expenditures in the Community Budget as agreed for 1979, and as proposed in the 1980 Preliminary Draft and Draft Budgets, analysed between the various Sections of the Budget is as follows:

EUA

	1979 Budget (1)	1980 Preliminary Draft Budget	1980 Draft Budget
Council of Ministers	102,807,700	108,613,649	108,613,649
European Parliament	144,190,700	167,880,232	167,880,232
Commission	13,436,420,670	15,988,249,650	14,596,318,600
Court of Justice	19,576,220	23,917,810	21,627,470
Court of Auditors	12,718,580	15,443,090	13,039,290
Total	13,715,713,870	16,304,104,431	14,907,479,241

The total of commitment appropriations provided for in the Draft Budget is 15,981,327,241 EUA, made up as follows:

	1979 Budget (1)	1980 Preliminary Draft Budget	1980 Draft Budget
Council of Ministers	102,807,700	108,613,649	108,613,649
European Parliament	144,190,700	167,880,232	167,880,232
Commission	14,417,740,715	17,616,695,650	15,670,166,600
Court of Justice	19,576,220	23,917,810	21,627,470
Court of Auditors	12,718,580	15,443,090	13,039,290
Total	14,697,033,915	17,932,550,431	15,981,327,241

(1) including Supplementary Budgets Nos 1 and 2 for 1979.

10. The Budgets of the Council, European Parliament, Court of Justice and Court of Auditors are almost entirely for their administrative and running expenses. The main Community policies (eg. the CAP, the Social Fund, the Regional Development Fund, Aid, etc) are included in the Commission's Budget, which accounts for some 98% of the expenditure and commitments provided for in the Draft Budget.

11. Some 176 MEUA of the expenditure proposed in the Draft Budget would be financed from various miscellaneous receipts etc. The remainder, 14,731 MEUA would be financed by Member States in accordance with the Council Decision of 21 April 1970 (the "Own Resources Decision").

12. The revenue section of the 1980 Draft Budget has been prepared on the basis that VAT own resources, as provided for in the Own Resources Decision, will form part of Budget revenue and will be contributed by all Member States. The Sixth VAT Directive, laying down the harmonised base from which VAT own resources are calculated, was adopted by the Council on 17 May 1977. It is estimated that the percentage of the harmonised base required to finance the 1980 Draft Budget is 0.74.

13. The UK's share of gross contributions to the 1980 Community Budget is estimated at 3063 MEUA (20.8%). At the rate of conversion used in preparing the estimate, this would amount to £2068 million. Since, under the full own resources system, Member States have no obligation to finance a specific share of the Community Budget, the actual UK gross contribution to the 1980 Community Budget will depend on the volume of own resources actually established. The UK's gross contribution to the Budget will be partially offset by receipts from the Budget.

14. The commitments and payments provisions proposed by the Commission for its section of the Preliminary Draft Budget, and the provision agreed by the Council, compared with the 1979 Budget provision are as shown on the table overleaf.

15. The Council agreed the following main changes to the proposals put forward by the Commission in the Preliminary Draft Budget:-

FF

BREAKDOWN OF EXPENDITURE PROVISIONS - SECTION 3 (COMMISSION) ONLY

Million European Units of Account

	1979 including Supplementary Budgets Nos 1 and 2		1980 Preliminary Draft Budget		1980 Draft Budget	
	Commitment appropriations	Payment appropriations	Commitment appropriations	Payment appropriations	Commitment appropriations	Payment appropriations
Administrative and other expenditure (salaries, allowances etc, buildings and equipment, surveys, publications information, etc)	551	551	641	641	582	582
Repayments to member States for the cost of collecting on resources	692	692	733	733	738	738
Miscellaneous expenditure in Title 3 (certain social and environmental expenditure, agricultural expenditure, scientific expenditure, etc)	38	44	36	38	26	51
Industrial and energy policies	79	54	271	161	91	76
Research and investment	235	217	368	307	309	275
European schools	30	30	34	34	34	34
Social Fund	695	502	1,000	550	826	350
Regional Development Fund	945	499	1,200	610	850	527
*EAGGF - Guarantee Section	9,602	9,602	10,442	10,442	10,854*	10,854*
*EAGGF - Guidance and Fisheries Section	643	453	554	419	477*	359*
≠ Food and other aid	310	306	852≠	850≠	305	304
Aid to non-associates	116	67	147	27	116	25
Co-operation with non-member states	195	129	221	182	178	158
Other (eg. Provisional Appropriations and Contingency Reserves)	287	290	1,118	974	284	293
	14,418	13,436	17,617	15,988	15,670	14,596

* 1900 Draft Budget figures take account of the First Letter of Amendment.

≠ 1980 PDB figures included provision for Food Aid Refunds and ACP sugar, which the Budget Council on 11 September put back into the EAGGF Guarantee Section.

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CHANCELLOR OF THE EXCHEQUER

keep it fairly approximate and broad brush, and urge anyone who wants to go further [eg a tenacious questioner on the new Select Committee] to experiment with the Treasury model himself. To include the VAT figure in the text would make it more difficult to stick to such a line. For various reasons the range of possible VAT figures is far wider (from 8% to 26%). The further one is drawn in to discussing it, the greater are both the risk of being drawn into a morass of alternative forecasts and the pressure to undertake and make public a series of model runs which we would all rather avoid. I therefore recommend that no references to VAT should be used in the White Paper, though of course they should be drawn on in presentation and debate.

4. As a postscript I should mention that in this rather fascinating hypothetical world, to implement Labour's published plans for 80/81 in today's circumstances would cost more than £4 billion, *ceteris paribus*, because of subsequent developments, particularly in costs, prices and threatened cash limit overruns. I shall try to return to this if possible before the White Paper is published.

AR

ADAM RIDLEY
24 October 1979

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CHANCELLOR

OK - but leave out VAT

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Mr Cassell
Mr Unwin
Miss Peirson
Mr Cropper
Mr Cardona

PUBLIC EXPENDITURE BRIEFING: TAX IMPLICATIONS

You asked me to advise on what might be said about the tax implications of the previous administration's expenditure plans in the White Paper, in the light of Mr Cassell's advice to me in his minute of October 23rd.

2. After consultation with Miss Peirson and Mr Cassell I would propose insertingin paragraph 7 of the draft a new penultimate sentence:

> "To raise an extra £4 billion or so in additional
> [c](w)ould revenue requires an increase of about 8p in the basic ??
> rate of income tax."
> (, for example,

to which you <u>could</u> add

> ".. or around 10% or more on the VAT rate."

3. You should know that Mr Cassell is still anxious that such a formulation could provoke a sequence of questions from a Select Committee seeking to see Treasury model simulations of the effects of the previous Government plan, not only on taxes but also on the PSBR, inflation rate etc. Your earlier judgement that the Select Committee would not be provided with answers to requests for information requiring new model runs provides a defence against such requests. But it will not do so unless we stick to such a timeless statement of a "ready reckoner" kind,

SECRET AND PERSONAL

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FINANCIAL SECRETARY TO THE TREASURY

CHANCELLOR

Chief Secretary
Sir K Couzens

EEC BUDGET

I have read the limited circulation annex to the OD minutes on negotiating tactics on the Community Budget. I am sorry that your sensible proposal was not accepted by colleagues. If that decision has to be taken as final, it would seem that the only sensible approach would be the "empty chair" au de Gaulle. (It may be very much worth looking at this precedent and pressing minds on precisely what happened).

The FCO's suggestion of selected disruption is throughly unworkable and humiliating.

F.S7

Nous reculons pour mieux sauter - I hope - G.

SAJL

pp NIGEL LAWSON
26 October 1979

(approved by the Financial Secretary and signed in his absence)

SECRET AND PERSONAL

CHANCELLOR

Chief Secretary
Mr Couzens

EEC BUDGET

I have read the limited circulation annex to the OD minutes on negotiating tactics on the Community budget. I am sorry that your sensible proposal was not accepted by colleagues. If that decision has to be taken as final, it would seem that the only sensible approach would be the "empty chair" au de gaulle. (It may be very much worth looking at this precedent and pressing minds on precisely what happened).

The FCO's suggestion of selected disruption is thoroughly unworkable and humiliating.

NIGEL LAWSON
26 October 1979

(approved by the Financial Secretary and signed in his absence)

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CHANCELLOR OF THE EXCHEQUER

(1) Fix mtg for 2 wks

(2) See further on FST's minute just below

(3) All mins. (CST + FST) then to whom to produce their attitudes on ~~[illegible]~~ their own views. T.P.1

[Burns
Bray : Mr. Gardner]

CHANCELLOR

... I attach papers on:

... (a) the Autumn forecasts, together with Douglas Wass's note to you on the Industry Act forecast, and other linked decisions;

(b) the economic assumptions for the Government Actuary's national insurance contributions review.

2. As you will see from the papers the second of these two issues is inexorably linked with decisions on the first. And the need for decisions on the second is becoming pressing.

3. You will clearly want to discuss with other Treasury Ministers and then hold a meeting with them and officials. I have taken soundings in the office. I suggest you discuss with colleagues at morning prayers on Tuesday and then hold a wider meeting on Tuesday afternoon. I have put this to Douglas Wass and Brian Unwin: they too would urge that timetable on you.

Fix mtgs PS8

4. Assuming satisfactory discussions, you might aim to minute the Prime Minister (at least in general terms) about your conclusions, so that you can discuss at your meeting on Thursday morning. Because Bonn on Wednesday intervenes this requires officials to produce a draft immediately after the Tuesday afternoon meeting for you to consider overnight. It can then be awaiting the Prime Minister's return (very late I fear) on Wednesday night.

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I realise that this is yet another example of an over-compressed timetable. It may just not prove possible. But I suggest it is worth aiming at. If you agree, meetings can be arranged on Monday.

AMB

A.M.W. BATTISHILL
26th October 1979

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CONFIDENTIAL

Mr ~~Hall~~ PS

I spoke to Miss Peirson informally & warned her this was coming.

AR 29/10.

MR RIDLEY

cc: Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Mr Cropper
Mr Cardona
Miss Brown
Mr Cassell
Miss Peirson

LABOUR'S SPENDING PLANS FOR 1980/81 WHITE PAPER

The Chancellor has seen your minute of 26th October. He agrees with your final paragraph, and would therefore be grateful if figures could be produced.

MAH

M. A. HALL
29th October 1979

CONFIDENTIAL

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CONFIDENTIAL

CHANCELLOR

c Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Mr Cropper
Mr Cardona
Miss Brown
Mr Cassell
Miss Peirson

LABOUR'S SPENDING PLANS FOR 1980/81 WHITE PAPER

I think it will be helpful if we added to the "8p on income tax" calculation included in the text of the White Paper another piece of arithmetic on local authority rates. The argument should go as follows. Labour's published plans involved an increase in local authority expenditure over what we are now planning of X per cent or £Y million in real terms. Assuming that the proportion of relevant expenditure which would have been financed by the government would have been (61%), this would have meant that ratepayers would have had to have paid an extra £A millions, which would have involved an increase of about B per cent on local authority rates. And it would have involved raising the remaining £C through direct taxation or other forces of Central Government revenue, which would in turn be equivalent to putting up income tax by about Dp in the pound.

2. No doubt you will be able to indicate over the weekend whether you would like to see calculations of this kind used in public. Perhaps any judgment about doing so will have to be provisional until one has seen the necessary figures.

ADAM RIDLEY
26 October 1979

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C - do you accept ARs amend't?
MW 29/10

CHANCELLOR

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Anson
Mr Butler
Mr Kemp

SAVINGS ON SOCIAL SECURITY

May I, at the risk of interfering very belatedly in a matter with which I have not kept in close touch, raise a major anxiety about a point in the draft letter to the Secretary of State for Social Security which Mr Kemp sent you on October 26th.

2. My anxiety is about paragraph 2, in particular the thought expressed there that you:

> "... would not at the moment (want) to suggest a general attach on our uprating practices."

With respect, as they say, that is surely just what is needed, and if so one wonders whether it would be wise to explicitly rule out the probability in advance.

3. You are familiar with some of my views on this matter, but it may be worth rehearsing some of them again.

(a) one will be hampered in dealing with poverty trap problems unless one challenges the up-rating principles;

(b) within an ever-tighter budget constraint, preserving up-rating gives you a smaller and smaller margin within which to deal with other (legitimately) growing claims for action on areas outside the mainstream of current benefits such as pensions;

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CHANCELLOR OF THE EXCHEQUER

(c) the growth of social security has long been the cuckoo in the public spending nest, and continues to be. Between 73/74 and 78/79 it took £5 billion out of the £5.3 billion increase in total spending [including child benefit net of child tax allowances in both cases]. Of that £5 billion around £2 billion would not have arisen, according to advice given Mr Cardona by officials here earlier in the year, if long-term benefits had only risen in line with prices. Social security showed the biggest increase - nearly £900 million - between 78/79 and 79/80. Even to consolidate it at its present real level in an otherwise static pattern of programmes would be to hold it, on any rational assessment at an excessive level in relation to other equally vital programmes such as health, and the heartland of traditional public spending. To make matter worse, it is a most inflexible programme with so much spending subject to de facto or de jure up-rating.

4. My own instinct is that the only solution has to be a very radical one, perhaps on the lines of indexing the revenue to the NI fund to a certain fixed proportion of national earnings, and tailoring the level of distribution of benefits to the amount of money thus generated. This may seem a wild idea but it is, I am informed, done elsewhere!

5. However that proposal is not the issue now. I would recommend your sending Mr Jenkins a briefer paragraph 2 of the following lines:

"I readily accept that this is no easy task, and that we should need to reflect very carefully before making further substantial changes given that we have already decided to remove the earnings link on pensions. Nevertheless there are possibilities we could look at. Two specific areas occur to me immediately."

X

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That wording does not rule out your raising radical issues from the start, as the present form of words does.

AR

ADAM RIDLEY

29th October 1979

(Not included in the Document Series)

EXPLANATORY MEMORANDUM ON EUROPEAN COMMUNITY DOCUMENT

Letter of Amendment to the Draft General Budget of the European Communities for 1980.

Submitted by HM Treasury 30 October 1979

SUBJECT MATTER.

The document provides for changes to the Draft Budget of the European Communities for 1980 as "established" (ie, approved) by the Council of Ministers on 11/12 September. It reflects the decisions of the Council of Ministers on the Commission's proposals in its second Letter of Amendment to the Preliminary Draft Budget. An explanatory memorandum on that document (9250/79) was sent to Parliament on 15 October 1979. An explanatory memorandum on the Draft Budget was sent to Parliament on 22 October 1979.

2. This Letter of Amendment affects both revenue and expenditure. The statement of revenue in Volume 1 has been revised to take account of the changes in expenditure provisions and also changes in the estimated yields of Customs duties and agricultural levies. It is reproduced in full, as amended, in the document.

3. The changes in Volume 4, the Draft Budget of the Commission, allow for:-

i. recent developments in agricultural markets and changes in the rules, which together account for an increase of 360,252,000 EUA* in the CAP Guarantee Section (including related entries in Chapter 100 (Provisional appropriations);

ii. an additional 4.649 MEUA in Article 921 (Food aid in the form of skimmed milk powder and 12.109 MEUA in Chapter 100 for food aid transport costs (Article 924);

*Not 460,352,000 EUA, as implied by the incorrect figure of 11,314,636,000 EUA entered on page III/43; this figure should read 11,214,536,000 EUA.

iii. provision of 21 MEUA for Article 992 (Commission delegations in the ACP (African, Caribbean, Pacific) countries and the OCT (Overseas Community Territories). This has been entered in Chapter 100 pending a formal Council decision giving legal effect to the intention of charging such expenditure to the Community Budget;

iv. an addition of 19.3 MEUA in Chapter 40 in respect of expenditure on the 10% refund of the cost of collecting own resources on account of the revised forecasts of Customs duties and agricultural levies referred to above.

4. These changes increase both payment and commitment appropriations provided for in the 1980 Draft Budget by 417.31 MEUA (about £281.7 million) to a new total of 15,324,789,241 EUA (about £10,345m) and 16,398,637,241 EUA (approx £11,070m) respectively.

5. As a result, the UK's estimated gross contribution to the 1980 Budget is increased by 168 MEUA (about £13.4 million) to 3231 MEUA (about £2181 million), implying a UK share of 21.33%. The UK's gross contribution will be partially offset by receipts from the Budget. Conversions into £ sterling in this explanatory memorandum have been made at the rate of 1.4813 EUA, the 1 February rate on which the Commission's proposals are based.

MINISTERIAL RESPONSIBILITY

6. Treasury Ministers are responsible for the Community Budget generally, but other Ministers are concerned with the parts of the Budget which concern their own departmental interests.

IMPACT ON UK LAW

7. The document has no implications for UK law.

POLICY IMPLICATIONS

8. The purpose of the document is to revise the figures in the 1980 Draft Budget in the light of the latest available information.

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TIMETABLE

9. The document records the decisions taken by the Council on 16 October. It has been forwarded to the European Parliament for its consideration.

Nigel Lawson

Spl Ad/Ex
C

F/G5
165

CHANCELLOR

c Chief Secretary
  Financial Secretary
  Mr Cropper

ITV SETTLEMENT

Gordon Reece has passed the attached to me. If there is anything in his point - and I believe there is - then one would ideally wish to act extremely fast on the point about changing the nature of the levy raised in the penultimate para.

2. It also raises wider questions on which I shall minute shortly.

AR

ADAM RIDLEY
5 November 1979

I have already asked - on some other papers - for this precise point to be examined urgently: I think the tax-payer paid 83% of the deal?

There are other questions to be asked about the levy.

And - in this connection - about Schedule 11, vis-à-vis BBC.

(I could seek a private view from Sir John Read - EMI + Thames)

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Conservative and Unionist Central Office

32 Smith Square Westminster SW1P 3HH Telephone 01-222 9000 Telegrams Constitute London SW1

Chairman of the Party: THE RT HON THE LORD THORNEYCROFT

Deputy Chairman: R. ALISTAIR McALPINE

Vice Chairmen: SIR FRANK MARSHALL
SIR ANTHONY ROYLE KCMG MP
THE BARONESS YOUNG

I thought the levy was on advertising. Has a copy of this gone to the Chancellor. I have heard similar arguments to those in this letter from other sources and will reply.

2nd November, 1979

My dear Willie

The abject Times surrender and the ITV settlement have given the union bosses in Fleet Street an immense fillip. Unless something can be done to stiffen the management in the media many of our friends, in most senior positions, believe that a far higher degree of news management by the unions will now be taking place.

As the managements appear to react to nothing but threats could I ask you as a matter of urgency to threaten the ITV management by changing the rules.

The ITV settlement was even worse than it at first seemed. Apart from the extra 7½% thrown in at the last minute (I understand on the instigation of Lord Grade) some 30 minutes before ITV was due back on the air the ACTT organisers demanded a £500 interest free loan for twelve months for all their members at Thames and possibly other companies. This was agreed without hesitation at Thames.

The doves who won the day in ITV won on this argument: "The ITV levy is on profits. Therefore any settlement we make will be 60% funded by the Tax-payer. So who cares what we pay?"

If that argument could be made untrue the bosses of the ITV companies who agreed to their surrender on that basis would be very seriously threatened in their own board rooms and it is even possible that there would have to be one or two resignations. This could be done if you were to announce either in reply to a Question in the House or in a speech that you were considering changing the ITV levy on profits back to a levy on advertising.

You will recall that in the old days it was always an advertising levy and was only changed by the Labour Government to assist small companies like Border. We now know that Border profits were £300,000 last year and I am sure that an advertising levy can be so administered to protect smaller companies. A switch to an advertising levy might bring a vote of no confidence in some board rooms to the managing directors of the ITV companies who settled on the understanding that the Tax-payer was to foot 60% of the bill. And the Government take for the ITV levy would probably be increased.

Yours

Gordon

GORDON REECE

The Rt Hon William Whitelaw, CH, MP

F/I.5

CHANCELLOR

c Chief Secretary
Financial Secretary

PUBLIC SPENDING

CRD are shortly undertaking a survey on attitudes to PE. I know you do not, as a rule, feel that such surveys are very informative. However, given the acute importance of this subject may I ask whether:

i. there are any issues, areas or questions which it should probe;

ii. you or your colleagues would like to see the rough questionnaire George Cardona and I will be putting to CRD for working up and polishing. If the answer is yes, I can let you have something on Monday night.

AR

ADAM RIDLEY
2 November 1979

§4 ✓

PWP.

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Confidential

Nil venture, nil gain: provisionally, I still think worth having a go

CHANCELLOR

RSG

When you de-briefed this evening, you mentioned the possibility of trying to re-open the RSG percentage. I have made one or two preliminary skirmishes.

2. Mr. Lankester's impression was that the Prime Minister remained pretty doubtful about this, even at the end of your meeting when she had appreciated better the size of the public expenditure problem. He senses her conclusion that she could not get a change through Cabinet. The onus is therefore upon you to take the initiative if you wish.

3. The RSG announcement is planned for next Friday. It has been rearranged once and could not decently be altered again. The first word with Mr. Kitcatt demonstrates the problems of re-opening:

(a) Policy: what has changed? How do you convince colleagues? Have you time enough to do so?

(b) Publication. The RSG announcement is customarily accompanied by a considerable amount of exemplification. The degree of detail is pretty considerable. It is all done by the computers. It is too late to re-do it with a different percentage. The only alternative, probably, would be to announce the figure and say the usual exemplification would follow later.

(c) Presentation. If you followed (b) everyone would sense a late decision. How would you justify this? Maybe, the answer lies in the rest of your announcement on Thursday. But some appearance of disorder and 11th hour-ness would hardly be avoided.

4. My suggestion would be that you see the chaps on Monday morning and consider how realistice an option it really is.

(A.M.W. BATTISHILL)
9th November, 1979

170 ew

CONFIDENTIAL

48TH MEETING

NOTE FOR THE RECORD

CHANCELLOR'S MORNING MEETING 2ND NOVEMBER 1979

Present: Chancellor
Financial Secretary
Minister of State (Commons)
Mr Cardona
Mr Cropper
Mr Ridley

Media Handling of Government Policy

1. Ministers felt there should be a thorough review of the way the media were presenting the Government's expenditure plan, in particular of press and radio treatment immediately before and after the announcement of the White Paper.

2. IDT would be asked to review their approach to organisation of press conferences such as the one on the White Paper. Ministers felt that there might be merit in (i) more informed off-the-record briefing of the "high-brow" journalists by Ministers, and (ii) separating the "low-brows" and the "high-brows" for press conference purposes.

3. Mr Ridley was asked to draft a minute for the Chancellor to send to the Prime Minister, the Chairman of the Conservative Party and the Paymaster-General raising the specific question of BBC reporting and presentation of Government policy.

Parliamentary Questions

4. The Parliamentary Clerk had minuted the Chancellor's Private Office to the effect that a potentially embarrassing number of Priority Written Questions were being given a holding reply.

5. Ministers were conscious of this problem. They asked, in the first instance, that the Parliamentary Clerk should make an analysis

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CHANCELLOR OF THE EXCHEQUER

comparing this Government's performance with the performance of its predecessor at a similar busy time.

6. The Minister of State (Commons) felt strongly that certain Opposition backbench Members were abusing the "Priority" procedure, using it for questions of only routine importance. This aspect of the matter also needed analysis.

7. If it was felt that there was abuse on the part of Opposition backbenchers, the subject would need to be raised through Parliamentary channels.

8. In the light of Mr Ridley's suggestion to the Chancellor, it was agreed that - just as Mr Cardona was reading all the Financial Secretary's PQ reply drafts for political content - it would be useful if he could also read those for the Chief Secretary and if Mr Cropper could do the same for the Ministers of State (Commons) and (Lords) and the Chancellor.

Medium-Term Financial Plan

9. A decision on publication of a Medium-Term Financial Plan had become urgent with the tabling of a question by Mr Bruce-Gardyne for reply on Thursday, 8th November.

10. Mr Battishill would be asked to set up a meeting of Ministers and officials as a matter of urgency.

First Order Questions - 8th November

11. Ministers were most appreciative of the ring books that had been put together, enabling them to study the Treasury First Order questions for the following Thursday well in advance.

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12. Ministers would meet on Monday morning, 2nd November, to discuss the questions. (Now fixed for 9.00 am)

Enforcement Powers of Revenue Departments

13. The Chancellor asked for a meeting to be arranged in the next fortnight, with Sir William Pile and Sir Douglas Lovelock, to discuss their submission on revenue enforcement and the accompanying paper of the Minister of State (Commons).

14. Messrs Cropper and Cardona would identify the salient points.

15. The Chancellor envisaged a slight broadening of the agenda to include:

1. Scope for tax simplification
2. Powers of assessment
3. Implications of successive reports of the Parliamentary Commissioner.

Industry Bill

16. The Financial Secretary pointed out that if the Industry Bill did not reach the statute book before the end of the year, the NEB disposals of £100 million would be lost. There was a possibility of partical compensation via a deal with the ICFC.

17. The Financial Secretary felt a guillotine was appropriate: the Leader of the House however had said he wished to avoid use of the guillotine this year.

18. The issue of repealing the "Bray Amendment" (discussed in Mr Folger's minute of 31st October) was also involved. Ministers were not certain whether they should repeal Bray, or simply omit the inflation forecasts. The Government Actuary's requirements complicated the matter. Further discussion would be needed.

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Strikers and Supplementary Benefit

19. The minute of the Secretary of State for Industry arising from discussion in E(EA) Committee was not firm enough.

20. This matter would need further attention.

Cash Limits and Nationalised Industries

21. The Chancellor had felt himself inadequately briefed for a recent Cabinet discussion of cash limits in the nationalised industry sector. He was the first to recognise that divisions concerned with expenditure had recently been very hard worked indeed and was making no criticism. It was therefore for Ministers to give themselves an opportunity to consider the intellectual problems arising in the field, jointly with officials, at an early opportunity.

Manpower Recruitment

22. Treasury Ministers would need to look at the future of civil service manpower in the Rayner/Soames context.

BP Issue

23. The Chancellor would be asking Mr Battishill for information on the "force majeure" clause in the BP issue prospectus, which had attracted Daily Telegraph comment.

PETER CROPPER

2nd November 1979

Distribution: Those present
Chief Secretary
Minister of State (Lords)
Mr Battishill
Sir Douglas Wass
Sir Lawrence Airey
Sir Fred Atkinson
Sir Kenneth Couzens
Sir Anthony Rawlinson
Sir William Pile
Sir Douglas Lovelock

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C

CHANCELLOR

c Chief Secretary
Financial Secretary

IRAN

This could well affect us, either well or badly, if it is true that Iran is cutting oil exports to the USA, as was reported on this morning's Today programme and, later on the tapes. The effects would be to take say 1 bn barrels a day off the market (equivalent to all North Sea production) of which the Americans can replace little except by going to the spot market, where prices will rise very sharply ($5-10 extra on a barrel?). That in turn would put the dollar and pound under downward and upward pressure respectively. Overseas money could pour into gilts. The good things that would follow would be a lowering of interest rates, an unplanned Duke of York and the sucking in of domestic liquidity which might otherwise go into swelling £M3. However that might well not come about, in which case we could be fairly swiftly faced with aggravated money supply problems since the absence of exchange controls will make a process of leakage from "external" to "internal" money a much quicker one.

2. I am trying to find out more about Iran, and will report if I learn more. Michael Portillo reports Yamani as saying that cuts in production are likely in Saudi Arabia, which decides - I think today - whether or not to continue its "optional" extra 1 bn barrels of production a day. The likelihood is that it will cut back, and that would make matters much worse still.

AR

ADAM RIDLEY
7 November 1979

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CONFIDENTIAL

C

FINANCIAL SECRETARY TO THE TREASURY

Check with G.C whether he's lobbying for D.W. to see

CHANCELLOR OF THE EXCHEQUER – discussed with D.W.

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

EXTERNAL SERVICES (BBC)

The cut of £2.7m in the External Services seems destined to become this Government's equivalent of museum charges. In each case, the mistake lay partly in giving a vocal lobby too much notice of some quite sensible change. The general problem is set out ... in paragraph 3 of the attached minute I wrote in July. (In August I spoke, with the Financial Secretary's agreement, to John Hoskyns about this: he agreed to ask the PM to put pressure on Lord Carrington and so on the BBC, but unfortunately Lusaka prevented him).

We may well be forced to back down completely on this cut. But one solution occurs to me: my source in Bush House tells me that a good deal of modern equipment was installed some time ago but has not been used because the trade unions will not allow it. I don't know how large the savings could be if the equipment were used, but one could certainly gain some public relations advantage by telling the External Services to put their own house in order and use the equipment they have before asking to be exempted from cuts that affect most of the public sector.

NOT [illegible] over PM's dead body: bring G.C up to date with the facts, cabinet decision.

How do we now get over the [illegible] facts?

As well as "fact" on earlier minute, what [illegible] G.C. quickly [illegible] the facts – so we may [illegible] [illegible] his sight

GEORGE CARDONA
8 November 1979

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FINANCIAL SECRETARY TO THE TREASURY

W FINANCIAL SECRETARY

CONFIDENTIALITY OF EXPENDITURE CUTS

Over the last two days, the Head of the BBC's External Broadcasting, Gerard Mansell, has been - literally - broadcasting to the world regular bulletins to the effect that the £4 million cut in expenditure will mean a drastic cut in services, etc.

2. I am not allowed to give anyone details of the expenditure cuts that are being discussed. Gerard Mansell has also signed the Official Secrets Act (everyone in the BBC does) - ~~only~~ why is he allowed to use the enormous information machine at his disposal to tell the whole world? (In parentheses, I should add that the £4 million cut is too small. There is an enormous amount of fat in the World Service. Michael Jones - whom you know from his days in Conservative Research - now works for the World Service, and tells horrifying tales of money wasted, even in this year of public austerity).

3. Is there any way in which Mr Mansell can be reprimanded, without an outcry about the freedom of the press? He is an extreme example (because of the publicity machine at his disposal) of a general problem. Every organisation asked to consider options for cuts is enabled to mobilise public opinion in its behalf, whereas the Treasury - naturally - cannot make the case for a cut publicly before that cut is announced as definite. So the Treasury will always be put in the position of making announcements that fly in the face of public opinion, with the result that yet another difficulty is put in the way of expenditure cuts.

4. Whether anything can be done about this problem, I am not sure. To ask Mr Mansell to come to see a Treasury Minister and explain himself would almost certainly be counte productive (and probably contrary to all the protocol in this area). But is it worth considering this: making it clear to the World Service (and any other quango that ~~schemes~~ behaves in the same way) that they have shown themselves incapable of keeping a confidence, and that therefore in any future round of cuts they will not be consulted or asked for options, but will have to wait to be told how large their cut will be? This could become quite an important weapon in the hands of Treasury expenditure divisions. (And incidentally they need all the weapons we can give them. I am slowly becoming persuaded that the traditional Treasury control of expenditure has been weakened too far, a wider topic on which I hope to do a great deal more work).

5. For the moment I have not copied these thoughts to anyone, in case you tell me they are too hawkish to be worth pursuing.

GC GEORGE CARDONA 24 July 1979

PRIME MINISTER

CONFIDENTIALITY OF [illegible]

Over the last two days the [illegible] of the [illegible] has been [illegible] the [illegible] would [illegible] that the [illegible] million [illegible] expenditure [illegible] a drastic [illegible].

2. [illegible] give anyone details of the expenditure [illegible] being discussed [illegible] but also [illegible] the [illegible] Act [illegible] and [illegible] is not allowed to [illegible] the [illegible] and that the [illegible] million [illegible]. There [illegible] the amount of [illegible] would [illegible] you know [illegible] Conservative [illegible] and [illegible] of money [illegible] public [illegible].

3. [illegible] there any way in which Mr [illegible] without [illegible] about the [illegible] of [illegible] is an extreme example (because [illegible] the [illegible] of [illegible] and [illegible] against [illegible] public [illegible] to [illegible] the [illegible] of [illegible] that [illegible] is the [illegible] public [illegible] difficulty [illegible] of [illegible].

4. Another [illegible] and [illegible] disaster and [illegible] the [illegible] is probably [illegible] the [illegible] and [illegible] in the [illegible] that they [illegible] themselves [illegible] and that [illegible] they [illegible] would [illegible] the [illegible] that [illegible] the [illegible] and [illegible] the [illegible] public [illegible] and [illegible] that [illegible].

5. For the moment I have not [illegible] I [illegible] thought [illegible] well as they are too [illegible] to be worth pursuing.

GEORGE CARDONA [illegible] 1979

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FINANCIAL SECRETARY TO THE TREASURY

PM

CHANCELLOR OF THE EXCHEQUER

BBC EXTERNAL SERVICES

You asked me for more facts about waste and restrictive practices in the External Services.

2. Unfortunately my facts are of an anecdotal, non-attributable and personal kind. My source is the ex-Conservative Research Department Michael Jones, now a high-flier in the World Service. He claims that he does his day's work in 3 hours a day, and as I share a house with him I can confirm that this is true. But this is scarcely usable material! Other examples: his boss spent 6 weeks in Tahiti this summer to write, if I remember correctly, three half-hour talks. Jones gets 3 to 5 weeks to write one 45-minute talk. There are more anecdotes of this sort, but of course they are not usable.

3. Moreover I have learnt today that the trade unions have just agreed to a partial lifting of the ban on using the modern equipment ("electronic distribution" systems) in Bush House. It is thought they may soon lift the ban completely, largely in response to the ~~presence~~ pressure of the expenditure cuts. So again the rug is being pulled from under our case.

4. I had envisaged a private confrontation between the FCO and Bush House, at which the latter would be forced to concede the existence of restrictive practices. This recognition could then be used in public debate.

GC

GEORGE CARDONA
12 November 1979

CHANCELLOR OF THE EXCHEQUER

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GEORGE CARDONA

12 November 1979

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

CHANCELLOR

PENSION FUNDS

Should we say something about this?

Like what?
Was it cleared with
us, or with I.R.?

PETER CROPPER

16th November 1979

Certainly it extends
the anomaly more
widely & further into the
future than I should
think was wise?

179 cc Mrs Lomax
Mr Maycock
" Shore
" Roberts

CONFIDENTIAL

GRS 3935
CONFIDENTIAL
FRAME ECONOMIC
DESKBY 200830Z
FM UKREP BRUSSELS 191911Z NOV 79
TO IMMEDIATE FCO
TELEGRAM NUMBER 6169 OF 19 NOVEMBER
INFO PRIORITY BRUSSELS, COPENHAGEN, THE HAGUE, ROME, DUBLIN, PARIS, BONN, LUXEMBOURG.

FINANCE COUNCIL: 19 NOVEMBER

CONVERGENCE

SUMMARY

1. A RESTATEMENT OF MEMBER STATES' VIEWS ALONG PREDICTABLE LINE. NO MOVEMENT DETECTABLE. MATTHOEFER (GERMANY) CRITICISED RECENT OIL PRICE INCREASES BY THE BRITISH NATIONAL OIL COMPANIES AND SAID THIS ISSUE SHOULD BE DISCUSSED AT DUBLIN.

DETAIL

2. DILLON (CHAIRMAN OF COREPER) PRESENTED A BRIEF FACTUAL REPORT ON DISCUSSION IN COREPER TO DATE. THE ABSENSE OF FIRM COMMISSION PROPOSALS HAD DISAPPOINTED THE MAJORITY OF MEMBER STATES, WHO FELT THAT SUCH PROPOSALS WERE INDISPENSABLE IN PREPARING FOR THE EUROPEAN COUNCIL. THE COMMISSION HAD SAID THEY WOULD BE UNABLE TO PRODUCE PROPOSALS BEFORE 21 NOVEMBER. THE UK'S REQUEST FOR A NOTE BY COREPER ON THE ISSUES FOR DECISION HAD RECEIVED NO SUPPORT. ON SUBSTANCE, THERE WERE IMPORTANT DIFFERENCES OF OPINION OVER THE SIZE OF THE UK'S PROBLEM AND ON ITS RELATIVE MERITS WHEN SEEN AGAINST THE ADVANTAGES OF COMMUNITY MEMBERSHIP TAKEN AS A WHOLE. MOST MEMBER STATES HAD STRESSED THEIR OWN RESOURCES WERE NOT NATIONAL CONTRIBUTIONS. THE UK HAD ARGUED THAT THE PRESENT IMBALANCE IN COMMUNITY POLICIES IMPOSED AN UNFAIR BURDEN. AS TO SOLUTIONS, MOST MEMBER STATES HAD FAVOURED BUILDING UPON THE 1975 DUBLIN MECHANISM AND/OR A SOLUTION ANALOGOUS TO THAT CONTAINED IN ARTICLE 131 FO THE TREATY OF ACCESSION. MOST MEMBER STATES HAD ALSO CALLED FOR RESPECT FOR THE ACQUIS COMMUNAUTAIRE AND THE OWN RESOURCES SYSTEM. THEY FELT THAT ANY MECHANISM AGREED

CONFIDENTIAL

/SHOULD

SHOULD BE FINANCED WITHIN THE BUDGET BY ALL MEMBER STATES AND SHOULD HAVE A TIME LIMIT. THE UK HAD ARGUED FOR BROAD BALANCE THOUGH ACTION ON BOTH SIDES OF THE BUDGET AND A SOLUTION WHICH LASTED FOR AS LONG AS THE PROBLEM CONTINUED TO EXIST. THERE HAD BEEN SYMPATHY FOR THE ITALIAN PROPOSALS FOR MEDIUM TERM RESTRUCTURING OF COMMUNITY SPENDING, BUT MOST MEMBERS HAD FAVOURED QUALITATITIVE RATHER THAN QUANTITATIVE STATEMENTS OF THE OBJECTIVES.

3. ORTOLI (VICE-PRESIDENT OF THE COMMISSION) CONFIRMED THAT A FURTHER PAPER WOULD BE PRESENTED THIS WEEK BY THE COMMISSION.

4. COLLEY (IRISH CHAIRMAN) SAID THAT THERE HAD BEEN WIDESSPREAD DISAPPOINTMENT THAT THE COMMISSION HAD NOT ALREADY PRODUCED A PAPER. A SERIES OF BILATERAL VISITS BY SENIOR IRISH OFFICIALS HAD AS YET FAILED TO PRODUCE EVEN THE OUTLINE OF A SOLUTION ACCEPTABLE TO ALL PARTIES. HE INVITED COLLEAGUES TO DEAL, AS FAR AS THEY WERE ABLE AT THIS STAGE, WITH THE FOLLOWING FIVE QUESTIONS:

(I) WHICH MECHANISM DID THEY FAVOUR?

(II) HOW LONG SHOULD IT LAST?

(III) WHAT SHOULD BE THE AMOUNT OF THE REFUND TO THE UK IN 1980?

(IV) WHAT OTHER AREAS OF COMMUNITY POLICY SHOULD BE TAKEN INTO ACCOUNT AS PART OF THE FINAL AGREEMENT?

(V) WHAT LONGER TERM MEASURES SHOULD BE ADOPTED TO ADJUST THE BUDGET?

5. O'DONOGHUE (IRELAND) SAID THAT AN ADJUSTED VERSION OF THE DUBLIN MECHANISM SEEMED THE MOST APPROPRIATE SOLUTION, THOUGH HE DID NOT RULE OUT A DEVICE ANALOGOUS TO ARTICLE 131. ON DURATION, TWO YEARS SEEMED ABOUT RIGHT, WITH A PROVISION FOR REVIEW. IN THE MEDIUM TERM THERE SHOULD BE A PROGRAMME OF BUDGETARY ADAPTATION TO AID CONVERGENCE. THIS IMPLIED MAKING THE BEST POSSIBLE USE OF EXISTING RESOURCES. POST-ENLARGEMENT PROBLEMS NEEDED TO BE CONSIDERED ALSO.

6. PANDOLFI (ITALY) SAID THAT IT WOULD BE DIFFICULT TO FIND A SOLUTION IN DUBLIN. HE ATTACHED THE GREATEST POSSIBLE IMPORTANCE TO THE UK PROBLEM AND THE PRESENT SITUATION MUST BE PROPERLY DEALT WITH. ON OWN RESOURCES, IT WAS CLEAR THAT A LESS PROSPEROUS COUNTRY COULD NOT BE EXPECTED TO CONTRIBUTE TO THE COMMUNITY A PROPORTION OF OWN RESOURCES MUCH GREATER THAN ITS SHARE OF COMMUNITY GDP. THIS WAS HAPPENING AND MUST BE CORRECTED. ON SPEDNING, WHICH WAS A MORE GENERAL PROBLEM, THAT A SOLUTION LAY IN THE PROPOSALS PUT FORWARD BY HIS GOVERNMENT. HIS GOVERNMENT WOULD DO ALL THAT IT COULD TO SUPPORT THE UK BUT IT WOULD FIND ITSELF IN A DIFFICULT POSITION IF THE UK ATTITUDES WERE TO HARDEN. ON THE WIDER BUDGET ISSUE, HE MADE TWO POINTS:

I. IRRESPECTIVE OF THE PROBLEMS NOW ENCOUNTERED BY THE UK, THERE WOULD HAVE BEEN A NEED TO RE-EXAMINE THE COMMUNITY'S BUDGET. THE IMPLICATION OF THE COMMISSION'S TRI-ENNIAL FORECAST WAS THAT OWN RESOURCES WOULD SOON BE EXHAUSTED. IF THIS WAS SO, AND THE TREND IN AGRICULTURAL SPENDING CONTINUED, THERE WOULD BE NO FUNDS AT ALL FOR RESEARCH, FOR REGIONAL POLICY OR FOR INDUSTRY.

II. THERE WAS ALSO A NEED TO RE-BALANCE AGRICULTURAL SPENDING. THIS DID NOT IMPLY OVER-TURNING THE COMMON AGRICULTURAL POLICY BUT ITS PROBLEMS HAD TO TACKLED COURAGEOUSLY.

7. THE LUXEMBOURG REPRESENTATIVE SAID THAT ANY MECHANISM DESIGNED TO MEET THE UK'S NEEDS MUST:

I. BE COMPATIBLE WITH THE TREATY AND COMMUNITY POLICIES.

II. NOT BE TOO FAR-REACHING IN ITS EFFECTS.

III. BE LIMITED IN TIME, LASTING NO LONGER THAN THIS PARTICULAR PROBLEM.

IV. MUST NOT IMPLY ''JUSTE RETOUR''.

HE TOO REGRETTED THAT NO COMMISSION PROPOSAL WAS AVAILABLE. ITALIAN VIEWS ON MEDIUM TERM RECONSTRUCTION OF THE BUDGET WERE INTERESTING BUT TOO FAR REACHING, PARTICULARLY IN ATTEMPTING TO RELATE BUDGET BENEFITS TO GNP PER CAPITA. ON THE OTHER HAND, REBALANCING COMMUNITY POLICIES WOULD BENEFIT ALL MEMBER STATES INDIVIDUALLY AND THE COMMISSION AS A WHOLE. IT WOULD PERHAPS BE APPROPRIATE FOR THE EUROPEAN COUNCIL TO DRAW UP A TIME-TABLE AND PROVIDE FOR REGULAR REVIEWS OF PROGRESS UNDER IT. THE OPERATION OF ANY MECHANISM FOR THE UK COULD BE REVIEWED AT THE SAME TIME.

8. ANDRIESSEN (NETHERLANDS) REGRETTED THE ABSENCE OF A COMMISSION PROPOSAL. THE UK CONTRIBUTION WAS UNFAIRLY LARGE BUT THE UK WAS SEEKING TOO MUCH. IN ARRIVING AT THE FIGURE FOR A UK DEFICIT, CUSTOMS DUTIES SHOULD NOT BE INCLUDED. NO SOLUTION WHICH BREACHED THE 1 PER CENT VAT LIMIT WAS ACCEPTABLE. THE MECHANISM MUST BE BASED ON THE EXISTING DUBLIN MECHANISM AND METHODS NOT BASED ON EXISTING COMMUNITY POLICIES WERE UNACCEPTABLE. FINANCING MUST BE BORNE BY ALL MEMBER STATES AND THE SOLUTION MUST LAST NO MORE THAN TWO OR, AT MOST, THREE YEARS. BROAD BALANCE WAS SIMPLY ANOTHER WAY OF ASKING FOR A JUSTE RETOUR AND WAS NOT ACCEPTABLE. NOR WAS A SOLUTION THAT LASTED FOR AS LONG AS THE PROBLEM EXISTED, AS THIS IMPLIED A RAPID CORRECTION OF PRESENT AGRICULTURAL POLICIES. HE TOO WARNED AGAINST A RIGID NEGOTIATING POSITION BY THE UK. A MARGIN FOR MANOEUVRE ON ALL SIDES WAS NEEDED IF AGREEMENT WAS TO BE REACHED. ON THE ITALIAN PROBLEM THE NEED WAS FOR LONGER TERM SOLUTION. HE WAS READY TO LOOK AT EXISTING COMMUNITY INSTRUMENTS BUT A NUMBER OF DEVICES TO HELP ITALY ALREADY EXISTED, WHICH WERE NOT USED TO THE FULL. A BETTER SHORT-TERM SOLUTION LAY IN GREATER UTILISATION OF EXISTING MECHANISMS.

9. THE CHANCELLOR SAID THAT THE COMMISSION'S PAPER WAS A VALUABLE BASIS FOR DISCUSSION IN DUBLIN. THE FURTHER PAPER PROMISED BY THE COMMISSION FOR THIS WEEK WOULD BE HELPFUL IF IT PROVIDED A MORE PRECISE IDEA OF THE RANGE OF POSSIBILITIES FOR THAT DISCUSSION.

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THE FINANCE COUNCIL SHOULD NOT SEEK IN ITS EXCHANGE OF VIEWS TODAY TO PREEMPT THE ROLE OF THE EUROPEAN COUNCIL. WHILE WELCOMING THE DOCUMENT THE UK COULD NOT ACCEPT IN EVERY RESPECT ASSUMPTIONS THAT THE COMMISSION HAD MADE IN DISCUSSING ITS BUDGETARY PROBLEM AND IN PUTTING FORWARD POSSIBLE SOLUTIONS TO IT. IN PARTICULAR, AS REGARDES THE ATTRIBUTION OF MCAS IN CALCULATING NET CONTRIBUTIONS, THE UK REMAINED CONVINCED THAT AN EXPORTER-PAYS TREATMENT PROVIDED THE BEST GUIDE TO THE FINANCIAL BURDEN IMPOSED ON MEMBER STATES BY THE COMMUNITY'S BUDGETARY ARRANGEMENTS. IT WAS IN ANY CASE THE INTENTION OF THE UK TO SEE MCAS PHASED OUT IN DUE COURSE. ON A SLIGHTLY DIFFERENT POINT, HE REMINDED THE COUNCIL THAT CUSTOMS DUTIES AND AGRICULTURAL LEVIES HAD BEEN TAKEN INTO ACCOUNT IN ASSESSING, FOR THE PURPOSES OF THE 1975 MECHANISM, THE BURDEN OF COMMUNITY FINANCING ON A MEMBER STATE.

10. THE CHANCELLOR MADE THE FOLLOWING FURTHER POINTS:

(I) TO SATISFY THE UK REASONABLE REQUIREMENTS A SOLUTION MUST BE COMMENSURATE WITH THE SIZE OF THE PROBLEM AND BRING ABOUT A BROAD BALANCE IN THE UK'S ACCOUNTS WITH THE COMMUNITY. IT HAD NOW BECOME INCREASINGLY CLEAR THAT THIS ENTAILED ACTION ON BOTH SIDES OF THE BUDGET, COMPENSATING THE UK FOR THE LOW LEVEL OF ITS RECEIPTS AS WELL AS ITS EXCESSIVE CONTRIBUTION. THE LARGER PART OF THE UK PROBLEM SEMMED FROM ITS DEFICIENT RECEIPTS. THIS IN TURN RESULTS DIRECTLY FROM THE FACT THAT COMMUNITY EXPENDITURES HAVE NOT DEVELOPED IN THE WAYS FORESEEN IN THE ACCESSION NEGOTIATIONS. THE PROPOSALS MADE BY THE ITALIAN GOVERNMENT WOULD HELP. BUT THE NEED WAS FOR A MECHANISM THAT ACTED ON BOTH SIDES OF THE BUDGET.

(II) ACTION CONFINED TO REMOVING CONSTRAINTS FROM THE EXISTING FINANCIAL MECHANISM WOULD NOT DO. AS AN EXAMPLE, IF ALL THESE CONSTRAINTS WERE REMOVED AND MCAS WERE TREATED AS A BENEFIT TO THE EXPORTER, THE REFUND WOULD STILL LEAVE THE UK'S NET CONTRIBUTION LARGER THAN THAT OF GERMANY AND SEVEN TIMES GREATER THAN THAT OF FRANCE. EVEN IF MCAS WERE TREATED AS A BENEFIT TO THE UK, OUR NET CONTRIBUTION WITH ALL CONSTRAINTS ON THE 1975 MECHANISM REMOVED WOULD BE THREE QUARTERS OF THAT OF GERMANY AND 3.7 TIMES THAT OF FRANCE. WE THEREFORE ARGUED WITHOUT HESITATION THAT A SOLUTION SHOULD OPERATE ON BOTH SIDES OF THE BUDGET.

 /(III)

(III) IT HAD BEEN SUGGESTED THAT WHAT THE UK WAS DEMANDING WAS INCOMPATIBLE WITH THE ACQUIS COMMUNATAIRE OR WOULD INVOLVE THE JUSTE RETOUR. BUT THERE WAS NOTHING COMMUNAUTAIRE ABOUT THE PRESENT BUDGETARY IMBALANCES, AS THE OPINION OF THE PARLIAMENT HAD RECOGNISED. NOR WAS SUCH A SITUATION COMPATIBLE WITH ARTICLE 6.2 OF THE TREATY, WHICH STATED THAT THE INSTITUTIONS OF THE COMMUNITY SHOULD TAKE CARE NOT TO PREJUDICE THE INTERNAL AND EXTERNAL FINANCIAL STABILITY OF THE MEMBER STATES. THE OBLIGATION ACCEPTED BY THE COMMUNITY IN 1970 TO FIND EQUITABLE SOLUTIONS TO AN UNACCEPTABLE SITUATION WAS THE HEART OF THE ACQUIS COMMUNAUTAIRE. CHANGES OF THE KIND THAT THE UK PROPOSED WOULD STRENGTHEN THE COMMUNITY, NOT WEAKEN IT. AS FOR THE JUSTE RETOUR, THE UK WAS NOT SEEKING AT ALL TIMES TO GET OUT OF THE COMMUNITY EXACTLY WHAT IT PUT IN. WE WERE SEEKING BROAD BALANCE.

(IV) THE COUNCIL SHOULD CONTEMPLATE SERIOUSLY THE CONSEQUENCES OF THE PROPOSALS IN PARA 24-27 OF THE COMMISSION PAPER. NONE WOULD REQUIRE ANY CHANGE IN THE DOCTRINE THAT OWN RESOURCES BELONGED TO THE COMMUNITY AND WERE TO BE DISPOSED AT COMMUNITY LEVEL. NOR WOULD ANY CHANGE TO THE PRINCIPLES OF THE OWN RESOURCES TREATY BE REQUIRED. NOR WOULD THEY INVOLVE ANY CHANGE IN THE PRINCIPLES OF MAJOR COMMUNITY SECTORAL POLICIES.

(V) IT WAS QUITE UNTRUE TO SAY THAT SOLUTIONS ALONG THESE LINES WOULD DIMINISH THE UK'S INTEREST IN FUTURE DEVELOPMENTS OF COMMUNITY POLICIES. ON THE CONTRARY, IT WAS THE PROBLEM OF THE UK'S BUDGETARY POSITION WHICH AT PRESENT DOMINATED THE UK'S RESPONSE TO PROPOSALS FOR COMMUNITY DEVELOPMENT AND, IF IT WERE NOT REMOVED, WOULD DO SO TO AN INCREASING EXTENT.

(VI) THE NEED NOW WAS TO PREPARE THE GROUND FOR A FRUITFUL DISCUSSION IN DUBLIN RESULTING IN AGREEMENT ON SOLUTIONS WHICH MATCHED THE SCALE OF THE PROBLEM. IN OUR VIEW, THE COMMISSION'S DOCUMENT SHOULD ENABLE THE EUROPEAN COUNCIL TO DECIDE ON EFFECTIVE SOLUTIONS FOR 1980. THE EUROPEAN COUNCIL SHOULD THEREFORE BE ASKED TO ADDRESS ITSELF TO THE FOLLOWING POINTS:

(A) THE SCALE OF THE ACTION TO BE TAKEN IN RELATION TO THE UK PROBLEM

(B) THE LENGTH OF TIME FOR WHICH ANY ARRANGEMENTS SHOULD OPERATE

(C) THE APPROPRIATE MACHINERY TO SECURE CORRECTIVE ACTION

(D) THE NEED, BOTH IN THE MEDIUM AND LONG TERM, FOR BROADER CHANGES IN THE STRUCTURE AND PATTERN OF COMMUNITY EXPENDITURE, INCLUDING THE POSSIBILITY OF ADOPTING QUANTIFIED TARGETS.

IT WOULD BE HELPFUL IF THE FINANCE COUNCIL AND THE GENERAL AFFAIRS COUNCIL TOMORROW COULD CLEARLY IDENTIFY THESE AS THE ELEMENTS ON WHICH THE EUROPEAN COUNCIL WOULD NEED TO TAKE DECISIONS.

11. GEENS (BELGIUM) REGRETTED THAT CONVERGENCE HAD COME TO MEAN NEGOTIATIONS OVER BUDGETARY POSITIONS BUT, ACKNOWLEDGED THE NEED FOR A POLITICAL SOLUTION. AND IN POLITICAL NEGOTIATIONS, A CERTAIN FLEXIBILITY WAS NECESSARY. ANY SOLUTION MUST BE FARI AND COMMUNAUTAIRE. HE MADE FOUR POINTS:

I. OWN RESOURCES WERE NOT NATIONAL CONTRIBUTIONS

II. ANY SOLUTION MUST BE FOUND WITHIN THE BUDGET, IN WHICH SOME INCREASE WAS ACCEPTABLE, THOUGH THE PRINCIPLE OF PROGRESSIVITY WAS NOT.

III. THE 1 PER CENT VAT LIMIT SHOULD NOT BE EXCEEDED AND HIS AUTHORITIES WOULD NOT CONSIDER THIS IN THE NEAR OR THE MEDIUM TERM.

IV. ANY SOLUTION SHOULD BE LIMITED IN TIME.

HE WAS HOPEFUL OF AGREEMENT IN DUBLIN BASED ON A CORRECTING MECHANISM AND A RECONCILIATION OVER TIME OVER REMAINING ASPECTS OF THE BUDGETAY PROBLEM.

12. NORGAARD (DENMARK) SAID THAT THE NET BUDGET CONTRIBUTION OF A MEMBER STATE DID NOT ACCURATELY REFLECT THE ADVANTAGES AND DISADVANTAGES OF MEMBERSHIP OF THE COMMUNITY. CONVERGENCE WAS A NATIONAL OBLIGATION TO BE AIDED BY A LIMITED COMMUNITY CONTRIBUTION. HE REGRETTED THE LACK OF A COMMISSION PROPOSAL BUT HE DID NOT REJECT OUT OF HAND THOSE OPTIONS SET OUT IN THE COMMISSION'S SOLUTIONS PAPER. HIS PRIME MINISTER WOULD TAKE FINAL POSITION ONLY AT THE EUROPEAN COUNCIL. ANY MECHANISM DEVISED THERE, HOWEVER, MUST RESPECT EXISTING COMMUNITY PRINCIPLES AND OWN RESOURCES AND BE FINANCED BY ALL MEMBER STATES WITHIN THE BUDGET. THE 1975 MECHANISM WAS THE MOST HOPEFUL AVENUE FOR DISCUSSION, THOUGH AN ARTICLE 131 TYPE SOLUTION COULD BE CONSIDERED. DENMARK WOULD NOT COUNTENANCE A SOLUTION BASED ON AN ATTACK ON THE CAP WHICH WAS THE ONLY INTEGRAL COMMUNITY POLICY. A SOLUTION COULD LAST FOR TWO YEARS AND THEN BE REVIEWED IN THE LIGHT OF SUBSEQUENT DEVELOPMENTS.

13. MATTHOEFER (GERMANY) SAID DISCUSSION OF THE PROBLEM SHOULD BE VIEWED AGAINST THE BACKGROUND OF THE NEED FOR WESTERN EUROPE TO STAND TOGETHER ECONOMICALLY IN COMPANY WITH THE UNITED STATES AGAINST THE GATHERING ECONOMIC STORM. HOWEVER THOUGH THERE WAS UNCERTAINTY ABOUT THE DETAIL OF THE BUDGET FIGURES, THERE WAS A CONSIDERABLE BURDEN ON THE UK : IT WAS A PROBLEM FOR THE COMMUNITY AS WELL AS THE UK. ANY SOLUTION, HOWEVER, MUST TAKE ACCOUNT OF THE VIEWS OF ALL MEMBERS OF THE COMMUNITY AND MUST BE COMPATIBLE WITH COMMUNITY FINANCING PRINCIPLES. THE EUROPEAN COUNCIL SHOULD LOOK FOR SHORT AND MEDIUM TERM SOLUTIONS. THE BEST WOULD BE ONE BASED ON THE 1975 MECHANISM. ALL MEMBER STATES MUST PARTICIPATE IN SUCH A SOLUTION AND HE APPEALED TO THE COMMISSION TO TAKE THE LEAD AND MADE SIMPLE PROPOSAL. HE SUGGESTED THE FOLLOWING GUIDELINES:

I. THERE COULD BE NO CONSIDERATION OF A WEIGHTED MECHANISM: IT WAS NOT OPEN TO DISCUSSION.

II. RESPECT FOR THE 1 PER CENT VAT CEILING MUST BE LAID DOWN FOR A LONG TIME TO COME.

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III. NO MECHANISM SHOULD BEAR DIRECTLY ON EXPENDITURE FLOWS, WHICH WERE THE PRODUCT OF COMMUNITY POLICIES. THE NEED WAS THERFORE TO EXAMINE THOSE POLICIES, ABOVE ALL AGRICULTURE WHICH BORE SO HEAVILY ON THE UK. IN THAT FIELD, THE PRIORITIES FOR 1980 SHOULD BE AN INCREASE IN THE CO-RESPONSIBILITY LEVY: A REDUCTION IN PRODUCTION QUOTAS FOR SUGAR: A PRELIMINARY MOVE ON BEEF: AND A VERY CAUTIOUS PRICE POLICY. NONE OF THESE POINTS CALLED INTO FUNDAMENTAL QUESTION THE PRINCIPLES OF THE CAP AND THE PROSPECTS OF SUCCESS IN DUBLIN WOULD BE GREATLY HELPED IF SOME ATTENTION COULD BE PAID TO THESE AREAS.

IF THE COMMUNITY CAME SOME WAY TO MEET THE UK, THE UK SHOULD MAKE A SIMILAR MOVE. IN THIS CONNECTION, HIS AUTHORITIES NOTICED THAT THE BRITISH NATIONAL OIL CORPORATION HAD IN RECENT MONTHS MET, OR EVEN GONE BEYOND, THE PRICE INCREASES LAID DOWN BY INDIVIDUAL MEMBERS OF OPEC, NOT JUST OPEC AGREED PRICES. THIS WAS NOT HELPFUL IN CREATING THE RIGHT ATMOSPHERE AND THE POINT WOULD BE RAISED IN DUBLIN.

14. MONORY (FRANCE) SAID THAT THIS WEEK WOULD SEE THE END OF THE DEBATE BY MINISTERS IN COUNCIL AND THE TIME HAD ARRIVED FOR THE COMMISSION TO MAKE ITS PROPOSAL. THE COMMISSION HAD RECEIVED THE CONCRETE PROPOSALS OF THE UK, THOUGH THEY HAD BEEN VAGUE AND UNREALISTIC AND ALSO THE COMMENTS OF OTHER MEMBER STATES AND THE PARLIAMENT. HE TOO STRESSED THAT ANY SOLUTION MUST NOT ATTACK EXISTING COMMUNITY POLICIES: THAT THERE COULD BE NO QUESTION OF A JUSTE RETOUR: AND THAT THE VALUE OF COMMUNITY MEMBERSHIP COULD NOT BE ASSESSED SIMPLY BY REFERENCE TO THE BUDGET. THE SIZE OF THE PROBLEM WAS, GREATLY EXAGGERATED. THE UK'S NET CONTRIBUTION AMOUNTED TO ONLY HALF PER CENT OF UK GNP AND CUSTOMS DUTIES AND AGRICULTURAL LEVIES IMPOSED NO PUBLIC EXPENDITURE BURDEN ON THE TUK, AS THEY DID NOT GO THROUGH THE DOMESTIC BUDGET. IN ADDITION, A MORE PROFOUND ANALYSIS OF THE IMPACT OF COMMUNITY POLICIES WAS NEEDED. HE RECALLED THAT THERE WERE A NUMBER OF UNCERTAINITIES ABOUT THE FIGURES.

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THE PAPER BEFORE THE FINANCIAL QUESTIONS GROUP HAD SUGGESTED MUCH GREATER BENEFITS TO THE UK FROM THE CAP THAN THOSE CONTAINED IN THE COMMISSION'S REFERENCE PAPER. THERE WERE UNCERTAINTIES OVER EXCHANGE RATES, MCAS, ADMINISTRATIVE EXPENSES AND THE TRENDS OF ALL THESE FIGURES. THE REAL UK CONTRIBUTION COULD BE SIGNIFICANTLY LOWER IN 1980 AND THE COMMISSION HAD BEEN QUITE RIGHT TO FORECAST NO FURTHER THAN 1980. THERE WERE TOO MANY UNCERTAINTIES. THE ONLY ESTABLISHED FACT WAS THAT THE UK BUDGETARY CONTRIBUTION WOULD RISE SHARPLY IN 1980 AND FRANCE WOULD CONSIDER SOLUTIONS TO THIS LIMITED TEMPORARY PROBLEM. HIS AUTHORITIES REGRETTED, HOWEVER, THAT IT WAS NECESSARY TO RETURN TO THE QUESTION OF THE COMMUNITY'S BUDGETARY SYSTEM AGAIN. THE IMPACT OF THE OWN RESOURCES SYSTEM REFLECTED THE NEED FOR COMMUNITY SOLIDARITY AGAINST THE REST OF THE WORLD. OWN RESOURCES BELONGED TO THE COMMUNITY AND MEMBER STATES HAD TO SOME EXTENT A FREE CHOICE IN THEIR TRADE PATTERNS. THE BUDGET ITSELF WAS NOT AN INSTRUMENT FOR CONVERGENCE BUT A PRODUCT OF COMMUNITY POLICIES DECIDED ON BY THE MEMBER STATES. THERE COULD BE NO QUESTION OF A JUSTE RETOUR. ON SOLUTIONS, ONLY TWO TYPES OF MECHANISM COULD BE DEFENDED: THE 1975 MECHANISM AND SOMETHING ON THE LINES OF ARTICLE 131. THREE CONDITIONS MUST BE MET AT DUBLIN. THE SOLUTION MUST BE MODEST, BECAUSE THE UK PROBLEM DEMANDED NO MORE THAN THAT. SECONDLY, ALL MUST BE INVOLVED IN FINANCING SUCH A MECHANISM OR THE LIMITS TO COMMUNITY SOLIDARITY WOULD BE QUICKLY REACHED. THIRDLY, THE EXISTENCE OF A TWO-TIER BUDGET MUST ONLY BE TEMPORARY AND SHOULD COVER 1980 ONLY. FINALLY IT MUST BE REVIEWED ONCE THE 1 PER CENT VAT LIMIT HAD BEEN REACHED. THESE CONSIDERATIONS LED HIS AUTHORITIES TO CONCLUDE THAT A SOLUTION MUST BE BASED ON ARTICLE 131 AND NOT ON THE DUBLIN MECHANISM.

15. COLLEY CONCLUDED THAT, NOT SURPRISINGLY, NO AGREEMENT HAD BEEN REACHED. HE ASKED COLLEAGUES TO MAKE SURE THAT THE VIEWS EXPRESSED WERE FULLY TRANSMITTED TO MINISTERS OF FOREIGN AFFAIRS IN TIME FOR THEM TO PREPARE THEIR COUNCIL DISCUSSION TOMORROW (20TH NOVEMBER).

COMMENT

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COMMENT.

16. WE UNDERSTAND GERMAN AND DANISH PRESS SPOKESMEN REPEATED MATTHOEFER'S COMMENTS ABOUT BNOC'S OIL PRICING POLICY. IN THE MARGINS OF THE HIGH LEVEL GROUP ON ENERGY ENGELMANN (GERMANY) TOLD JONES (UK) THAT THIS POINT HAD BEEN RAISED AT THE INSTANCE OF CHANCELLOR SCHMIDT FOLLOWING THE DISCUSSIONS AT THE ANGLO-GERMAN SUMMIT ON 31 OCTOBER. YOU MAY WISH TO CONSIDER WHETHER THAT POINT SHOULD NOT BE TAKEN UP WITH THE FINANCE MINISTRY AND CHANCELLOR'S OFFICE IN BONN.

FCO PASS ADVANCE COPIES TO:-

FCO PS/SOFS, PS/LPS, BRIDGES, FRETWELL, SPRECKLEY, FALL
CAB FRANKLIN, ELLIOTT, WALSH
MAFF EVANS
TSY PS/CHANCELLOR, COUZENS, JORDAN-MOSS, HEDLEY-MILLER ASHFORD, BAKER, THOMSON.
B/ENGLAND - BALFOUR, BULL

BUTLER. (ADVANCED AS REQUESTED)

FRAME ECONOMIC
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CONFIDENTIAL

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cc Mrs Lomax
M. Roberts
M. Shore

GPS 25ØØ
CONFIDENTIAL
FRAME ECONOMIC
DESKBY FCO 16Ø8ØØZ
DESKBY UKREP BRUSSELS 16Ø8ØØZ
FM LUXEMBOURG 151818Z OCT 78
TO IMMEDIATE FCO
TELEGRAM NUMBER 243 OF 15 OCT
AND TO IMMEDIATE ROME, UKREP BRUSSELS
INFO PRIORITY BRUSSELS, COPENHAGEN, THE HAGUE, DUBLIN,
PARIS, BONN.

FOLLOWING FROM UKREP BRUSSELS.

FINANCE COUNCIL: 15 OCTOBER.

CONVERGENCE.

SUMMARY.

1. A LOW-KEY DEBATE WITH PREDICTABLE EXPRESSIONS OF POSITION CONCLUDED THE PHASE OF DISCUSSION OF THE REFERENCE PAPER. THE GERMANS AND OTHERS STRESSED THE NEED TO BUILD ON THE 1975 DUBLIN MECHANISM. PRESIDENCY SUMMED-UP TO THE EFFECT THAT THERE WAS GENERAL RECOGNITION OF THE EXISTENCE FOR THE UK OF A PROBLEM, BUT THE SCOPE AND ORIGINS OF THAT PROBLEM WERE DISPUTED, AS WAS THE NATURE OF THE MECHANISM NEEDED TO SOLVE IT. THE COMMISSION MADE NO COMMENTS ON SOLUTION BUT UNDETOOK TO PRODUCE THEIR PROPOSALS IN GOOD TIME TO ALLOW SUFFICIENT DEBATE BEFORE THE 19 NOVEMBER ECO-FIN COUNCIL AND THE EUROPEAN COUNCIL.

DETAIL.

2. ANDREWS (IRELAND) REMINDED THE COUNCIL OF THE IRISH VIEWS THAT CONTRIBUTIONS BY A MEMBER STATE SHOULD NOT DIVERGE EXCESSIVELY FROM ITS SHARE IN THE COMMUNITY'S GNP. IN 198Ø IRELAND'S WOULD DO SO BY ONE-THIRD. THE FINANCIAL MECHANISM SHOULD BE REEXAMINED. THIS TOGETHER WITH EXPANTION AND REFINEMENT OF STRUCTURAL FUNDS WITH THE RIGHT APPROACH TO THE CURRENT PROBLEMS.

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HE RESERVED THE RIGHT OF HIS AUTHORITIES TO REVERT TO THE PROBLEM OF IRELAND'S EXCESSIVE GROSS CONTRIBUTION TO THE COMMUNITY IN THE LIGHT OF DECISIONS TAKEN AT THE EUROPEAN COUNCIL IN DECEMBER.

3. PANDOLFI (ITALY) SPOKE TO A PAPER CIRCULATED BY THE ITALIAN DELEGATION (FULL TEXT FOLLOWING BY BAG VIRTUALLY AS IN ROME TELNO 459 OF 13 OCTOBER). THE UK BUDGET PROBLEM, SERIOUS THOUGH IT WAS, WAS NOT THE WHOLE STORY. THE WIDER ISSUE WAS THE NEED FOR THE BUDGET TO PROMOTE CONVERGENCE IN SUPPORT OF THE EUROPEAN MONETARY SYSTEM. THE COMMISSION'S FIGURES SHOWED THAT AT PRESENT THE BUDGET DID NOT PROMOTE CONVERGENCE. THE WHOLE BUDGET SHOULD THEREFORE BE BROUGHT UNDER CONTROL, IN PARTICULAR COMPULSORY EXPENDITURE. THE CAP SHOULD NOT BE ALLOWED TO CROWD OUT THE SOCIAL AND REGIONAL FUNDS AND OTHER STRUCTURAL SPENDING. THE QUESTION OF THE ABSOLUTE AMOUNT OF AGRICULTURAL SPENDING WAS QUITE DIFFERENCT FROM THAT OF THE DISTRIBUTION OF SPENDING WITHIN THE AGRICULTURE BUDGET. HE WAS NOT CRITICISING THE CAP SIMPLY FROM THE POINT OF VIEW OF MEDITERRANEAN AGRICULTURE, THOUGH THERE SHOULD BE A BETTER GUARANTEE WITHIN THE CAP FOR MEDITERRANEAN PRODUCTS. IT WAS ALSO POSSIBLE TO ENVISAGE GREATER PROTECTION FOR ITALIAN PRODUCERS OF CONTINENTAL AGRICULTURE, NOTABLY HILL FARMERS. ITALY DEMANDED THAT THE COMMUNITY PAY ATTENTION NOW TO POLICY TRENDS THAT COULD REQUIRE MORE DRASTIC ACTION LATTER. IN THE WIDER CONTEXT OF THE BUDGET THE COMMUNITY SHOULD CONSIDER QUANTITATIVE CASH LIMITS, WHICH SOME MEMBER STATES NOW USED IN NATIONAL BUDGETS. HE RECOGNIZED THAT THIS WOULD NOT DEMINISH THE UK'S PROBLEM. THE DUBLIN SUMMIT SHOULD LAY DOWN A GRADUAL QUANTIFIED PROGRAMME OVER, SAY, THREE-FIVE YEARS, FOR REBALANCING THE COMMUNITY BUDGET, WHICH SHOULD INCREASE THE SHARE OF THE SOCIAL AND REGIONAL FUNDS AND OTHER STRUCTURAL FUNDS TO ABOUT 25 PER CENT OF THE TOTAL. THE NEED, ABOVE ALL, WAS FOR A BETTER BALANCE TO BE ACHIEVED IN COMMUNITY EXPENDITURE.

4. THE CHANCELLOR THEN SPOKE AS IN MIFT.

5. LAHNSTEIN (GERMANY) SAID THAT HE WAS INCREASINGLY APPREHENSIVE AT PROSPECTS FOR THE EUROPEAN COUNCIL. GERMANY HAD IN SEPTEMBER STATED THAT IT WOULD BE READY

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TO MAKE A CONSTRUCTIVE CONTRIBUTION , BUT THE SCALE OF THE PROBLEM DESCRIBED BY THE BRITISH WOULD POSE A DIFFICULT TASK FOR THE COMMISSION AND THE COUNCIL. HE THEREFORE WISHED TO LAY OUT CERTAIN GUIDELINES WITH WHICH HIS AUTHORITIES THOUGHT SOLUTIONS TO THE BRITISH PROBLEM SHOULD BE FOUND:-

(I) THE OVERALL FRAMEWORK OF THE NEGOTIATIONS SHOULD AIM TO ACHIEVE A BETTER BALANCE OF THE BUDGET WITHIN THE PRESENT STRUCTURE OF OWN RESOURCES:

(II) THERE SHOULD BE NO NEEDLESS INFLATION OF THE COMMUNITY BUDGET:

(III) THERE SHOULD BE NO ATTACK ON THE PRINCIPLE OF OWN RESOURCES.

(IV) THE 1975 DUBLIN MECHANISM HAD BEEN ACHIEVED AFTER DIFFICULT NEGOTIATIONS AND A SOLUTION TO THE PRESENT PROBLEM SHOULD BE BASED ON IT. HIS AUTHORITIES WERE RELUCTANT TO DEPART FROM THE DUBLIN MECHANISM, NOT LEAST BECAUSE OF THE ORDERS OF MAGNITUDE THE ADOPTION OF ANY NEW MECHANISM WOULD IMPLY:

(V) THERE COULD BE NO COMPREHENSIVE SOLUTION AT THE END OF NOVEMBER TO A PROBLEM THAT HAD EMERGED GRADUALLY. FIRST STEPS WERE NEEDED. OTHER ELEMENTS COULD BE TACKLED ONLY IN THE MEDIUM-TERM. IN THIS CONTEXT, HE NOTED THAT THE OVERALL BUDGET, AND IN PARTICULAR THE REGIONAL FUND, FOR 1980 WAS NOT YET DECIDED.

HE CONCLUDED THAT THIS WAS A COMMUNITY PROBLEM AND NOT A QUESTION OF THE UK AGAINST THE REST. BUT A TOTAL SOLUTION, ABOVE ALL IN AGRICULTURE, COULD NOT BE SPEEDILY ACHIEVED. HE DOUBTED THAT PANDOLFI'S PROPOSALS ON ''CASH LIMITS'' WERE COMPATIBLE WITH THE TREATY AND WITH PARLIAMENT'S PREROGATIVE, BUT THE IDEA SHOULD BE LOOKED AT.

6. GEENS (BELGIUM), AFTER PREDICTABLE REMARKS ON THE MANNER IN WHICH THE COMMISSION HAD ATTRIBUTED ADMINISTRATIVE EXPENDITURE, REGRETTED THE TURN THAT THE

DEBATE

DEBATE ON THE BUDGET HAD TAKEN. BUDGETARY FLOWS WERE AN INDADEQUATE REFLECTION OF THE TRUE COSTS AND BENEFITS OF COMMUNITY MEMBERSHIP. THAT SAID, FOR TWO COUNTRIES AT LEAST THERE WAS A POLITICAL PROBLEM OF SOME MAGNITUDE, HIS AUTHORITES WISHED TO SUGGEST THE FOLLOWING GUIDELINES TO THE COMMISSION. NEGATIVELY, THE SOLUTION MUST NOT:

(I) ENVISAGE AN EVER-INCREASING COMMUNITY BUDGET. NATIONAL BUDGETARY DISCIPLINES MUST FIND A REFLECTION IN THE COMMUNITY'S BUDGET:

(II) THE ONE PER CENT VAT CEILING MUST NOT BE BREACHED:

(III) THERE MUST BE NO PROGRESSIVITY IN OWN RESOURCES. POSITIVELY: THERE MUST BE A SOLUTION, WHICH:

(I) MUST COVER A LONGER PERIOD THAN ENVISAGED BY, FOR EXAMPLE, THE ITALIANS: (3-5 YEARS WAS TOO SHORT),

(II) WAS BASED ON A RESTRUCTURING OF THE BUDGET.

(III) THE RESTRUCTURING OF THE BUDGET MUST BE QUALITATIVE NOT QUANTITATIVE. THE NEED WAS FOR MORE EFFICIENCY AND BETTER BALANCE.

7. ANDERSEN (DENMARK) REGRETTED THAT THE COMMISSION HAD NOT BEEN ABLE TO PRODUCE FIGURES AS REQUESTED, WHICH WOULD RELATE AGRICULTURAL EXPENDITURE TO REGIONAL PRODUCTION. HE THEN SPOKE ON FAMILIAR LINES CONCERNING OWN RESOURCES, THE FEOGA EXPENDITURE PATTERN (THE BUDGETARY FIGURES FOR WHICH CONSIDERABLY UNDERSTATED THE BENEFITS TO THE UK FARMERS), THE INVIOLABILITY OF THE CAP AND THE LACK OF DEVELOPMENT IN BRITAIN'S TRADE PATTERN WITH THE COMMUNITY.

8. MONORY (FRANCE) SAID THAT THE UK SITUATION WAS NEITHER SIMPLE NOR EASY TO UNDERSTAND. THE THREE NEWER MEMBERS OF THE COMMUNITY HAD ALL BENEFITTED FROM THE WIDER ASPECTS OF THE COMMUNITY MEMBERSHIP. THE RULES OF THE COMMUNITY HAD BEEN CLEAR WHEN THE UK JOINED, BUT THEY HAD BEEN ALREADY EXTENSIVELY REVISED TO SUIT THE UK. THERE HAD BEEN SPECIAL PROVISIONS ON IMPORTS OF SUGAR, MEAT AND BUTTER: THE FINANCIAL

MECHANISM

MECHANISM OF 1975 HAD BEEN DEVISED: AND IN 1977, THE TERMS OF ARTICLE 131 HAD BEEN ALTERED TO SUIT THE UK. CUSTOMS DUTIES AND AGRICULTURAL LEVIES WERE NOT NATIONAL CONTRIBUTIONS, BUT BELONGED TO THE COMMUNITY. IF THE UK WISHED TO CONTINUE WITH A TRADE PATTERN THAT PRODUCED A HIGH PROPORTION OF SUCH LEVIES AND DUTIES, IT COULD HARDLY COMPLAIN. THE SOLUTION TO THE UK'S PROBLEMS THUS LAY IN ITS OWN HANDS. THERE COULD BE NO QUESTION OF JUSTE RETOUR. THE ACQUIS COMMUNAUTAIRE, WHICH HAD BROKEN THE LINK BETWEEN GNP AND NATIONAL CONTRIBUTIONS, HAD BEEN ACHIEVED WITH GREAT DIFFICULTY AN COULD NOT NOW BE QUESTIONED. NOR WOULD HE ACCEPT ANY BUDGETARY PRINCIPLE OF REDISTRIBUTION. GNP PER HEAD WAS NOT A GOOD MEASURE OF ECONOMIC PROSPERITY, ENERGY RESOURCES FOR EXAMPLE, SHOULD BE TAKEN INTO ACCOUNT. HE CONCLUDED THAT THE UK BUDGET PROBLEM DID NOT STEM FROM FUNDAMENTAL MECHANISMS LAID DOWN BY THE TREATY. NONETHELESS THERE WERE CLEARLY PROBLEMS IN 1980 AS THE BENEFITS OF ARTICLE 131 CAME TO AN END. OTHER MEMBER STATES HAD PROBLEMS RESULTING FROM THE END OF THIS TRANSITION AND THE COMMUNITY SHOULD THEREFORE BE PREPARED TO MAKE LIMITED, TEMPORARY, CORRECTIONS.

9. VAN AARDENNE (NETHERLANDS) MADE THE FOLLOWING POINTS:

(I) BENEFITS OF COMMUNITY MEMBERSHIP INCLUDED ECONOMIC GROWTH AND AN ASSURED FOOD SUPPLY:

(II) THE JUSTE RETOUR WAS NOT AN ACCEPTABLE NEGOTIATING BASIS:

(III) IN ASSESSING THE BURDEN OF COMMUNITY REVENUES, AGRICULTURAL LEVIES AND CUSTOMS DUTIES SHOULD BE DIS-REGARDED:

(IV) AT THE MOMENT, AND HE STRESSED AT THE MOMENT, AN INCREASE IN OWN RESOURCES WAS NEITHER FEASIBLE NOR DESIRABLE:

(V) ON THE EXPENDITURE SIDE, THERE WAS A NEED TO LOOK CRITICALLY AT ALL CATEGORIES, BUT ABOVE ALL THE CAP:

(VI) THERE WAS NO TIME BEFORE DUBLIN TO WORK OUT A TOTALLY NEW SOLUTION. THERE WOULD HAVE TO BE A MEDIUM-TERM APPROACH TO CHANGING THE BALANCE OF THE BUDGET COMBINED WITH A TEMPORARY SOLUTION FOR THE UK. ONE BASED ON THE ADJUSTMENT OF THE DUBLIN MECHANISM FOR A FEW YEARS, LINKED WITH A REVIEW OF THE WAY IN WHICH REVENUE WAS RAISED, MIGHT BE ACCEPTABLE:

(VII) THE COMMISSION SHOULD LOOK PARTICULARLY AT THE DESIRABILITY OF REMOVING THE RESTRICTIONS IN THE DUBLIN MECHANISM. A CEILING TO REPAYMENTS MUST CONTINUE, AS SHOULD THE GDP PER HEAD AND ON GDP GROWTH CRITERIA. HE SUMMED UP THAT THE UK HAD A PROBLEM AND THAT SOME FLEXIBILITY WOULD BE NEEDED FOR A PERIOD OF, SAY, TWO YEARS. BUT IT SHOULD BE QUITE CLEAR THAT A SOLUTION WHICH ENVISAGED A TURN-AROUND OF 1 AND ONE HALF BILLION EUA WAS UNTHINKABLE.

1∅. ZANTER (LUXEMBOURG) SHARED THE BELGIAN VIEW ON ATTRIBUTION OF ADMINISTRATIVE EXPENSES. THERE HAD TO BE A MEDIUM-TERM REBALANCING OF THE COMMUNITY BUDGET AS WELL AS A REVISED FINANCIAL MECHANISM.

11. ORTOLI (COMMISSION) SAID THAT THE COMMISSION'S TASK TODAY WAS TO LISTEN. HE DETECTED A COMMON CONCERN THAT COMMUNITY FUNDS SHOULD BE CAREFULLY MANAGED. HE RESERVED THE COMMISSION'S RIGHT TO PROPOSE AN INCREASE IN ''OWN RESOURCES'' IF IT JUDGED THIS NECESSARY. BUT LISTENING WAS EASY AND THE COMMISSION NOW FACED THE MOST DIFFICULT PART OF ITS TASK, WHICH THEY WOULD ATTEMP TO FULFIL CONSTRUCTIVELY AND IN GOOD TIME BEFORE THE EUROPEAN COUNCIL.

12. IN A SECOND INTERVENTION THE CHANCELLOR SAID HE WAS GRATEFUL TO COLLEAGUES FOR ACKNOWLEDGING THE INJUSTICE DONE TO THE UK BY PRESENT ARRANGEMENTS AND THE CONSEQUENT NEED TO DO SOMETHING TO RECTIFY THAT INJUSTICE. ALL HAD ALSO AGREED THAT THIS COULD NOT BE DONE BY EXPANDING EXISTING COMMUNITY PROGRAMMES. HE REMINDED MONORY AGAIN OF WHAT THE COMMUNITY HAD SAID IN 197∅ ABOUT ''UNACCEPTABLE SITUATIONS''. THE COMMUNITY HAD FAILED TO FORESEE THE SIZE OF THE INEQUITY WHICH MIGHT ARISE AND HAD ADMITTED THIS IN NEGOTIATING THE 1975 DUBLIN MECHANISM.

IT WAS

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IT WAS IMPORTANT TO REMEMBER THAT IN THE DISCUSSIONS LEADING UP TO DUBLIN 1975 IT WAS EXPLICITLY RECOGNISED THAT THE IMPACT OF THE COMMUNITY'SYSTEM OF OWN RESOURCES SHOULD BE FULLY TAKEN INTO ACCOUNT WHEN ASSESSING THE FINANCIAL POSITION OF MEMBER STATE. THE COMMUNITY HAD NOW ADMITTED THAT A SEVERE PROBLEM EXISTED FOR ONE MEMBER STATE: THAT A REMEDY SHOULD BE FOUND: AND THAT THE 1975 MECHANISM WAS NOT WORKING. TO LAHNSTEIN'S COMMENT THAT THE COMMUNITY MUST BUILD ON THE 1975 MECHANISM THE CHANCELLOR SAID THAT THIS WAS A BUSTED FLUSH: WE HAD ALREADY MADE IT CLEAR THAT SIMPLY REMOVING THE RESTRICTIONS WOULD NOT SUPPLY A SUFFICIENT REMEDY TO THE PROBLEM, AS LONG AS IT DEALT ONLY WITH GROSS CONTRIBUTIONS AND NOT WITH THE INADEQUACY OF UK RECEIPTS.

13. MONORY, WITH SUPPORT FROM LAHNSTEIN AND ANDERSEN, REACTED SHARPLY TO THE CHANCELLOR'S USE OF THE WORD ''INJUSTICE''. HE HAD ACKNOWLEDGED NO SUCH INJUSTICE AND WOULD NOT SEE THE COMMUNITY SO CONDEMNED. A FREINDLY UNDERSTANDING THAT A PROBLEM EXISTED IN 198Ø SHOULD NOT BE MISTAKEN FOR ACQUIESCENCE IN THE WHOLE OF THE CHANCELLOR'S ANALYSIS. LAHNSTEIN ADDED THAT THE COMMUNITY WAS ENGATED IN A CO-OPERATIVE EXERCISE, FLOWING FROM THE DECISIONS OF ITS INSTITUTIONS. THERE WAS NO ETHICAL DIMENSION TO THE EXERCISE AS WAS IMPLIED BY THE USE OF THE WORD INJUSTICE.

14. COLLEY THEN SUMMED UP AS ABOVE.

FCO PASS ADVANCE COPIES TO:-

FCO	PS/SOFS, PS/LPS, PS/PUS, PS/MR HURD, BUTLER, FRETWELL, SPRECKLEY, HAZLE.
CAB	ELLIOTT, FRANKLIN, WALSH, PS/LORD PRESIDENT.
NO.1Ø.	ALEXANDER
TSY	PS/CHANCELLOR, COUZENS, JORDAN-MOSS, MRS HEDLEY-MILLER, MIDDLETON, ASHFORD, THOMSON, BAKER.
B/ENGLAND	GPS, MCMAHON, BALFOUR, BULL.

WRIGHT. (ADVANCED AS REQUESTED)

FRAME ECONOMIC
EID(I)
FRD.
ECON.D.

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cc Mrs Lomax
M. Roberts
M. Shore

CONFIDENTIAL
FRAME ECONOMIC
DESKBY FCO AND UKREP BRUSSELS 160800Z
FM LUXEMBOURG 151820Z OCT 79
TO IMMEDIATE FCO
TELNO 244 OF 15 OCTOBER
AND TO ROME
INFO IMMEDIATE UKREP BRUSSELS PRIORITY BRUSSELS COPENHAGEN THE HAGUE DUBLIN PARIS BONN

FOLLOWING FROM UKREP BRUSSELS

FINANCE COUNCIL: 15 OCTOBER

CONVERGENCE: MIPT

FOLLOWING IS THE TEXT OF THE CHANCELLOR'S FIRST INTERVENTION.

1. THE CHANCELLOR EXPRESSED SYMPATHY WITH ITALIAN CASE. AS THEY RIGHTLY SAID, THE BUDGET SHOULD BE BETTER BALANCED: THE SHARE OF COMMUNITY EXPENDITURE DEVOTED TO CAP SHOULD BE REDUCED: FLOW OF RESOURCE TRANSFERS IN THE COMMUNITY SHOULD BE IMPROVED TO PROMOTE CONVERGENCE AND REDUCE THE NON-BUDGETARY RESOURCE COSTS WHICH ARE IMPEDING CONVERGENCE. BUT WE HAD OUR ADDITIONAL AND IMMEDIATE BUDGETARY PROBLEM. NOTHING IN THE SUPPLEMENTARY MATERIAL TABLED BY THE COMMISSION IN ANY WAY DETRACTED FROM THAT, OR DIMINISHED ITS SERIOUSNESS.

2. THE CHANCELLOR THANKED COMMISSION FOR SPEED AND EFFICIENCY IN PRODUCING SUPPLEMENTARY PAPER. IT WAS IMPORTANT THAT COMMISSION SHOULD NOW PROCEED AS EXPEDITIOUSLY AS POSSIBLE TO IDENTIFY AND ASSESS THESE POSSIBILITIES FOR REMEDIES AND TO PUT FORWARD ITS PROPOSALS ON POSSIBLE SOLUTIONS. THESE SHOULD BE AVAILABLE TO MEMBER STATES BY THE END OF OCTOBER OR A DAY OR TWO AFTER, OTHERWISE THE COMMUNITY WOULD NOT BE ABLE TO ADHERE TO THE TIMETABLE LAID DOWN AT THE JUNE EUROPEAN COUNCIL. THE CHANCELLOR SAID THAT THE SUPPLEMENTARY MATERIAL INCLUDES TEXT OF HIS STATEMENT AT LAST FINANCE COUNCIL ON 17 SEPTEMBER. HE DID NOT WISH TO REPEAT IT.

3. BUT HE WAS CONCERNED BY INDICATIONS THAT HAD REACHED HIM THAT THERE WAS STILL ROOM FOR SOME MISUNDERSTANDINGS. WE MUST BE SURE THIS WAS NOT SO BEFORE WE MOVED INTO THE FINAL PRE-DUBLIN STAGE.

4. THE FIRST POSSIBLE MISUNDERSTANDING WAS THAT WE WERE CONCERNED ONLY WITH THE CONTRIBUTIONS SIDE OF THE BUDGET, AND THAT THE SOLUTION COULD BE CONFINED TO THAT ASPECT. THAT WOULD NOT BE ENOUGH. THE SOLUTION MUST DEAL WITH THE LOW LEVEL OF UK RECEIPTS AS WELL AS WITH OUR EXCESSIVE GROSS CONTRIBUTION SO AS TO ACHIEVE A BROAD BALANCE. SO AN AMENDMENT OR AMENDMENTS OF EXISTING FINANCIAL MECHANISM MIGHT HELP, BUT IT WOULD NOT BE ENOUGH.

5. A SECOND POSSIBLE MISCONCEPTION WAS THAT A SOLUTION MIGHT BE FOUND THROUGH MAJOR EXPANSION OF COMMUNITY STRUCTURAL FUNDS. FOR THE UK THIS DID NOT PROVIDE THE ANSWER. THE COUNCIL SHOULD LOOK AT THE TABLES IN PAGES 1ø AND 11 OF SECTION A OF THE COMMISSION'S SUPPLEMENTARY PAPER. THEY SHOWED THAT EVEN IF THE REGIONAL FUND WERE MORE THAN DOUBLED FROM ITS PRESENT SIZE, THE NET GAIN TO THE UK WOULD BE NO MORE THAN 95 MEUA. TO YIELD A GAIN EVEN OF 475 MEUA TO THE UK , THE FUND WOULD HAVE TO BE INCREASED BY 5,øøø MEUA. THIS WOULD BE INSUFFICIENT. EVEN THEN THE BENEFIT WOULD TAKE THREE TO FIVE YEARS TO COME THROUGH.

6. THIRD, THE SOLUTION MUST LAST AS LONG AS THE PROBLEM . FOR EXAMPLE, THERE HAD BEEN SUGGESTIONS THAT THE PRESENT TRANSITIONAL ARRANGEMENTS MIGHT BE EXTENDED FOR A LIMITED PERIOD, OR THAT ANY SOLUTION SHOULD BE APPLIED ONLY OVER A FIXED PERIOD OF A YEAR OR SO. NEITHER WOULD MEET THE CASE. DEVICES OF THIS KIND WOULD MERELY PROVIDE A MARGINALLY MORE GRADUAL APPROACH TO THE INTOLERABLE. THEY WOULD ENSURE THE RE-EMERGENCE OF THE PROBLEM IN EVEN MORE ACUTE FORM WITHIN A YEAR OR SO LATER. THEY WOULD BE NO SOLUTIONS.

7. THIS DID NOT MEAN THAT THE SOLUTION MUST LAST FOREVER. FEW THINGS DID. ON THE EXPENDITURE SIDE ALL RECOGNISED THAT, IN TIME, SOME CHANGE IN THE STRUCTURE OF THE BUDGET IS DESIRABLE IN ITSELF

/ AND

AND WOULD BE NECESSARY TO REDUCE THE PREDOMINANCE OF THE CAP. ON THE REVENUE SIDE, FURTHER RE-ORIENTATION OF THE UK'S TRADE PATTERN TOWARDS THE COMMUNITY SHOULD LEAD TO A REDUCTION IN THE UK'S GROSS CONTRIBUTION. BUT, AS OUR EXPERIENCE MADE CLEAR, THESE DEVELOPMENTS WERE LONG-TERM AND UNPREDICTABLE. THE CHANCELLOR RECALLED ACCESSION NEGOTIATIONS OF 197Ø. THE COMMISSION HAD THEN ENVISAGED A SITUATION IN WHICH THE CAP COULD BY 198Ø REPRESENT ONLY 4Ø PERCENT OF BUDGET EXPERIENCE SHOWED WE SIMPLY COULD NOT BANK ON SUCH FORECASTS AGAIN. WE WOULD LOOK FOR FAVOURABLE DEVELOPMENTS, BUT MEANWHILE THE COMMUNITY SHOULD PROVIDE FOR AN IMMEDIATE SOLUTION WHICH WOULD LAST WHILST THESE LONG-TERM TRENDS WERE COMING INTO EFFECT, AND UNTIL SUCH TIME AS THEY COULD BE CLEARLY SEEN TO HAVE REMOVED THE PROBLEM. NOBODY HOPED MORE THAN UK THAT NEED FOR SOLUTION WOULD GO AWAY.

8. THERE HAD BEEN SUGGESTIONS THAT THE ANSWER COULD BE FOUND THROUGH REDUCING CAP EXPENDITURE. THIS WAS CLEARLY DESIRABLE. WE BELIEVE EXPENDITURE COULD BE REDUCED WITHOUT ATTACKING BASIC PRINCIPLES OF THE POLICY. BUT WE HAD TO BE REALISTIC. GIVEN RISING FARM PRODUCTIVITY, IN THE SHORT TERM, A MAJOR EFFORT WOULD BE NEEDED TO KEEP FEOGA AT PRESENT LEVEL, LET ALONE REDUCE IT. IT WAS DESIRABLE IN ITSELF BUT NOT THE ANSWER TO OUR PROBLEM, WHICH WAS IMMEDIATE.

9. THE CHANCELLOR ASKED THE COUNCIL TO CONSIDER WHY WE WERE PRESSING FOR A SOLUTION WITH IMMEDIATE EFFECT. WAS OUR PROBLEM REALLY SO BIG AND SO URGENT? IT WAS COMMON GROUND, FROM THE COMMISSION'S PAPER, THAT IN 198Ø OUR NET CONTRIBUTION WOULD BE OVER POUNDS STERLING ONE BILLION - 4Ø PERCENT ABOVE THE ONLY OTHER MAJOR NET CONTRIBUTOR, GERMANY. CALCULATIONS FURTHER AHEAD, OF COURSE, INVOLVE ALL SORTS OF ASSUMPTIONS ABOUT CHANGES IN TRADE PATTERNS, ABOUT EXCHANGE RATES, ABOUT DEVELOPMONT OF THE CAP, ABOUT RESOURCE TRANSFERS, ABOUT RELATIVE CHANGES IN GNP, AND ABOUT ENLARGEMENT OF THE COMMUNITY. BUT UNLESS SOME QUICK-ACTING CORRECTIVE MECHANISM COULD BE FOUND, WE WERE CERTAIN THAT, ON ANY COMBINATION OF ASSUMPTIONS THAT WE HAD YET BEEN ABLE TO MAKE, THE UK'S NET CONTRIBUTION SEEMED DESTINED TO RISE EVEN MORE STEEPLY OVER THE

/ NEXT

NEXT FEW YEARS. ON ONE CALCULATION, BASED ON QUITE REASONABLE ASSUMPTIONS, OUR NET CONTRIBUTION COULD EASILY BE POUNDS STERLING ONE AND A HALF BILLIONS BY 1983, AT PRESENT PRICES. THE IMMEDIATE PROBLEM WAS BAD ENOUGH. THE PROSPECT OF SUCH A SITUATION IN FUTURE WAS LUDICROUS AND INTOLERABLE.

1ø. HE WAS BOUND TO REGARD SUCH A TREND AS SERIOUS AND REQUIRING IMMEDIATE ACTION. HE HOPED OUR CONCERN WAS NOW ABSOLUTELY CLEAR. HE WAS NOT CALLING INTO QUESTION COMMUNITY POLICIES AS THEY HAVE EVOLVED OVER THE PAST TWO DECADES. CHANGES WERE NEEDED, MAYBE (EG IN CAP COSTS). BUT THAT WAS A SEPARATE QUESTION. NEITHER WAS HE CALLING INTO QUESTION FUNDAMENTAL COMMUNITY CONCEPTS - OWN RESOURCES, ESSENTIAL PRINCIPLES OF THE CAP, THE COMMON COMMERCIAL POLICY. WE WERE CONCERNED SOLELY AND SUBSTANTIALLY WITH THE PERVERSE AND INTOLERABLE CONSEQUENCES OF THE PRESENT BUDGETARY POSITION. AS PANDOLFI HAD SAID, WE HAD A SYSTEM WHICH OUGHT TO PROMOTE CONVERGENCE, BUT WHICH NEVERTHELESS WAS CLEARLY PACING THE GREATEST BURDEN ON THE SLOWEST GROWING MEMBERS OF THE COMMUNITY. FOR THE SAKE OF THE COMMUNITY, THIS REQUIRED CORRECTION, URGENTLY, BY A MECHANISM WHICH EFFECTIVELY, AND FOR AS LONG AS THE PROBLEM PERSISTED DEALT WITH THE INEQUITY WHICH THE COMISSION'S PAPER SO CLEARLY DEMONSTRATED.

11. IT MIGHT BE SUGGESTED THAT THE UK WAS MAKING UNREASONABLE DEMANDS ON THE COMMUNITY. THAT WAS NOT SO. THE UK HAD BEEN ASSURED IN ACCESSION NEGOTIATIONS THAT BALANCE OF COMMUNITY BUDGET WOULD CHANGE AND THAT BUDGETARY PROBLEMS OF THE SORT WE NOW FACED WOULD THEREFORE NOT ARISE. COMMUNITY ALSO DECLARED, IN PAPER ON FINANCIAL ARRANGEMENTS IN AN ENLARGED COMMUNITY, THAT ''SHOULD UNACCEPTABLE SITUATIONS ARISE . . . THE VERY SURVIVAL OF THE COMMUNITY WOULD DEMAND THAT THE INSTITUTIONS FIND EQUITABLE SOLUTIONS''.

12. THE TRANSITIONAL ARRANGEMENTS NEGOTIATED FOR UK ENTRY ARE NOW OVER. BUT THE PROMISED IMPROVED BALANCE HAD NOT BEEN ACHIEVED. THE ''UNACCEPTABLE SITUATION'' ENVISAGED AT THE TIME OF ENTRY HAD

/ ARISEN.

ARISEN. AND, UNFORTUNATELY, THE FINANCIAL MECHANISM NEGOTIATED IN 1974/5 HAD PROVED TO BE INADEQUATE TO DEAL WITH THIS SITUATION. IT WAS ''AN EQUITABLE SOLUTION'' TO A MAJOR COMMUNITY PROBLEM THAT THE UK NOW SOUGHT. COLLEAGUES SHOULD BE UNDER NO ILLUSION AS TO THE SCALE AND THE URGENCY OF THE SOLUTION SOUGHT.

FCO ADVANCE TO:
FCO - PS/SOFS, PS/LPS, PS/PUS,PS/MR HURD, BUTLERN FRETWELL
SPRECKLEY, HAZLE
CAB - ELLIOT, FRANKLIN, WALSH, PS/LORD PRESIDENT
NO 1Ø. - ALEXANDER
TSY - PS/CHANCELLOR, COUZENS, JORDAN-MOSS, MRS HEDLEY-MILLER
MIDDLETON, ASHFORD, THOMSON, BAKER
B/ENGLAND - GPS, MCMAHON, BALFOUR, BULL.

WRIGHT

[ADVANCED AS REQUESTED]

FRAME ECONOMIC:
EID

CONVERGENCE : STATEMENT OF THE UNITED KINGDOM DELEGATION OF ITS OPINIONS AND REQUESTS IN CONCRETE FORM REGARDING ITS BUDGETARY POSITION

The UK's budgetary problem is simple and readily visible. The Commission's reference paper has shown clearly its size and seriousness. By 1980 the UK will be one of only two significant net contributors to the Budget. On any attribution of MCAs our payment will be over 1,500 MEUA (£1,000 million) - over 40 per cent larger than Germany's and representing 55-60 per cent of total net transfers through the Budget in that year, although the UK ranks 7th in the Community in GNP per head.

Our net contribution has grown fast - from only £167 million in 1976 and is likely to grow equally fast after 1980 unless a solution is found.

The reference paper has also shown clearly the two causes of the problem - both our excessive contributions to financing the Budget and our low level of receipts from it. Next year, when our share of GNP will be 16 per cent, we will finance over 20 per cent of the Budget, but get back only 10 per cent or less. This is a manifest inequity which the Community must find a way of removing. It is bad for the Community if a country with below average wealth is a main source of its finance, and is not tolerable for any British Government.

It is accepted that budgetary transfers are not the only element in Community membership. Budgetary figures may also be misleading, as regards their true economic incidence, for other Member States such as Belgium and Luxembourg, but the reference paper shows that for the UK they are a reasonably accurate representation of the facts. Non-budgetary effects make the position worse, as the UK incurs substantial resource costs as a result of the CAP. Nor does the "Rotterdam effect" alter the position of the UK.

As regards solutions, given our per capita GNP the UK should at worst be in broad balance on contributions and receipts to the Community. The solution must :

.../...

a). act effectively on the net contribution, compensating for the low level of receipts - over half the problem - as well as the excessive gross contribution;

b). be put into operation immediately;

c). last as long as the problem, and no longer.

The UK rules out no approach at this stage, but there are a number of false trails. We see no scope for an adequate solution through :

a). reform of the Common Agricultural Policy. However desirable and necessary it is to curb CAP expenditure, as the Commission recognises, this will not act quickly enough or be on a sufficiently large scale, or be sufficiently related to the budgetary problem;

b). increased receipts from Regional and Social Funds. Some expansion may no doubt be justified. But they could not conceivably remove UK's imbalance on a sufficient scale. Nor would it be right or practicable to solve our problem through unnecessary expansion of the Community Budget or through artificial distortions of existing Community policies;

c). Loans. As the Commission has rightly pointed out, these do not constitute a transfer of resources, though they have an important role to play in the development of Community policies. They bear interest and they have to be repaid, and the UK has no problems in raising loans from other sources.

It is equally insufficient for the UK to wait until the development of our trade patterns and the development of Community policies solves our problem with the passage of time. Our trade has undergone the biggest reorientation towards the Community of any Member State since 1972, to the considerable benefit of our partners. This reorientation will no doubt continue, but even at the present rate of progress this cannot help with our immediate problem over the Budget.

The remit from the Strasbourg European Council invited countries to make clear their views on a solution in concrete terms. In our view some form of corrective mechanism is indispensable. But it

.../...

must correct the net position - counteracting our low receipts as well as our excessive gross contribution.

One possibility which we think the Commission should examine is a mechanism which addresses itself directly to the net contribution position, and takes account of GNP per head as does the present Financial Mechanism.

Another possibility is that the Commission might start from the existing Financial Mechanism. They would first have to remove all the multiple restrictions, which, as they have shown in the reference paper, limit or exclude the UK from benefit at present. The restrictions which would have to be removed include the balance of payments condition, the tranches system and the overall 3 per cent limit.

Removal of these restrictions alone, however, will be nothing like sufficient. So long as the Financial Mechanism is restricted to dealing with the gross contribution, it cannot meet the larger part of our problem. A further change would have to be made to amend it to compensate for an inadequate level of receipts.

We do not suggest that these exhaust the possibilities. There may be others, and other combinations.

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CONFIDENTIAL

C1

PRINCIPAL PRIVATE SECRETARY

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

INDUSTRY ACT FORECAST

The Financial Secretary discussed the latest draft with Mr Ridley this morning, in the light of comments from No 10 and elsewhere.

In the Financial Secretary's view, there is a very strong case indeed for publishing a very much shorter piece, containing just paragraphs 2, 10, 21, 22, 23 and 24 of the draft attached to Mr Shepherd's minute of 16 November. The remainder of the material could then be used as background briefing. It might be possible to publish the whole thing as a Press Notice rather than as a supplement to the Economic Progress Report.

There are obvious difficulties in making such a radical change at this late stage: Sir D Wass and Sir F Atkinson would need to be consulted very quickly. But you might like to put the point to the Chancellor nonetheless.

SAJL

S A J LOCKE
20 November 1979

CONFIDENTIAL

PRINCIPAL PRIVATE SECRETARY

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

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S A J LOCKE
20 November 1979

P.A. note.

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Chancellor discussing with DW! 13/12

A.B:
— for attention: *
I feel there is substance in this †.
Cd. we discuss?
You, A.R., me.

B.8

CHANCELLOR

cc Mr Cardona

CHRISTOPHER WALTON

I attach a note summarising the key points he made to Mr Cardona and me at lunch on Wednesday the 28th. In addition I should add that one thing Walton said quite strongly implied he would be willing to make use of his right to a sabbatical year from the Bank to come and do some work here on the principles of Aid policy. I also thought I detected a willingness to write you an "issues" paper at some point.

2. Mr Cardona and I have not been involved in the pursuit of the current Aid Review. Nor, as far as we are aware, has it been the subject of much consultation between officials and Ministers or Advisers. This raises an interesting and important general question, since much inter-departmental manoeuvres will often be rather futile without some guidance at the start or steering while they proceed. Yet whether this happens is pretty much a matter of luck. The last thing one wants is to complicate matters further with yet more paper. On the other hand it is fairly absurd if important reviews and inter-departmental exercises such as this one proceed largely in ignorance of Ministers' considered view of what is needed or when. Perhaps we might air this issue at an early morning meeting. †

AM

ADAM RIDLEY
30th November 1979

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See 1.G's letter in todays box

Points

1. The proliferation of international aid-giving bodies [International Financial Institutions or IFIs] has passed all reasonable limits and is now making aid intolerably wasteful and administratively cumbersome. The Brandt report's publication could well provide a focus for such an effort.

2. The obvious IFI to bear down on and eliminate is the new IFAD, an agricultural development bank, based in Rome.

3. The aid-giving process is taxing the resources of the recipient countries. IFIs or donor countries give money to LDC Governments who then channel it through overstrained para-statal bodies. This bias merits attack.

4. The proposal to increase the World Bank's capital offers an opportunity to seek a quid pro quo. The best thing to seek would be greater coordination, control and effectiveness; and sustained onslaught on the tendency to use Bank programmes as a device for income support and distribution or redistribution within recipient countries; and by the same token a higher priority for activities which promote the growth process.

5. The UK nominees on the Bank Board (from ODA) tend to be men of very narrow vision, and ill suited to any effort to impose a discipline on the Bank. Apart from anything else they know little or no relevant economics, particularly of the macro kind.

6. Any tendency in the UK to turn Aid into industrial policy in disguise, particularly aid for lame ducks, is fraught with risk though not necessarily wrong in all cases.

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7. The British Aid scene needed the illumination which comes from clear and well founded basic principles. Though the present review was most unlikely to provide it, there is in any case not much which can be done in the short-to-medium run anyway. What was needed was, in all probability, a Treasury dominated exercise, which would look ahead over a considerable period.

CONFIDENTIAL

G.3

CHANCELLOR

More agenda for our mtg on indexn.

+ + have some attractions

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

CHILD BENEFIT

Mr Kemp's submission of November 28th on the problems of uprating child benefit is an interesting one. I know it is somewhat unfashionable, but I am quite convinced in my own mind that a substantial uprating of child benefit, in line with prices, is the right thing to do. Furthermore I think it is so difficult to contemplate not doing it, but I think one has little choice in the matter. That is not to say that there may not be interesting variations in the scheme which might be explored in terms of varying levels of benefit for different family size, some trade-off against the VAT zero rating and so on.

2. It may be objected that there is inadequate provision made for doing so. My own belief is that the best way to pay for it would be simply to raid some other part of the system for national insurance benefits. By far the best thing to raid would be either unemployment benefit or old age pensions. I think the act of doing so, and declaring that one is doing so in public, would help a great deal to dramatise the "zero sum" (at best!) + game in which of necessity the poverty lobby must accept that they are henceforward involved.

3. I think this approached would also make it much easier to + get away with a reduction in the child allowances to the unemployed, the sick and so on.

AM

ADAM RIDLEY
3rd December 1979

CONFIDENTIAL

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I.17

MR HALL

CONTINGENCY PLAN FOR A CENTRAL PRESS UNIT

In your minute of December 3rd you asked me and the other advisers for quick comments on E(79)62. I have nothing to say about the technicalities, on which Mr Davies will, no doubt, have an expert view. One immediate point which occurs to me, however, is the obvious need for liaison with Central Office. This paper demonstrates the need for a "Shadow Press Committee" and defines another of its tasks. It prompts one to ask what has happened to the proposals made in your letter to the Prime Minister of November 8th "Balance in the Media", paragraph 4(v) of which suggested a co-ordinating activity in Central Office to deal amongst other things with lack of balance in the media. The modus operandi of the old Sturges-Jones Committee in 1970-74 could be just an useful in helping to put over the Government's point of view during a strike as it could dealing with distortions of the public expenditure policy.

2. The paper also prompts the somewhat cynical question which you have recently asked about in another context, as to what has happened to the Paymaster General's Assistant Secretary. Getting right the presentation of an emergency generated by an industrial dispute fits naturally into the wider campaign for economic realism, responsibility in pay matters and the avoidance of strikes. So one naturally asks the question, and suggests that you should pose this at the Committee, as to whether the Assistant Secretary who has been inspected by the Paymaster General will be in post shortly. If he is not there will be little point in setting up the CPU, since there will be no-one to run it!

3. Finally may I suggest that, given the close interests of this Department in the presentation of policy generally, that it might

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be sensible if Mr Davies liaises fairly closely with one or other adviser, dispute by dispute. I have no idea what this could involve in practice - and I suppose no-one else does yet! However it is a point worth considering in the meeting.

AR.

ADAM RIDLEY
3rd December 1979

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FINANCIAL SECRETARY TO THE TREASURY

MR HALL

cc Mr Ridley
Mr Cropper

CONTINGENCY PLAN FOR A CENTRAL PRESS UNIT

I would not dissent from Mr Ridley's note of 3 December about E(79)62, but I would add the qualification that any liaison between CPU and Central Office must be very discreet indeed: in the highly charged atmosphere of a bitter industrial dispute, a journalist's misunderstanding of the relationship could be very damaging indeed.

Angus Maude's second recommendation, that the Contingency Reserve should finance additional advertising costs caused by an emergency, seems acceptable and unlikely to be an undesirable precedent.

GC

GEORGE CARDONA
3 December 1979

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CHANCELLOR

cc Chief Secretary
Sir Anthony Rawlinson
Sir Lawrence Airey
Mr Lavelle
Mr Moore
Mr Cardona

BL - E COMMITTEE

As you know, I have not had the chance to study the papers thoroughly. So the following notes are very brief and the ideas behind them need working up properly.

LESSONS OF THE PAST

1. The Ryder plan has failed in financial terms. BL have not been able to generate the internal cash-flow relied on by Ryder to match Government assistance;

2. This is because BL itself has failed dismally, as regards industrial relations, productivity and sales. For example since Ryder, ie over the period 1976-1979 Q II:

(a) Disputes

1976-79 Q II have seen 33.6 million man hours lost in internal disputes = 4 million man days = 17,500 man years (approx).
External disputes have lost a further 6½ million man hours, ie 2,500 man years.
[Source: Table 1. Col 1.]

(b) Loss of Production

Measured against admittedly stiff test of normal capacity, loss of vehicles, on the assumption that 1978 record is typical in its financial consequences, has been;

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CHANCELLOR OF THE EXCHEQUER

Vehicles lost:

474,000 internal disputes
111,000 external disputes
585,000 total all disputes

Sales value:

	£1.46 billion	Total all disputes
of which	£1.185 billion	internal
	£0.275 billion	external.

(c) Productivity

BL the only European car firm in which real value added per capita fell between '70 and '77.

By 1978 value added per man, the only really accurate measure of output per head was 15% below best year, viz .72/3, and only 4% above 1970. [See figures in last Col of Table II and summary below.]

Sales per man year equally distressing. Similarly output per man of cars and vehicles:

Summary of Productivity (or lack of it)

	Sales Man yr.	Production/ man yr.		Real Value Added per man year 1970 = 100
		Cars	Other Vehicles	
1969/70	4.9	n.a.	n.a.	100
1974/5 [Ryder Year]	4.1	5.9	1.7	92.8
1976	4.3	6.3	1.6	91.6
1978	4.2	5.6	1.4	104
1979 [Forecast]	4.3	5.7	1.6	n.a.

Source: Department of Industry letter to Treasury of November 14th.

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(d) In effect assistance from Government has permitted Leyland the luxury of doing nothing whatever to improve its performance to competitive levels, has de facto financed strikes and allowed BL to go into reverse at a time when other competitive motor industries have advanced despite all difficulties. EG

World Motor Industry Productivity

		1972	1977
	GB	100	93
of which	BL	100	87
	Italy	100	89
	Sweden	100	100
	France	100	124
	Germany	100	126
	Japan	100	135
	USA	100	108

Source: Financial Times, 4th December.

(e) Conclusion

No point in pretending that Government will help anything other than controlled run-down unless performance improves dramatically first.

THIS AFTERNOON'S MEETING

- Some grounds for fearing Ministers are about to be bounced, eg by threat of Edwardes' flight to Japan to see Honda on December 20th. Which would require hasty and inadequately considered decisions. Officials here have not had time to analyse position fully or properly yet, nor options open to Treasury Minsiters.

- Cash requirements of Leyland need to be seen in context of other industrial problems, such as Rolls with its £700 million (?)

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cash shortage; and the overrun of cash limits by several NIs, such as Posts, Electricity and, one fears, BSC particularly if there is a strike. For future years as well as this year.

- Department of Industry/BL's needs for money this year a serious threat to contingency reserve; and alternative methods of finance proposed (lines of credit, and twisting arms of US banks to lend more in the short-run) no more appetising than factoring PO Debt. The public spending implications will in the long run be just as severe.

- We feared - as did Hoskyns - that Department of Industry's ineptness over the BL ballot would create false impression that HMG would cough up the money. This has indeed proved to be the case. But it is for Department of Industry and BL to dispel that false impression, not for us to acquiesce in it.

PRIORITIES FOR THE FUTURE

- A very tough line is now needed. But one which ensures that Government is not seen to be behaving unreasonably.

- There is no point in supporting the corporate plan as at present drawn up. As described [Mr Moore's brief, paragraph 5], this plan will only offer 15% on assets (historic), well below a proper rate of return/ in real terms. That means the firm's objective is not one of viability, and that cash needs will continue indefinitely if not infinitely, and Government will have to neet or underwrite them.

- The salami tactics now proposed by Department of Industry and BL are partly sensible. But partly foolish, since longer run implications are not clear, and saving a little money today could well mean spending much more tomorrow.

- Planning for a phased rundown therefore vital.

- However it is quite possible that BL could vastly improve its performance, as its 1972/73 figures show. To provide every

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possible inducement to that would be an equally important aim whether one ultimately runs down or builds up on the basis of the corporate plan.

- That requires turning the screw on Department of Industry and Leyland further.

SPECIFIC POINTS

I would recommend you to agree to as little as possible of the Department of Industry's proposals at E this afternoon. The right way ahead perhaps should include the following elements:

- No claim on the contingency reserve this year under any circumstances.

- No agreement amongst Ministers until after the wage and industrial relations package is accepted. [I would like to see it ballotted, but do not know if that is possible.]

- Clear understanding that present corporate plan is unacceptable ab initio, because objectives for profit too modest.

- No money for anything other than a phased run down until and unless better coporate plan put forward; and

    - firm vastly improved output/productivity profits in short-run [see below];

    - BL makes further progress on IR, and virtually eliminates the self-indulgence of strikes and stoppages.

  In other words, no agreement for any money for 1980/81 onwards pro tempore, and the barest minimum for the time being.

- BL workers must make, and be made to feel to make, their own contribution to the firm's future, and extremely quickly. This could be via

    - higher productivity (the 15% shortfall on 1972 value added per man implies massive slack which could be picked up very quickly);

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- something like a loan by the workers to BL, amounting to, say, 5% of their gross wages from the New Year on; as well as

- a very modest wage settlement, as already suggested.

So far they have only sacrificed their colleagues in the least competitive plants. Why cannot they help themselves a bit by helping their firm?

Mr Moore's Brief

The above notes are incomplete as already stressed, and hastily considered. Subject to that, I would comment on Mr Moore's (TSY) recommendations (paragraphs 26-31 of his brief of December 6th) as follows:

paragraph 26: "support BL board through 1980"
No. Issue should not be resolved one way or the other yet.

paragraph 27: (i) lean on banks to ease this year's finance;
(ii) offer not fuel money but line of credit;
(iii) do not concede on converting £150 million loan to equity now.
Concede nothing yet, and yield on none at the very least until BL have made progress on wage front.

paragraph 28: Do not guarantee private sector loan.
Agreed, though it helps only a little.

paragraph 29: You and Chief Secretary to hold back from playing a part in negotiations with BL.
Agree only if Treasury officials keep in better touch than they have up to now.

paragraph 30: Statement before Christmas?
On above assumotions seems imprudent.

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paragraph 31: BL to prepare contingency plans for run-down.
Agreed, quite vital.

AR

ADAM RIDLEY
10th December 1979

TABLE1.   Z10

BL LOSSES DUE TO INDUSTRIAL DISPUTES 1970-1979

	Manhours lost due to		No of Vehicles lost due to	
	Internal Disputes	External Disputes	Internal Disputes	External Disputes
1969-70	5.0m	4.0m	N/A	N/A
1970-71	8.0	0.3	N/A	N/A
1971-72	10.0	3.4	N/A	N/A
1972-73	7.4	3.9	N/A	N/A
1973-74	9.6	14.2	N/A	N/A
1974-75	9.9	N/A	N/A	N/A
1976 (15 months)	7.0	1.3	145,000	30,000
1977	14.8	3.4	192,900	58,600
1978	10.0	0.5	110,800	12,500
1979 Q1	1.2	1.2	19,100	10,400
1979 Q2	0.6	-	6,500	-
·76 - 79-Q2. Σ	m 33.6 = 4 m mandays 1,920 m.hrs/yr 17,500 m yrs.		474	111

Σ = 585

No estimates of lost production were made prior to BL's entry into public ownership, and it is not possible to base a valid estimate of lost production on the number of manhours lost, because of the great differences in the effects of lost man-hours in different parts of the company.

No consistent run of estimates of the value of lost production is available for the period, and there is again no constant relationship between numbers and value of vehicles lost because of the widely different values of vehicles sold by different parts of the company. For 1978 BL estimated that their loss of 123,300 vehicles was equivalent to a £300m reduction in sales revenue, ie roughly £2500 per vehicle.

·76 - 79Q2 loss £m revenue @ £2,500/pm

£1,185 m   £275 m

G.D. loss   £1,460 m

TABLE 2.

BL PRODUCTIVITY AND VALUE ADDED PER MAN 1970-1979

	BL Vehicle/sales/Man/Yr	BL Cars output Vehicles/Man/Yr	Leyland Vehicles output Vehicles/Man/Yr	Value added Per man (£)	Real val added per man (1970=100
1969/70	4.9	N/A	N/A	1721	100
1970/71	5.4	N/A	N/A	2141	113.7
1971/72	5.9	N/A	N/A	2302	114.1
1972/73	5.7	N/A	N/A	2650	120.3
1973/74	4.9	N/A	N/A	2638	103.3
1974/75 Fuller Man	4.1	5.9 (i)	1.7 (i)	2945	92.8
1976	4.3 (ii)	6.3	1.6	3388 (ii)	91.6 (i
1977	4.0	5.7	1.7	4220	98.5
1978	4.2	5.6	1.4	4906 (iii)	104 (i
1979 Q1	-	5.3	1.7	-	-
1979 Q2	-	6.2			
1979 forecast	4.3	5.7	1.6	-	-

(i) Calendar year 1975

(ii) Figures for period 1 October 1975 - 31 December 1976 annualised.

(iii) These are DOI estimates extending the 1970-77 series, for which the source is Euroeconomics, Automotive Performance Indicators No 1. This series shows that no other European motor manufacturer recorded a fall in real value added per man between 1970 and 1977.

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CHANCELLOR

cc Financial Secretary
Mr Cropper
Mr Cardona
Mr Unwin
Mr Butt
Mr Macrae

MOTOR INDUSTRY PRODUCTION

The following figures from today's Financial Times tell a very sad story to which you might want to refer both at tomorrow's NEDC and subsequently. It might be worth having them updated to cover 1978 and 1979, at least for the UK.

FT. 4 Dec '79. p. 25

WORLD MOTOR INDUSTRY PRODUCTIVITY

	1972	1973	1974	1975	1976	1977
Production Indices (1972=100)						
GB	100	102	93	86	87	92
France	100	108	102	100	127	131
West Germany	100	109	95	99	111	121
Italy	100	109	101	83	94	99
Sweden	100	109	125	124	112	110
Japan	100	115	108	116	136	149
U.S.	100	101	87	76	96	109
Total Employment (1972=100)						
GB	100	104	102	93	91	99
France	100	105	101	100	106	106
West Germany	100	102	92	88	93	96
Italy	100	114	108	100	105	112
Sweden	100	102	107	114	115	110
Japan	100	109	111	108	108	110
U.S.	100	110	99	89	99	101
Labour Productivity (1972=100)						
GB	100	98	91	92	96	93
France	100	103	101	100	120	124
West Germany	100	107	103	112	119	126
Italy	100	95	93	83	89	88
Sweden	100	107	117	109	97	100
Japan	100	106	97	107	126	135
U.S.	100	92	88	85	97	108

Source: ISRI based on OEDC and Italian national statistics

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ADAM RIDLEY

4th December 1979

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C 213

See my comment on G.R.'s cabinet note*

I entirely agree: it is urgent & illustrative. Every possible agency for attack shd. be used a.s.a.p. Perhaps George Cooper (former MD of Thames, & now with AGB – a good friend of mine – would respond to a request from me for advice)

CHANCELLOR

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

RESTRICTIVE PRACTICES AND THE TV COMPANIES

The note by Gordon Reece* which I sent you earlier today prompts me to deploy more fully and urgently an idea which I have, I believe raised with you before.

2. All the TV companies are vulnerable to massively costly restrictive practices because of:

(1) the ACTT;
(2) their degree of financial exposure during strikes;
(3) the nature of the levy system; and, I suspect
(4) wet management.

3. We face here not one but several interlocking monopoly problems. The companies are free to behave monopolistically inasmuch as:

(a) they can pass on higher costs very freely (in perfect competition all firms are price takers). This is partly a matter of the way the levy system works, but not wholly;

(b) entry into the industry is totally restricted, except when franchises are renewed;

(c) they are therefore stalking horses for equally monopolistic unions.

The extraordinary terms and conditions now in force for TV staff, particularly technicians, are quite unrelated to proper market criteria, and the process of earning them has encouraged the unions involved to go further and further down the same lucrative road.

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Furthermore, there can be little doubt that the recent awards at ITV companies will spill over to the BBC and aggravate the problems of the licence fee etc.

4. It would seem reasonable to attempt to do something to stop the situation getting worse. The following ideas occur to me, very much in principle:

(1) the independent TV franchises will shortly be renegotiated by the IBA. Might it be possible for the IBA to lay down conditions for the new franchise holders which ensure the minimum scope for re-entrenching restrictive practices and high wages in the new companies ab initio, or introducing them subsequently under threat of strike action?

(2) one could imagine a variety of possible investigations of monopoly practices in television, which could, while unrelated to the granting of franchises or higher BBC licence fees, create rulings, principles or guidelines whose implementation would be mandatory when such occasions subsequently arose;

(3) it might be possible to investigate some of the practices of the unions directly;

(4) the narrower issues of monopoly, desire of unions to control editorial matters and exploitation of the strike weapon could even be swept up in a broader enquiry into freedom of the media, which could embrace the press if one so wished.

5. I am well aware all this is rather speculative, but I am not convinced that it is irrelevant to our present problems. If you think there is anything at all in these ides, there might be ways in which one could get them examined.

AR

5th November 1979

ADAM RIDLEY

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CHANCELLOR

Below are the two draft papers for the smaller group.

(i) pay and price provisions in 80/81 cash limits ✓ AS
(ii) the economic outlook and public expenditure ✓ Amdd.
plus (iii) a note of options for further expenditure cuts.
For circuln on table

2. Are you content with (i) and (ii). Do you wish to modify (ii) in light of Mr. Butler's note? And may we circulate them to the smaller group tomorrow? Are you content with the PS letter covering (ii)? ✓

3. On (iii), there just isn't time for the discussion suggested by Mr. Bailey. Can you therefore given some steer in comment on the papers? The issues for decision are set out in para.11 of Mr. Butler's note, below the Bailey note.

For [illegible]

4. You will certainly wish to discuss tactics with the Chief Secretary before Friday's meeting - it looks like to-morrow evening in the House or at No.11 after the Party, (unless Cabinet were to finish at say 11.30 a.m., which would give you half an hour). I have spoken to his Private Office. When?

5th December 1979

Probably best not to [illegible] circulate [illegible], [illegible], letter @ this stage.

✓

GECS PA

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CONFIDENTIAL

A.B: This draws together v. usefully some issues on which further work is v. important - and urgent :: §10*.

N.B. too my comments to D.W. yesterday on the dons & the PA national [illegible] & Uegs, PRU etc: [illegible] > fundamental [illegible] may be needed to displace [illegible] in-house prejudices ([illegible] natural).

I am also concerned that the no. of new offices [illegible] to Uegs [illegible]

CHANCELLOR

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Cropper
Mr Cardona

THE RELATIVE PRICE EFFECT [RPE]

You asked for any further views I might have on how one might make economies through restraint of the RPE. I have some and sketch what seem to me to be the key points below. I must stress that these are not definitive views. A little more thought and examination of the figures is needed to establish how reliable are some of my assertions and to get the orders of magnitude more accurate.

BACKGROUND

2. The RPE is a measure of the extent to which public sector costs rise faster than those in the rest of the economy. That they do so is a well established observation not only in the UK, but elsewhere. Traditionally it was believed that the trend increase, year to year, added about ½% to the cost of total public spending. With a total of circa £70 billion projected for next year the "normal" RPE would, on that basis, be around £350 million per annum, or £1.75 billion over a 5 year period. The RPE, when positive (ie public sector costs growing more quickly than private) has, obviously to be financed by higher taxes or borrowing. Hence public spending planning in pure volume terms, excluding the RPE is incomplete and, sometimes, misleading. All the more so since the RPE has been very volatile indeed since 1970.

3. Briefly it was held down a bit initially under the 1970/74

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Government, by "n-1" and formal pay policies;

- shot up dramatically in 1973-75;
- fell back somewhat in subsequent years;
- has shot up again now.

Whether it is now subject to a trend is doubted by officials. However that does not stop one from having views about whether its constituent elements are too high or not.

4. The chief elements which go to make up up are the movements in

(1) public servants' pay and other costs;

(2) bought-in goods and services on current account;

(3) capital expenditure, particularly land and the output of the construction industry.

The scope for action on these fronts, and the possible timescales vary considerably.

SCOPE FOR ACTION

5. The most important area is wage and other related costs. In my judgement almost all the Clegg catching up pay increases now allowed for in 1980-81, and estimated at £1½-2 billion extra on total public expenditure in cost as opposed to volume terms, is not catching up with the historical trend but exceeding it. While some groups deserve increases above the whole economy or public sector average, there is no justification whatever in terms of historical relationships or market pressures for the bulk doing so. Most of the Clegg proposals, including those still in the pipeline, are mandatory. But some are not, and could be challenged in time for 1980/81. Even where the Clegg element in 1980/81 pay settlements is not challengeable, there is no overriding reason why there should not be offsetting attempts to bear down on results of 'normal' pay bargaining which will be super-imposed on whatever Clegg

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recommends. This point is implicitly recognised already in the way the RSG has been set. It could be generalised elsewhere. But if so decisions would be needed quickly, since the remaining cash limits will be set shortly, and decisions on the lines to be followed in some of them have already been made, in effect being embodied in your Cabinet paper on cash limits for Departments inter alia. What can not be achieved next year could, of course, be sought in later years.

6. Particular problems arise over Central Government. White collar workers are subject to pay research and, I think, blue-collar workers are too. The former are subject to the PRU, and the second have, if my memory does not deceive me, the prospect of being treated in an analogous way for the first time. For the coming year nothing much can be done about pay research, I suspect, though the modest latitude it leaves for bargaining could certainly be exploited. But in later years it might be possible to achieve something by strengthening the criteria of the salary comparisons and so on.

7. Also noteworthy is expenditure on pensions. You are already well acquainted with the position and prospects over the classic inflation proofed pensions. There may be more to do here. [The problem of NI pension funds also emerges under this rubric, of course.]

8. The remaining elements are less likely to yield substantial sums, but merit some careful consideration nonetheless. Bought in goods and services on current account will offer little scope. Public procurement procedures are tight already. Raynerism is probably the most obvious way ahead, and that is, I imagine, being pressed on with as fast as possible in any case. One might want to give it a push in case it is not, but it is a secondary priority at best.

9. Land and construction services have moved seriously out of line since the early 1970s, and if their relative costs could be brought back nearer the trend, useful economies of - at a guess - several hundred millions could be made. However the methods of

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achieving this aim are indirect. In any case, it is not obvious that a complete return to historical trend is a valid target, since some of the excess reflects higher energy prices. [Energy forms a very high proportion of total construction industry costs, and that proportion is likely to rise further in years to come.] So a quick appraisal suggests that

- construction costs will fall relatively to the extent demand for the industry's output sinks and the pressure of work with it. It is a fairly competitive industry. The current prospect will help assure that development without further decisions, and it would be absurd to cut capital expenditure on construction merely to get a more favourable RPE when the industry is already depressed;

- land costs will fall as inflation and the money supply are mastered. There is nothing more to be done about either, but if success attends present policies the trend may, ex post facto, be more favourable than is currently expected. However easement of planning controls might help a bit, particularly in the early days after any relaxation.

10. The priorities for dealing with the classic RPE elements then boil down in order of priority to a firm policy for public pay and pensions followed, well behind by pressure for Raynerism on procurement and measures to ease the supply of land such as easier planning controls. I do not think the politics of any of these is quite as tricky as that of further attacks on Social Security.

POSTSCRIPT

11. Underlying the RPE lies the tendency in normal economies for the "trading" sector to enjoy productivity growth while the public sector does not; and, more fundamental still, for the financing of a given volume of public sector inputs to require each year a share of the national growth dividend to be devoted to supporting it. Obviously this is not normally possible in periods in which national

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productivity is stagnant; or a fortiori when the resources available for domestic spending are not growing. [The latter can happen even with productivity growth if adverse movements in the terms of trade require more net exports (or growth in debt repayment obligations or some other capital account outflow) and thus preempt all the fruits of growth. For the present this means, crudely, stagnant living standards for public sector as well as workers if present RPE is held, and falling standards if past excesses are eliminated. It is not a view they will readily accept!

12. I would suggest that it might be sensible, should you wish to pursue this further, to have any appropriate work commissioned in the light of the note on the RPE recently requested from officials - provided it comes forward soon. I should like to formulate more considered views in the light of that material and a further consideration about the issues of public sector pay with Mr Littler.

AR

ADAM RIDLEY
6th December 1979

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C

10 DEC 1979

FINANCIAL SECRETARY TO THE TREASURY

~~FINANCIAL SECRETARY~~ I agree. KR.

Chancellor

1922 COMMITTEE

The Prime Minister is due to address the 1922 Committee this Thursday, and is likely in particular to talk about expenditure cuts, or so the FT informs me. I don't know whether it's customary to brief her for an occasion of this sort, and I expect she is very fully briefed on expenditure, but is it worth thinking about getting her to defend our position on NHS spending? As you know, I am very worried by the fact that even our own supporters think we are cutting the NHS whereas ~~she~~ we can make a very good case for saying that we are not spending a penny less than Labour had planned.

She will have a good stock of this I am sure.

GC

GEORGE CARDONA
10 December 1979

FINANCIAL SECRETARY

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GEORGE CARDONA
10 December 1979

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cc Financial Secretary
Minister of State (Commons)
Minister of State (Lords)

CHANCELLOR

VALUE ADDED TAX

1. I see that the Minister of State (Commons) has a Private Member's Motion on Small Business this Friday.

2. I also see that there is a set of Enterprise Proposals for E(79) covering the VAT area.

3. Should we be thinking about the VAT registration threshold, which is not mentioned here?

4. I understand that the EEC restriction would now permit us to raise the starting point to £12,500. That would have the advantage of taking a certain number of traders out of VAT, the disadvantage of creating unfair competition at the margin.

5. Would it be true to say that we would still think the economic advantages of raising the threshold outweighed the disadvantages? And that we would therefore want Customs to be favouring the idea.

6. I raise this because it was very much one of our stalking horses in Opposition.

Subject to any advice to contrary.
GH

PETER CROPPER

12th December 1979

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C

CONFIDENTIAL

CHANCELLOR
CHIEF SECRETARY
FINANCIAL SECRETARY
MINISTER OF STATE (COMMONS)
MINISTER OF STATE (LORDS)
MR RIDLEY
MR CARDONA
SIR DOUGLAS WASS
SIR LAWRENCE AIREY
SIR KENNETH COUZENS
SIR ANTHONY RAWLINSON
MR UNWIN

CONSERVATIVE PARTY FINANCE COMMITTEE 11TH DECEMBER 1979

(Mr Ian Stewart MP kindly took notes)

1. Sir Anthony Tuke and Harold Rose of Barclays attended. The more interesting of their comments were:-

i. Lending. Demand is not interest rate sensitive in the short term. However, the higher mortgage rate will certainly reduce other personal spending quickly, with rapid effect on retail sales. Problems in the housing market will mean more extended bridging loans from clearers. Advances will remain high into 1st quarter 1980, and then may ease rapidly.

ii. Corset. Several banks will remain in penalty for 2-3 more months. Corset not very effective now and will cease to be needed after a few months next year. But corset does have some effect, and some form of quantitative restriction will be needed again.

iii. MBC. Bank of England known to be sceptical (inference: this will not help its credibility when introduced). Will not be effective on its own.

iv. Exchange Control. Consequences so far entirely beneficial, contrary to their expectations.

v. Public Expenditure. Good start. Must tackle housing finance.

vi. Inflation Accounting. Subject is becoming a bore. !!!

Especially for Bank Profits??

PJC PETER CROPPER
17th December 1979

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CHANCELLOR

cc Financial Secretary
Chief Secretary
Minister of State (C)
Minister of State (L)
Sir Lawrence Airey
Mr Lavelle
Mr Moore

BL

1. Mr Hall has asked me to comment on the draft statement by Sir Keith Joseph annexed to E(79)86. Since a new version is now expected at any moment, I shall restrict myself to a few issues. In general I agree with the points made in Mr Moore's brief of 18th December, but would wish to go further.

2. The kinds of changes which seem to be required could but be effected as follows in relation to the present obsolete draft:

(a) More stress on poor performance to date, eg by redrafting the beginning of paragraph 3

"By any of the key yardsticks BL's performance since the Ryder Plan has been disappointing. Profits and productivity have been consistently inadequate, market share has fallen and industrial disruption has continued on an unacceptable scale. BL's performance has, in a word, fallen far short of what was called for in response to massive support from the taxpayer."

(b) It would be better to economise on excuses. Thus in lines 7, 8 of paragraph 3 I would omit references to strengthening of sterling and, a fortiori, the company's own self-inflicted loss of market share.

(c) The first sentence of the penultimate paragraph is a freudian slip, and a dangerous one as it implies "full support for the BL board's plan". That clearly

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CHANCELLOR

cc Financial Secretary
Chief Secretary
Minister of State (C)
Minister of State (L)
Sir Lawrence Airey
Mr Lavelle
Mr Moore

BL

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(c) The first sentence of the penultimate paragraph is a freudian slip, and a dangerous one as it implies "full support for the BL board's plan". That clearly

is not intended, yet an ordinary reader would see it as meaning continuing support - and, perhaps, the provision of more money than BL have asked for if it should be required. The whole sentence is much better omitted.

The third sentence is plain wrong, as Mr Moore points out in paragraph 11 of his brief.

(d) In picking out and expanding on the warnings on performance in the last part of the penultimate para, I would seek to strengthen the feeling that BL must achieve dramatic improvements quickly to have any hope of survival - eg by saying in addition

"If BL is to survive, large, immediate and lasting improvements in performance are essential. The time has come when BL's workforce must match the massive assistance they are receiving from Government with a massive effort of their own."

A BROADER ISSUE

3. You asked me to pursue with Mr Moore the questions raised by Chrysler (US) workers' cash assistance to their company and the 25% productivity improvement now sought at Talbot. Mr Moore has advised against putting these ideas forward in the present context and, given pressure of other BL business, we have not been in a position to agree how to take these ideas forward. Hence we have not prepared any letter for you to send to Sir Keith Joseph about them. However I still feel that it might be sensible to raise both as principles which merit further examination in the near future. At present the trip-wires which would trigger off a run-down of BL are both

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insufficient to exercise the maximum leverage on the workers and such that HMG will pick up much of the blame if/when the painful decision is taken.

AM

ADAM RIDLEY
18th December 1979

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C.

CHANCELLOR

DE-MERGERS

1. Worth glancing at the attached papers sent to me by George Stout at the Alliance Trust, Dundee. They illustrate de-mergers in Japan and a recent American example.

2. I note that GEC has now sent in specific recommendations for changes in the law, which Mr Isaacs* at the Inland Revenue is studying.

3. I am also interested to see in the letter from Roger Plant, circulated by the Financial Secretary, the words:-

> "I know the argument that if you raise the tax thresholds larger businesses will split up into small ones to avoid tax. But in many cases that is no bad thing; and ICFC has been doing a cracking trade in helping managers buy control of their businesses from parent companies who are glad to let them go because their own overheads are too high for them."

Good

I shall contact Plant and ask him what legal obstacles exist.

20 Dec

All good. We brought to attn of *

– I am encouraging other

to press ahead on this front

5/12/79.

HITACHI (Major general electric and electronic equipment maker)

Revenues Y.1,510b. = £3,480m. Net Income Y.37½b. = £86½m. Present market cap. £1,227m.

List of Subsidiaries

Hitachi Cable (Wire-cable, rolled copper products)

Parent company holding 57.4%

Revenues Y.153b. = £353m. Net Income Y.5¼b. = £12¼m. Present market cap. £119m.

Hitachi Metals (Steel and special steel, pipe fittings)

Parent company holding 58.0%

Revenues Y.190b. = £438m. Net Income Y.4¼b. = £9½m. Present market cap. £170m.

Hitachi Chemical (Electric insulating materials - synthetic resins)

Parent company holding 66.2%

Revenues Y.126b. = £290m. Net Income Y.1¼b. = £3¼m. Present market cap. £83m.

Hitachi Maxell (Dry cell batteries and magnetic recording tapes)

Parent company holding 58%

Revenues Y.43b. = £99m. Net Income Y.4b. = £9¼m. Present market cap. £120m.

Hitachi Plant & Engineering (Design and construction of power facilities)

Parent company holding 58.2%

Revenues Y.88b. = £205m. Net Income Y.2¼b. = £5m. Present market cap. £82m.

Hitachi Credit (Instalment financing of consumer sales)

Parent company holding 62.0%

Revenues Y.306b. = £706m. Net Income Y.5¼b. = £12m. Present market cap. £154m.

Hitachi/

<u>Hitachi Sales</u> (Wholesaler of consumer products)

Parent company holding 74.0%

Revenues Y.426b.	Net Income Y.$2\frac{3}{4}$b.	Present market cap.
= £982m.	= £$6\frac{1}{2}$m.	£74m.

Total market cap. of subsidiaries	£802m.
<u>Less</u> Parent company holdings	489m.
"Free" for investment	£313m.

Revenues and net income translated at Companies' year end exchange rate of Y.434 = £1

Market capitalisation translated at current rate of Y.551 = £1

5/12/79.

MATSUSHITA (World's largest producer of consumer electric and electronic products)

Revenues Y.2,146b.	Net Income Y.89b.	Present Market Cap.
≈ £5,600m.	≈ £232m.	£1,522m.

List of Consolidated Companies

Victor Co. of Japan (Audio equipment and V.T.R.)

Parent company holding 50.4%.

Revenues Y.188b.	Net Income Y.3.84b.	Present Market Cap.
≈ £447m.	≈ £9m.	£286m.

Matsushita Communication (Communication and electronic equipment, audio-visual apparatus and car telephones)

Parent company holding 66.9%.

Revenues Y.108b	Net Income Y.3.7b.	Present Market Cap.
≈ £281m.	≈ £9$\frac{3}{4}$m.	£277m.

Kyusku Matsushita (Electric and wireless machines and electronic parts)

Parent company holding 52.5%.

Revenues Y.56b.	Net Income Y.2b.	Present Market Cap.
≈ £146m.	≈ £5$\frac{1}{4}$m.	£84m.

Matsushita Kotobuki (Electric appliances, sound and heating equipment)

Parent company holding 60.5%.

Revenues Y.93b.	Net Income Y.2$\frac{1}{2}$b.	Present Market Cap.
≈ £242m.	≈ £6$\frac{1}{2}$m.	£170m.

Matsushita Reiki (Refrigerators, freezing equipment and air conditioning)

Parent company holding 50.5%

Revenues Y.128b.	Net Income Y.4$\frac{1}{2}$b.	Present Market Cap.
≈ £342m.	≈ £12m.	£149$\frac{1}{2}$m.

Matsushita/

Matsushita Seiko (Home electric equipment, ventilators and air conditioning)

Parent company holding 50.7%.

Revenues Y.71b.	Net Income Y.$3\frac{3}{4}$b.	Present Market Cap.
= £190m.	= £10m.	£155m.

Matsushita Electric Trading (Operates imports of raw materials and exports of finished goods)

Parent company holding 50.7%.

Revenues Y.532b.	Net Income Y.$6\frac{3}{4}$b.	Present Market Cap.
= £1,422m.	= £18m.	£183m.

Total market cap. of subsidiaries =	£1,305m.
Less Parent company holdings	724m.
"Free" for investment	£ 581m.

Revenues and net income translated at Companies' year end exchange rate of Y.376 = £1

Market capitalisation translated at current rate of Y.551 = £1

5/12/79.

NIPPON ELECTRIC (Major manufacturer of telecommunications equipment and electronic computers)

Revenues Y.615b.	Net Income Y.7.6b.	Present Market Cap.
= £1,420m.	= £17½m.	£614m.

List of Subsidiaries

Nitsuko (Communications equipment and electronic parts)

Parent company holding 40.6%.

Revenues Y.20b.	Net Income Y.0.36b.	Present Market Cap.
= £46m.	= £0.8m.	£20m. (Est.)

Toyo Communication (Telecommunications machinery manufacturer)

Parent company holding 47.5%

Revenues Y.14.8b.	Net Income Y.0.22b.	Present Market Cap.
= £34.2m.	= £0.51m.	£15m.

Anritsu Electric (Wire communication machines, wireless machines)

Parent company holding 35.7%.

Revenues Y.30.4b.	Net Income Y1.1b.	Present Market Cap.
= £70.2m.	= £2½m.	£48m.

Tohoku Metal (Electronic raw materials and processed products, magnetic dust cores)

Parent company holding 45.0%.

Revenues Y.18.2b.	Net Income - Loss	Present Market Cap.
= £42m.	-	£27½m.

Nippon Electric Industrial (Power units for telecommunication industry, automobile control machines and precision instruments)

Parent company holding 34.6%.

Revenues Y.14.2b.	Net Income Y.0.21b.	Present Market Cap.
= £32.7m.	= £0.48m.	£15m.

Japan/

[illegible]

[illegible]

[illegible]

[illegible]

Parent company holding [illegible]

[illegible]

[illegible] communication machines, wireless [illegible]

Parent company holding [illegible]

[illegible]

Parent company holding [illegible]

[illegible]

Japan Aviation (Largest manufacturer of electrical connectors, exposure to defence budget through aerospace)

Parent company holding 55%.

Revenues Y.19½b.	Net Income Y.0.92b.	Present Market Cap.
= £45m.	= £2.1m.	£60m.

Total market cap. of subsidiaries =	£185½m.
Less Parent company holdings	83m.
"Free" for investment	£102½m.

Revenues and net income translated at Companies' year end exchange rate of Y.434 = £1

Market capitalisation translated at current rate of Y.551 = £1

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IU International

Corporate Headquarters:
1105 North Market Street
Wilmington, Del. 19801
Executive Offices:
1500 Walnut Street
Philadelphia, Pa. 19102

Edgar K. Sheldon
Director of Public Relations
Corporate Affairs Department
Telephone: 215 985-6477
After Hours: 215 247-5077

For Immediate Release

IU SHAREHOLDERS APPROVE DISTRIBUTION OF SHARES OF GOTAAS-LARSEN

WILMINGTON, Del., Tuesday, November 27, 1979 -- At a special meeting held here today, shareholders of IU International Corporation approved the distribution of the shares of IU's wholly-owned ocean shipping subsidiary, Gotaas-Larsen Shipping Corporation, directly to IU common shareholders. The shareholder vote ran about 30 to 1 in favor of the proposal, with approximately two-thirds of the shareholders voting.

Following the shareholder meeting, the IU board of directors voted to proceed with the distribution plan and established a record date of December 7, 1979 for distribution of the Gotaas-Larsen shares to the holders of IU common stock as of that date. One new share of Gotaas-Larsen stock will be distributed for each three common shares of IU.

Owners of IU convertible securities will receive Gotaas-Larsen shares only if they convert their securities into common shares by the December 7 record date. If they choose to retain ownership of convertible securities, a more favorable conversion rate will apply to their securities after the Gotaas-Larsen distribution, as stated in the proxy sent to each shareholder.

John M. Seabrook, IU chairman, said that the new Gotaas-Larsen shares will be mailed to shareholders about two weeks after the December 7 record date. Approximately 10.5 million shares of Gotaas-Larsen common stock will be distributed to IU shareholders. The distribution is expected to be tax-free to IU shareholders in the United States and Canada.

- more -

For Immediate Release

[illegible]

WILMINGTON, Del., Tuesday, November [illegible] [illegible] [illegible]

[illegible] stockholders of [illegible] [illegible] that [illegible]

of the shares of [illegible] which [illegible] shipping [illegible] [illegible]

shipping Corporation, directly [illegible] common shareholders. The [illegible]

[illegible] about 30 [illegible] of the [illegible] [illegible]

[illegible] voting.

Following the shareholder meeting, the [illegible] board of directors [illegible] to proceed

with the distribution plan and established a record date of [illegible] for

distribution of the Christiana [illegible] shares to the holders of its common stock as of

this date. One new share of [illegible] common stock will be distributed for each three

common shares held.

Owners of [illegible] convertible securities will receive [illegible] shares only

if they convert their securities into common stock before the December [illegible] record date.

If they choose not to [illegible] of convertible securities [illegible] the con-

version rate will apply to shares [illegible] the Christiana [illegible] distribution, as

stated in the [illegible] sent to stockholders.

[illegible] will be [illegible] [illegible] for the [illegible]

[illegible]

[illegible]

- more -

2/IU Shareholders Approve Distribution of Shares of Gotaas-Larsen

"Before the spinoff," Mr. Seabrook said, "the common shareholders of IU owned 100% of Gotaas-Larsen indirectly through IU, and now they will still own 100% of Gotaas-Larsen, but directly. This allows each shareholder to make his own investment decision on IU, a diversified dividend-paying company, or Gotaas-Larsen, a non-dividend-paying international ocean shipping company, or both. The shareholder now has three investment choices where before he had only one. He can retain both stocks and be in the same posture as before the spinoff, but with greater flexibility. Or, he can retain one or the other, or any mix of the two. The important factor is that each shareholder can decide for himself based on his own investment goals."

The New York Stock Exchange is expected to start trading IU common on an "ex-distribution" (that is, ex-Gotaas-Larsen) basis during the week starting Monday, December 3. The Gotaas-Larsen shares will trade in the over-the-counter market and may begin trading on a "when issued" basis at about the same time.

The new independent Gotaas-Larsen Shipping Corp. will hold the first meeting of its board of directors this afternoon in Hamilton, Bermuda.

Gotaas-Larsen, which was acquired by IU in 1963, is a diversified ocean shipping company with interests in liquefied natural gas (LNG) carriers, chemical and crude oil vessels, offshore drilling rigs, and passenger cruise ships. The company's principal offices are in Hamilton, Bermuda. It also has offices in London, England; Oslo, Norway; and New York City.

IU is a diversified company with interests in transportation services, utilities, industrial, distribution, and agribusiness markets. In 1978, IU had revenues of $2.5 billion. The company is headquartered in Wilmington and has executive offices in Philadelphia.

# # #

(2) Shareholders [illegible] distribution of Shares of Gotaas-Larsen

"Before the spin-off," Mr. Seaman said, "[illegible] shareholders, in effect, owned 100% of Gotaas-Larsen indirectly through IU. Now they still [illegible] 100% of Gotaas-Larsen, but directly. This allows [illegible] shareholder to [illegible] investment decisions [illegible] diversified holding company [illegible] Gotaas-Larsen, a [illegible] dividend-paying [illegible] shipping company, or both. The shareholder now has the flexibility to choose between the two [illegible]. He can hold both stocks in the same ratio as before the spin-off, but with greater flexibility. Or, he can sell [illegible] either, or any mix of the two. The important factor is that each shareholder can now do for himself [illegible] best to fit his own investment goals."

The New York Stock Exchange is expected to start trading IU common on an "ex-distribution" basis, that is, ex-Gotaas-Larsen shares during the week starting Monday, December 3. The Gotaas-Larsen shares will trade in the over-the-counter market and [illegible] trading [illegible] when-issued basis at about the same time.

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[illegible]

# # #

IU-79-18

Chancellor

① would be safer.

R.T.
20/12.

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CHANCELLOR

BERNARD AUDLEY

SAINSBURYS

1. Bernard Audley complains that higher paid members of the AGB Employee Loan Scheme who borrow interest free to buy shares in the company are taxed on the notional interest benefit.

2. The Sainsbury memorandum (Appendix D attached) made the same point.

3. The FASE report (FASE(79)8) "Profit Sharing and Share Options" says, at paragraph 11:-

> "Directors and higher paid employees are taxable under the 1976 Finance Act on the value of loans from employers at less than a commercial rate of interest. The acquisition of shares at an under-value, or of partly-paid shares, may also be treated as an interest-free loan for this purpose. The Group recommends that if the 1978 legislation is extended to give relief for share purchases, there should be comparable relief from tax on the benefit of such loans by employers to assist with the purchase of shares."

4. Would it be right to draft a reply to Audley saying:

"Matter under review" ① or "Will be hopefully dealt with" ②

Or some intermediate formula?

A) We are aware of the point [illegible]

B) No. [illegible] for it needs to be studied + that is in hand

PETER CROPPER

20th December 1979

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AGB Research Limited 76 Shoe Lane London EC4A 3JB Tel: 01-353 3172

27th November 1979

The Rt. Hon Sir Geoffrey Howe, Q.C., M.P.,
11 Downing Street,
London S.W.1.

Dear Geoffrey,

Share Ownership

The policy of H.M. Government on encouraging share ownership among employees in the future is well-known.

The AGB Employee Loan Scheme with which you are familiar is a successful example of this policy in action. So successful indeed that 82 out of 84 employees eligible are subscribing for the latest batch of shares on offer, even though the current market price is well below the required offer price. This is the kind of belief in, and enthusiasm for, the company they work for that I know you want to promote.

The Inland Revenue attitude towards such schemes is discouraging. Interest-free loans made for the purpose of acquiring shares in the employing company are to be assessed to tax on the notional interest benefit. Such a policy must go a long way towards negating the kind of results you wish to achieve, and I am wondering if you will give consideration to changing the provisions currently in force.

My proposal is that the Inland Revenue should be required to allow offset of dividend income received against the notional interest assessment. If this does not happen, I fear that hopes of wider share ownership by employees will turn out to be dupes.

Yours sincerely,

Bernard

G. B. Audley.

[illegible] RESEARCH PUBLIC LIMITED COMPANY [illegible]

27th November [illegible]

The Rt. Hon. Sir Geoffrey Howe, Q.C., M.P.,
11 Downing Street,
London S.W.1.

Dear Geoffrey,

Share Ownership

The policy of H.M. Government on encouraging share ownership among employees in the future is well-known.

The AGB Employee Loan Scheme with which you are familiar is a successful example of this policy in action. So successful indeed that [illegible] of the employees eligible are subscribing for the latest issue of shares, even though the current market price is well below the offer price. This is the kind of belief in, and enthusiasm for, the company they work for that I know you want to promote.

The Inland Revenue attitude towards such schemes is discouraging. Interest-free loans made for the purpose of acquiring shares in the employing company are to be assessed to tax as a notional interest benefit. Such a policy must go a long way towards negating the good results you wish to achieve, and I am wondering if you will give consideration to changing the [illegible].

My proposal is that the Inland Revenue should be told to allow offset of dividend income received against the notional interest assessment. If this does not happen, I fear that hopes of wider share ownership by employees will turn out to be [illegible].

Yours sincerely,

[illegible]

APPENDIX 'D'

Relief is currently available on interest payable in respect of a borrowing made by an individual for the purpose of acquiring shares in or lending money to a close company in which he already holds more than 5% of the shares. The relief does not apply in the case of a close company, three-quarters of whose income is investment income. We consider that this relief should be extended to any case where an employee borrows money with a view to acquiring shares in a company of which he is a full-time employee. In such a case, the requirements that the company be close and that the person concerned hold more than 5% of the shares in that company should not apply.

APPENDIX [illegible]

Relief is currently available on interest payable in respect of a borrowing [illegible] the purpose of acquiring [illegible] to a close company in which he already holds more than 5% of the shares. The relief [illegible] in the case of a close company, three-quarters of whose income is investment income. [illegible] this relief should be extended to any case where an employee borrows money with [illegible] in a company in which he is a full-time working [illegible] such a case, the requirement that the company [illegible] and that the person concerned holds more than 5% of the shares in that company should not apply.

pwp

10 DOWNING STREET

10 May 1979

CH/EXCHEQUER
REC. 10 MAY 1979
ACTION
COPIES TO

Mr A Battishill
Private Secretary to
Chancellor of the Exchequer
HM Treasury
Downing Street
LONDON SW1

Dear Battishill,

The Chancellor asked for a copy of the enclosed paper about Waste, for circulation to certain people inside the Treasury.

Yours sincerely

George Cardona

GEORGE CARDONA

Mr Hall.

Is a paper based on the Cardona papers wanted for the Seminar? & if so, by when?

AM 6/7.

Adam Ridley

I return this to you, à toutes fins utiles.

MM 5/7

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CHANCELLOR OF THE EXCHEQUER

I have now read through Mr Cardona's paper fairly carefully. It has many virtues, and is a good effort for someone working in Opposition with no experience of the official machine. But I rather suspect that it would not greatly impress senior officials in this Department, and would therefore be inclined not to circulate it. I have indicated the passages which strike me as least appropriate for that purpose by side-lining.

2 That said, this paper, or some of the ideas in it, touch on a key issue made all the more important by the creation of Sir Derek Rayner's unit. I would suggest that, once the Budget is out of the way, you might like to ask the Chief Secretary and some of his senior officials to have a fairly strategic discussion with you about this subject and the policies being pursued, or which might be pursued. Cash Limits are not enough! A contribution to that discussion could be a paper based on Mr Cardona's work. If you approve, I could consult your private office how best to proceed.

YES - IN LIGHT OF SUGGNS ALRDY MADE BY ME FOR A 1-DAY (?) SEMINAR, WITH RAYNER, C.S.T., P/SECS et al

AR

A N RIDLEY

18 May 1979

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CONFIDENTIAL

WASTE

IN

PUBLIC

EXPENDITURE

Conservative Research Department
24 Old Queen Street
London SW1.

10 May 1979

CONFIDENTIAL

"As regards areas of waste that do not involve functions or overmanning, I think that whenever we inspect we find a margin which we can save. It would be very rare if we did not."
(Sir Douglas Allen, GCB, now Lord Croham, then Head of the Home Civil Service, speaking to the General Sub-Committee of the Expenditure Committee on 3rd May 1976, Ministers of Evidence page 67).

WASTE IN PUBLIC EXPENDITURE

Introduction

1. We are relying very heavily on the elimination of waste and inefficiency in order to reduce public expenditure. These kinds of reduction in spending are distinct from the particular cuts we plan to make in individual programmes, and also quite different to the specific changes of policy on which we have determined in order to cut public sector costs. We have relatively clear plans for particular cuts and policy changes. But we are relatively poorly-equipped with plans for finding and cutting out waste and inefficiency in general.

2. It follows from the very nature of the problem that while still in Opposition we cannot identify the cuts to be made in order to deal with waste. We cannot know all the areas where there are fifty people doing the work of five, or perhaps doing something that need not be done at all. We have given too little thought to the general techniques that would enable us to identify such areas of waste.

3. Of course there are close parallels between closing down a small building that no longer fulfils a necessary function, and a decision to end a £50m programme. The same attitude to public expenditure is required; but the difference in scale means different policies will be necessary.

4. We have all used figures for the savings that will result from economies achieved through better management and increased efficiency. The modest figure of one per cent of all general Government expenditure would save £710m, equivalent to almost two pence off the standard rate of income tax. Even three per cent (£2,130m, some 5 pence off tax) sounds like a modest amount of fat to cut. After all, everyone knows the public sector is fat in parts. But without policies to trim that fat we shall be hoping in vain for some sort of accident that would allow spending to be cut relatively painlessly and unobtrusively.

5. Admittedly the figures above are based on the total of General Government expenditure. One per cent of the expenditure on bureaucracy and administration would be a good deal less.

6. Public expenditure statistics do not come in a form which makes it easy to estimate the amount of expenditure on which savings could be made by eliminating waste. A rough, but low, estimate of such expenditure in 1978/79 is £20,500m. (at 1978/79 Estimates prices), composed of £18,200m. (total public service pay) and £2,300m. for general Central Government services such as accommodation, transport and computers. The £2,300m. covers some of the kind of areas Leslie Chapman was able to cut with such marked success, but only in Central Government. An even rougher estimate, but for the whole of the public sector (except nationalised industries), might be £27,500m. (at 1977 survey prices, equivalent to £30,000m. at 1978/79 prices), which is the cost in 1978/79 of all public sector wages and salaries (again excepting nationalised industries) plus "Other current expenditure on goods and services", according to the Public Expenditure White Paper.

/7. Leslie Chapman

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7. Leslie Chapman was able to cut 35 per cent of his budget in the Southern Region of the Property Services Agency. Thirty-five per cent of £20,500m. (our lower estimate) is £7,175m. (18 pence off the standard rate).

8. Clearly these games with figures cannot be taken too literally. But they do give some idea of the magnitudes of both the potential reward and the difficulties.

9. This paper brings together the policies, of varying adequacy, that we already have for dealing with waste. It does on to consider some new ones. No great institutional changes are suggested. The instruments with which to control public spending - Treasury controls, PESC, PAR, the CPRS - are already there. They merely need to be used in slightly different and better ways.

10. Some of our general policies for dealing with waste and inefficiency ~~have been~~ were discussed by policy groups, but ~~have~~ were not ~~been~~ firmly approved by any higher authority; some ~~have been~~ were discussed by the Policy Sub-Committee or the Shadow Cabinet, but the degree of endorsement ~~of the policies~~ was ~~been~~ far from clear; some policies, used by the last Conservative Government, have scarcely been discussed at all, but there has been widespread tacit acceptance that they will be used by any Conservative administration; and some policies, such as making use of the private sector whenever this is both practicable and cheaper, are obvious.

11. We intend to cut waste throughout both Central and Local Government. This paper is primarily concerned with Central Government - and with the Quangos that feed off it - rather than with local government. The Environment team already have a relatively clear idea of how they will cut local government waste. Central Government must however make a very important contribution to cutting waste at the local level: it must be mean with RSG orders and it must very greatly reduce the flow of circulars and other directives going to local government (Mr. Bellow, Leader of Leeds Council, has estimated that just the writing and sending of circulars by Central Government departments and the reading of them in local government, but not their implementation, costs £50m per annum).

Cash Limits

12. We are clearly committed (in the Public Sector Policy Group's Report LCC/76/124 and in public statements) to squeezing bureaucracy through cash limits. In practice this may not be as easy as it sounds. The trade unions watch the calculation of cash limits on pay very closely, for obvious reasons. The unions are unlikely to welcome a reduction of say one per cent, or even half a per cent, in the cash limit in order to help to cut waste. Indeed if the Government is bargaining with them, then forgetting the deduction for waste is likely to be the first concession the Government makes.

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13. A further difficulty is created by another of our policies. There was a firm recommendation, in a report produced by the Public Sector Manpower Group, that the cash limits on "Pay and general administrative expenses" should be altered to cover only pay, as a way of making the trade-off between pay increases and jobs clearer to the trade unions. This report was not discussed by any higher authority and the matter is in any case part of the wider issue of dealing with trade unions. But if cash limits are changed to cover only pay, then it is all the more likely that it will prove politically impossible to squeeze waste out of manpower budgets. One of our most important weapons in the war on waste may well be very difficult to use. Other policies are needed.

Smaller cash limits and accountable units

14. There is evidence that smaller cash limit blocks encourage underspending, presumably because within larger blocks it is possible for over and under-spending in different areas to cancel each other out. There is therefore a case for breaking down larger cash limit blocks into smaller ones. To a certain extent this happened already when cash limits and Estimates was assimilated. They logical extension of introducing smaller cash limits is to break them down as far as "accountable units". There are however limits to the extent to which it is useful to introduce accountable units into Government. Those limits may already have been reached. On the other hand the Select Committee on Expenditure appears determined to press for the greatest possible use of accountable units, and in Government one could probably rely on that pressure to provide the impetus and restrict Ministers' actions to not obstructing the Committee's initiatives.

Financial Secretaries

15. Both the Public Sector Policy Group's and the Public Sector Manpower Group's reports recommended that Financial Secretaries be appointed in spending departments, notably Defence, Home Office and Health and Social Security. Such ~~The~~ Financial Secretaries would ~~will~~ be an extremely useful group of people to have on our side, but their mere presence in office ~~will~~ would not be enough. They ~~will~~ would need policies too.

Sir

Ministerial manpower watch

16. The Public Sector Manpower Group's report, endorsed by the Policy Sub-Committee, recommended that:

> "Within three months of taking office, and thereafter every six months, the Secretaries of State of the main employing departments should report to the Prime Minister on the progress they have made .... Every Secretary of State should be personally involved in keeping down staff numbers in his Department. He should be presented each month with a total of staff employed." (Paragraphs 5 and 6)

/Prime Minister's

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Prime Minister's Directive

17. It has been accepted that it would be desirable for the new Prime Minister, soon after taking office, to send a memorandum to all levels of Central Government urging the importance of carrying out all the tasks of Government as economically as possible. The same memorandum should perhaps stress that we will do everything possible to avoid any redundancies.

Secrecy

18. Perhaps the most important and lasting single change which we could make in order to cut waste would be an ~~radical~~ amendment to ~~of~~ the Official Secrets Act. Originally intended only to catch spies, this Act now suppresses discussion of vast areas of the public sector's activities. The people best informed about waste are those who are working next to it. They will be able to bring it to other people's attention once the Act's constraint is removed.

19. Amending the Act would be an important and necessary measure in its own right. With Socialist Governments giving the State ever greater powers, we cannot allow those powers to be used in secret.

20. Amending the Official Secrets Act would also be very popular with the Press.

The Civil Service

~~If properly managed~~ there is no reason to

21. ~~We can~~ expect the Civil Service to be hostile, if properly handled ~~on our side~~. The climate of opinion is right at the moment. But it may change. Some desirable reforms to consider are listed below. Many of the suggestions draw unashamedly on the ideas of Leslie Chapman.

(i) Reporting on consciousness of cost-effectiveness

22. At present decisions ~~about promotion~~ for civil servants (at least in junior and middle grades) are based on annual reports by superiors. The reports are divided into a number of headings but none of them, it seems, covers cost-consciousness. An additional element ~~heading should be printed~~ in each report should require ~~form, so~~ that superiors ~~will have~~ to make some judgement about every officer's attitude to the effective and economic use of public money. This change should, if it achieves nothing else, make both promoters and promoted think about cost-effectiveness at least once every year.

(ii) Signing the directive about waste

23. It might help to focus civil servants' minds on the problem of economic use of resources if on entry to the Civil Service they were asked to sign a copy of the Prime Minister's directive (referred to in paragraph 17 above) as well as a declaration about the amended Official Secrets Act.

(iii) Publicity for Civil Servants

24. Most civil servants prefer not to have publicity. But they like their work to be appreciated. It should be a relatively simple matter for Ministers to refer, in speeches about the progress being made in the war on waste, to the work of particular civil servants. A few sentences like: "A great deal of credit for the Department's contribution to the war on waste must go to Mr. Smith ~~Snooks~~, of our establishment department ~~Nuts and Bolts Division~~, who has found a way of saving the public £6m a year by suggesting that ...."

(iv) Ministers' papers

25. There is evidence that the convention that the papers of a Government are not shown to its successor can hinder a campaign against waste. Whenever Ministers give an instruction that needs to be followed up over several years, they should also give instructions that certain clearly-identified papers should be shown to their successors. They should also keep the "Over-government" unit informed.

Overgovernment Unit

26. A paper on "The Attack on Overgovernment", dated 25 April 1977, was endorsed at a meeting between Mrs Thatcher and the Treasury team. It recommends that a "taut, lean and political" unit in No. 10 or the Cabinet Office should co-ordinate the War on Overgovernment. It might also be possible ~~may be more sensible~~, as suggested below, to place this Unit in the CPRS, or indeed explicitly to make the war on overgovernment and waste a principal function of the CPRS.

PAR, PPU & CPRS

27. The last Conservative Government proposed the extensive use of Programme Analysis and Review, as well as Planning Policy Units in individual departments. It has proved very difficult to discover what use the Labour Government has made of these techniques. Our Parliamentary Questions have unearthed very little. The meagre evidence available suggests that PAR has fallen into desuetude. Should it not ~~It should~~ be revived? There seems no need to make any great changes in the structure of these systems provided that it is felt that in each particular PAR team there are enough individuals committed to reducing public expenditure. Some areas in which a PAR might ~~would~~ be desirable include:-

- the relationship between earnings in work and benefits out of work;
- care of the elderly;
- unemployment, perhaps of a particular kind such as youth or long-term;
- assistance to industry (the multiplicity of grants and allowances);
- Government safety and other regulations, and their duplication with those of local authorities, trade associations, etc.
- law and order, to cover police, social services, prisons, etc.

- Law and order, to cover police, social services, prisons, etc.

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28. The need for strong representation of an expenditure-cutting interest in PARs means that someone from the Overgovernment Unit should take part, even if only intermittently. The fact that this is a traditional function of the CPRS reinforces the view that the Overgovernment Unit should be in the CPRS.

Zero-based budgeting and surveys of Government

29. Zero-based budgeting (ZBB), as originally conceived, simply does not work. (In the USA they say that ZBB's only achievement was to make Jimmy Carter famous, because it was introduced in Georgia with so much fanfare.) It cannot work because the administrative procedures that are supposed to back it up are extraordinarily cumbersome: staff work on a massive scale would be required to present a series of different options for different levels of expenditure. But the idea implied by the term ZBB is of course just what we are looking for.

30. There is a far better way of doing it. This is to go systematically through every part of Government asking "Does this office/institution/Quango need to exist? What would happen if it did not exist?" This operation should be carried out at more than one level, so that, for example, one should question the survival of a programme costing, say, £25m per annum on the one hand, and a small section employing two or three people on the other.

31. Clearly rather different instruments are needed for these different levels, though of course there will be continuities, and the principles at stake will be similar. A small programme should be questioned either by a PAR or (more simply and swiftly) in the course of the continuous negotiation between spending departments, the Treasury and the CPRS. The detailed workings of departments are best questioned by Chapman's technique of "survey teams".

This is very close to normal inspection procedures, I suspect

32. This highly-successful technique was almost entirely responsible for Chapman's dramatic savings. He used small teams to survey all the activities of his region of the PSA in great detail. A team typically consisted of three people: one from the institution or section being surveyed, one from a completely different part of the organisation and one "outsider". There is no reason why such teams, suitably modified, could not be used throughout Central Government; and there is every likelihood that the savings they would produce would be as large as those found by Chapman, provided the teams have the backing of those in authority.

33. These teams are clearly most suitable for very detailed analyses. The people staffing the PARs operating at the higher level of a programme, would in effect also be survey teams at a higher point in the hierarchy. So the hierarchy would be a simple one: the Overgovernment Unit (perhaps the CPRS) would co-ordinate the teams analysing programmes, who would co-ordinate the survey teams operating below them.

/34. Once

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34. Once examples of waste were brought to light in the survey teams' reports, the majority of departments would be likely to take the necessary action without further prompting. But naturally some unresolved disagreements would travel up the hierarchy until they reached some point where they could be resolved. In practice they are likely to become part of the continuous bargaining about expenditures that goes on between the Treasury and spending departments.

35. The hierarchy proposed here is in no sense meant to bypass or surplant Treasury control of expenditure. It is designed to reinforce it, by injecting more political motivation at the top and more detailed examination of expenditure at the bottom. It is nothing short of miraculous that the Treasury have been able to achieve any control at all of public expenditure with the resources they have:

> "The entire Treasury sector overseeing public spending comprises only 28 people above the level of Principal .... If a certain Treasury Under Secretary devoted every minute of every working day for a full year simply to reviewing existing government expenditure, he would be able to give perhaps 35 seconds to every £100,000 spent."
> (Heclo and Wildasky, The Private Government of Public Money Macmillan, 1974, p.23.)

36. A strict timetable should be drawn up - but not necessarily disclosed - for surveying departments. Candidates for treatment in the first year are:

Department of Employment

Ministry of Defence

Department of Education and Science

Property Services Agency

The survey should also cover Quangos.

Exchequer and Audit Department

37. It is not clear why the E &AD has been so very effective in combatting impropriety in Government finances but only moderately effective in dealing with waste. According to the Comptroller and Auditor General himself, his examination "is not limited to the correctness of the accounts and matters involving regularity or propriety (a much misunderstood word). The Government auditor has also been required for many years past to direct his attention to'... value for money" audit, which embraces matters of economy, efficiency in administration, adequate pricing and charging policies and where feasible comparisons of achievements with objectives ... I do not however conduct, and I have not the staff to do so, an organisation and methods type survey of for example, the operational layout and procedures of a department, levels and grades of staff, the layout of forms, and so on. In the UK this is the responsibility of the Executive; and the central role played in such matters by the CSD and the Treasury will be familiar to the Committee." (Memorandum submitted by the Comptroller and Auditor

/General to the

General to the General Sub-Committee of the Expenditure Committee, Session 1976/77, published in Volume II (Part II) of Minutes of Evidence, pp583-4.)

38. The Government have been conducting an internal review of E & AD, and it may have produced some useful conclusions. But on the whole we should probably do better, and achieve quicker results, by using the existing mechanisms (whose strengths and weaknesses we know) supplemented by the surveys suggested above, rather than by trying to force the E & AD into a new role which spending departments may not fully respect.

Parliamentary Control of Expenditure

39. The Expenditure and Public Accounts Committees have already determined on certain desirable reforms. ~~All~~ The next Government should ~~need do is~~ help their initiatives, which include bringing various outlying parts of the public sector into the Committees' spheres of influence, and insisting on breaking the operations of Government down into accountable units as much as possible.

The longer-term

40. It is commonplace to say that any campaign to reduce spending will lose impetus unless there is continuous and political reinforcement. A public spending campaign will only yield significant results after two or three years, because it must necessarily start with small savings. (And of course it will not yield its full benefit until the General Election of 1984.)

41. It is traditionally a function of the CPRS to call a Government's attention to the longer-term strategy, for example by means of an all-day Cabinet meeting every six months. This suggests that the continuance of our entire public expenditure strategy - both the war on waste on the one hand and our planned policy changes on the other - should become the responsibility of the CPRS.

Conclusion: Politics

42. Public opinion can rarely have been as well-disposed towards reducing public expenditure as it is at present. This seems to be partly a reaction to Labour's extravagance and wastefulness. But it also seems to be part of a reaction against excessive Government spending in much of the Western World. The most obvious example is Proposition 13 in California, which was followed by similar referenda in 12 other States. There are other examples: the eviction in 1976 of the Socialist Government that had ruled Sweden for 44 years and the sudden rise of the anti-tax "Progress" Party to become the second largest in Denmark.

43. Finally, everyone is in favour of cutting waste. Even the Labour Party say they are in favour of it, even if they do not care as much as we do. The whole nation is behind a policy to increase the efficiency of Government and therefore improve the services which Government provides.

CONFIDENTIAL

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CHANCELLOR
CHIEF SECRETARY
FINANCIAL SECRETARY
MINISTER OF STATE (COMMONS)
MINISTER OF STATE (LORDS)
MR RIDLEY
MR CARDONA
SIR DOUGLAS WASS
SIR LAWRENCE AIREY
SIR KENNETH COUZENS
SIR ANTHONY RAWLINSON

PWP

CONSERVATIVE PARTY FINANCE COMMITTEE 13TH NOVEMBER 1979

1. The meeting was addressed by Mr Walter Goldsmith, Director-General of the Institute of Directors, on the subject of Capital Taxation.

2. This was a fairly primitive presentation, starting from the assumption that a full year's VAT would provide ample revenue for tax giveaways, and going through the whole gamut of capital taxes - and income taxes at that - with a scythe. There was no justification for retaining Development Land Tax or Investment Income Surcharge, and it was high time that tax relief was restored for interest on all personal borrowing.

3. Mr Goldsmith, just returned from three years working in California, did feel that tax relief on the interest on personal borrowing was a powerful element in American entrepreneurial success.

4. Members of the Committee were not, generally, very sympathetic to Mr Goldsmith's approach.

PC

PETER CROPPER

14th November 1979

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cc Mr Ridley
Mr Cardona

CHANCELLOR
CHIEF SECRETARY
FINANCIAL SECRETARY
MINISTER OF STATE (COMMONS)
MINISTER OF STATE (LORDS)

EEC BUDGET COMMITTEE

Alan Reid telephoned the attached paragraphs this morning during our morning meeting. They may be of urgent interest to Ministers.

PJC

PETER CROPPER

13th November 1979

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Message from Alan Reid (Tel Strasbourg 61 49 49 X3716)

Vital paragraphs from draft Resolution which the Budget Committee will consider at 1.00 pm today, and which is for discussion in plenary tomorrow.

6. Considers that only a new and lasting system of financial equalisation between the member states within the Community - based on the concept of per capital Gross National Product and organised within the framework of the system of own resources and of the Community Budget - can effectively contribute to the furtherance of efforts at convergence aid through the common policy.

7. Is of the opinion that, through such a system, the member states whose per capital Gross Domestic Product is higher than the Community average should finance - in proportion to their position in relation to this point of reference - a further separate component of budgetary resources.

8. Considers that this component should be made available to those member states whose per capita Gross Domestic Product is lower than the Community average - in proportion to their position in relation to this point of reference and with a view to supporting their efforts to make good their economic backlog; this component would be used in accordance with guidelines flowing from the common policies and only decisions taken by the budgetary authorities.

13 Nov 79.

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