SECRET
(Circulate under cover and notify REGISTRY of movement)

TREASURY

PO -CH /NL/0010
PART D

FOR DISPOSAL ADVICE SEE INSIDE COVER

DATE	SIGNATURE
6/1/94	C Dunt

DISPOSAL DIRECTIONS

DESTROY AFTER 25 YEARS

PRESERVE

FILE BEGINS 2/3/87 ENDS 25/3/87

PO -CH /NL/0010
PART D
MISCELLANEOUS PAPERS

[REGIS]TRATION USE ONLY

REFER TO	DATE	REFER TO	DATE
PA(25/3/87) PAR	6/1/94		

CLOSED
CONTINUED ON:-
PART E

A23/1 COPY NO 86

MONTHLY ECONOMIC BRIEF

Prepared by the CSO on 2 March 1987

There was an estimated net PSBR repayment of £3.7 billion in January, giving a cumulative PSBR total for the first ten months of 1986-87 of £0.5 billion. The PSBR is likely to undershoot the forecast of £7 billion for 1986-87 given in the Budget and the Autumn Statement.

A period of lower growth in the average measure of GDP during 1985 (after allowing for the effects of the coal strike), was followed by faster growth during 1986. However, there is still uncertainty surrounding the estimates of GDP for the fourth quarter of 1986. Projections for the average measure suggest growth of 1 per cent between the third and fourth quarter, while the published output measure was flat. Our assessment of the current underlying trend in GDP suggests a range of 2-4 per cent per annum.

In January exports were 4 per cent lower than in December and imports 8½ per cent lower. Visible trade showed a deficit of £0.5 billion compared with the deficit of £0.9 billion in December. The current balance showed a surplus of £0.1 billion. The underlying levels of both non-oil export volume and non-oil import volume continue to rise. The current account deficit for 1986 shown in the trade press notice was £0.4 billion, though this is subject to revision when the CSO press notice is released on 5 March.

Adult unemployment changed little between December and January following falls in each of the previous five months. Unemployment in January was 34,000 lower than a year ago and the trend in unemployment still seems to be downward. It seems likely that even without Restart and other measures the previous upward trend would have been halted. The employed labour force rose by 80,000 in the third quarter of 1986 and later figures for manufacturing employment in the fourth quarter show little change compared with a fall of about 14,000 per month in the first three quarters of the year.

Inflation in January, as measured by the 12-month change in the retail prices index, rose to 3.9 per cent from the 3.7 per cent recorded in December. Higher petrol prices announced in January had less than half their full effect on the January index and will contribute in February towards a further small rise in the 12-month rate.

RECENT RATES OF CHANGE AND ASSESSMENT OF CURRENT
TREND FOR SOME KEY ECONOMIC INDICATORS

In the following notes, the figures for current trend represent our best assessment of the current underlying rate of increase after making allowance for temporary distorting factors such as strikes, unseasonal weather effects, etc. The figures show how the series are moving currently and may be different from the comparisons over the latest published twelve months.

GDP (average measure) in the third quarter of 1986 was 2½ per cent higher than in the same period a year ago. This figure does not take account of past experience which shows that revisions to growth rates for the initial published estimates of GDP were on average, upwards, though not uniformly so. The assessment of current underlying trend for the fourth quarter of 1986 is that the rate of increase lies in the range 2-4 per cent per annum.

Industrial production in the fourth quarter of 1986 was 1 per cent higher than in the same period a year ago; manufacturing output was 2 per cent higher. The assessment of underlying trend for industrial production is that the rate of change currently lies in the range 1-3 per cent per annum. The trend in manufacturing output is in the range 2-4 per cent per annum.

Retail prices rose by just under 4 per cent in the twelve months to January 1987. It is only possible to provide a useful indicator of trend for about 70 per cent of the RPI, mainly that covering private sector prices and excluding eg mortgage interest, rent, rates, products produced by nationalised industries, seasonal food and petrol. The current trend for this series is just under 4 per cent per annum. In the twelve months to January 1987 this series rose by just over 4 per cent (not published).

Producer input prices showed a small increase of 0.2 per cent in seasonally adjusted terms in January. The index is expected to show little change in February.

Average earnings (underlying) in the twelve months to December rose by 7¾ per cent. The current trend is estimated to be 7½ per cent per annum.

Unit wage costs in manufacturing in the fourth quarter rose by 3½ per cent compared with the same period a year ago. The current underlying trend is estimated to be in the range 3-5 per cent per annum.

Unemployment (excluding school leavers) in the twelve months to January has fallen on average by nearly 3,000 per month. Over the past 6 months there has been an average fall of over 17,000 per month.

Movements over the latest published 12 months include any revisions that may have occurred since last publication (in general any such differences only occur in the GDP series).

CHART 1A

Gross domestic product (average measure)

1980 = 100, seasonally adjusted

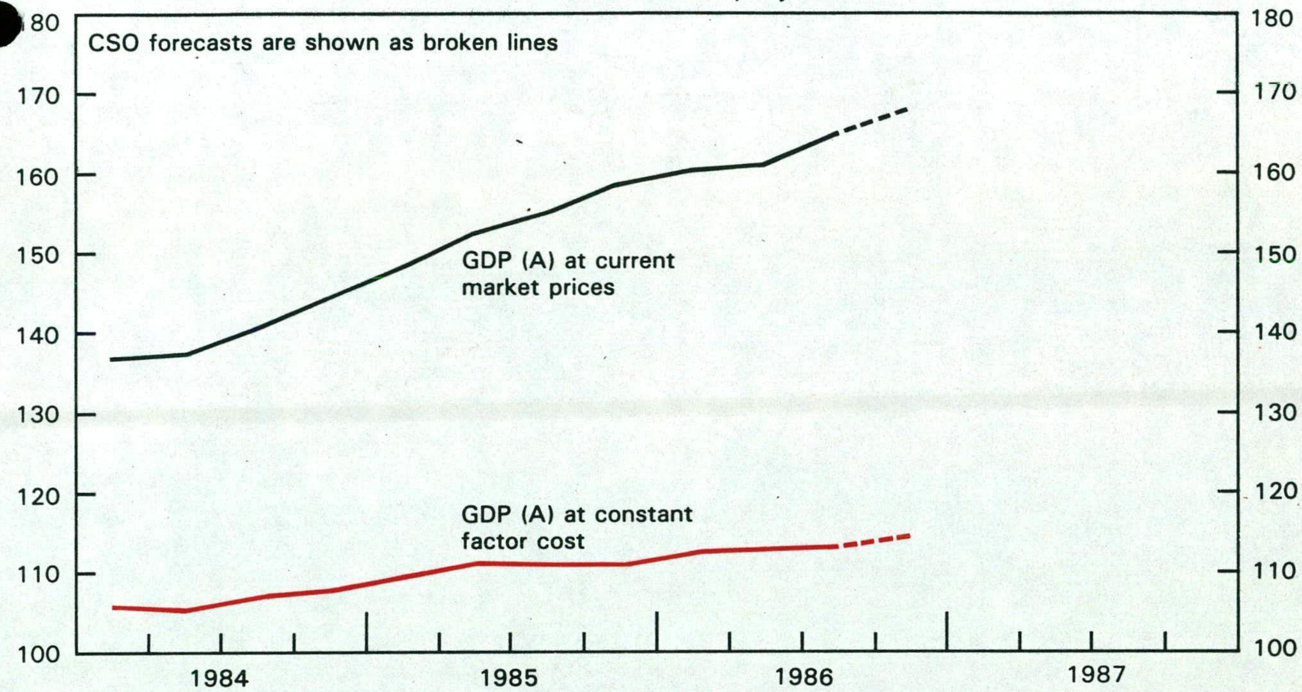


CHART 1B

Gross domestic product (average measure)

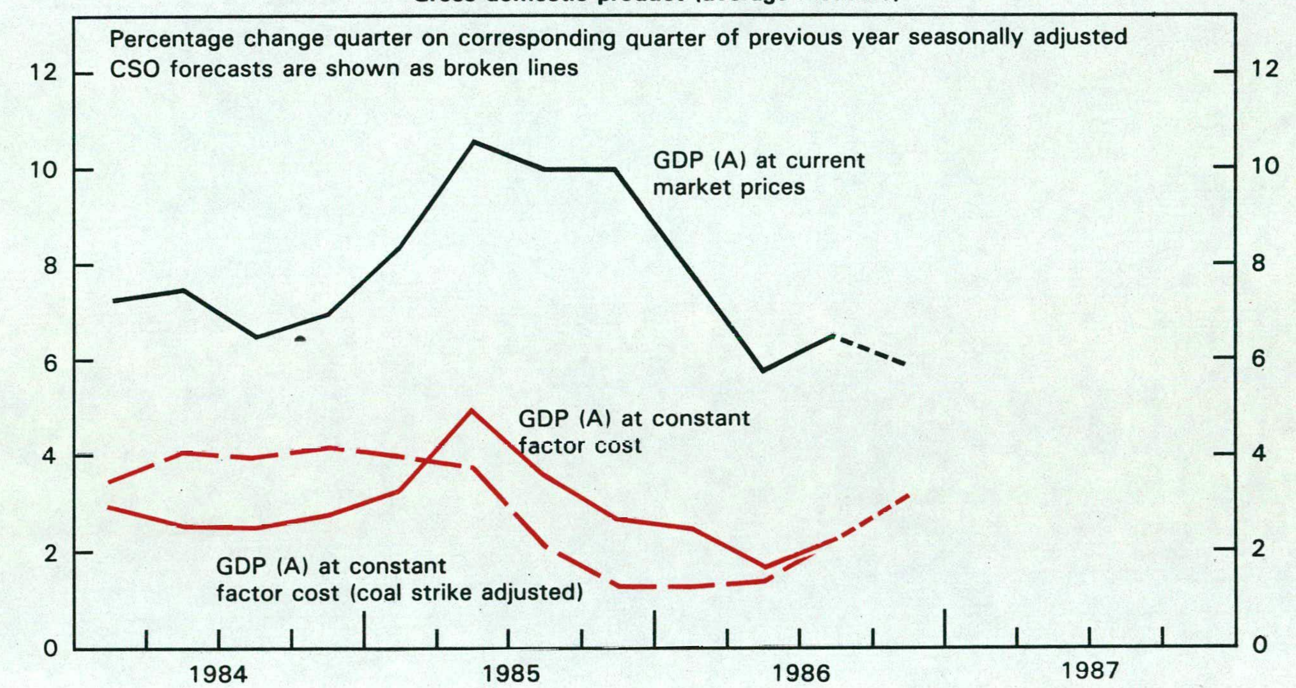
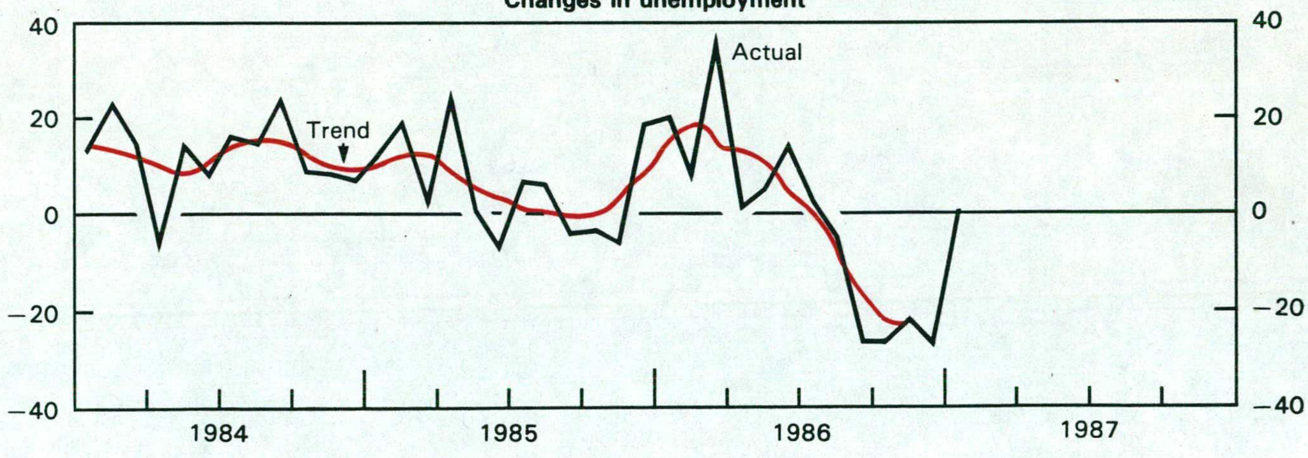


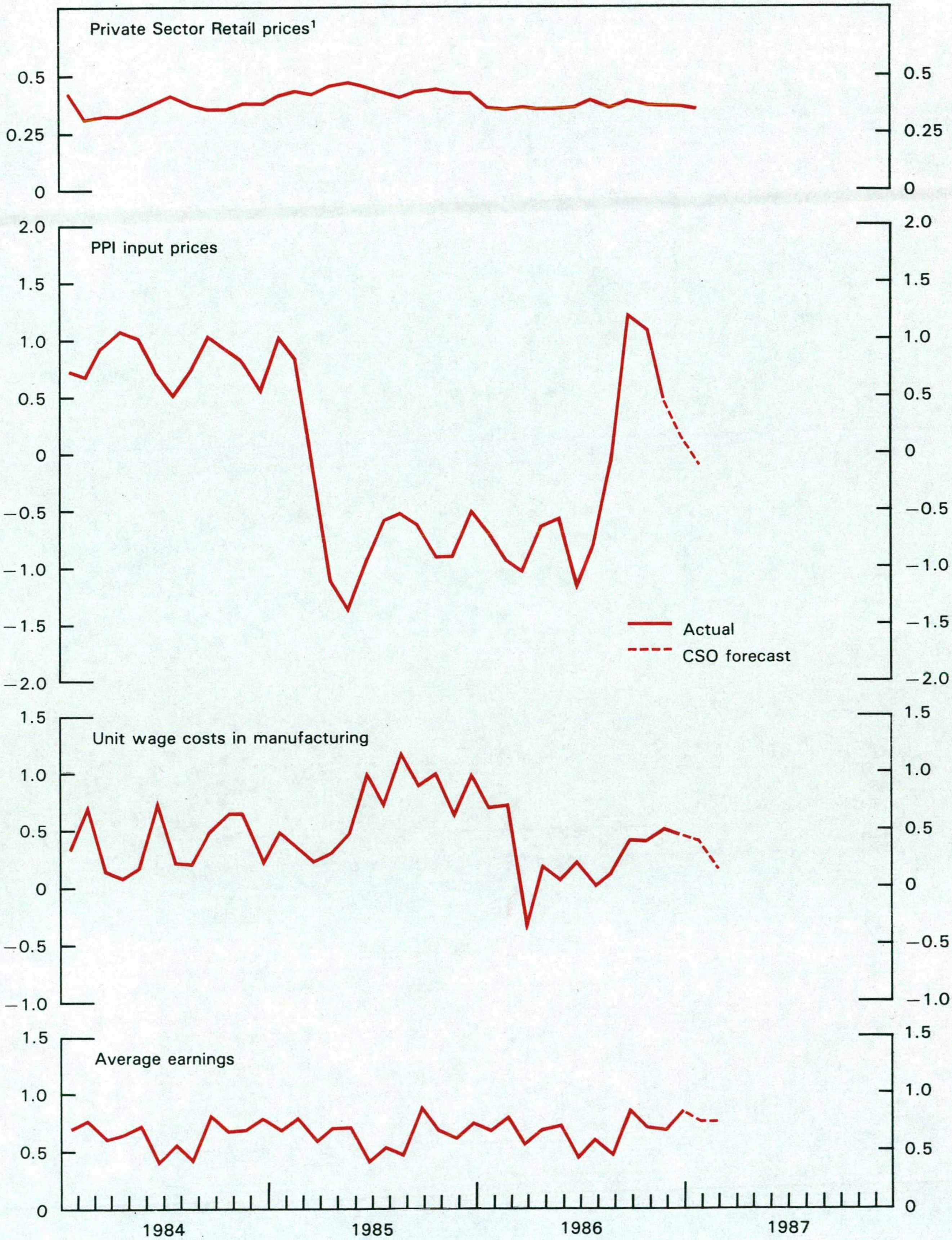
CHART 2

Changes in unemployment



Rate of increase in average earnings, unit wage cost in manufacturing PPI input prices and Private sector retail prices

Month to month percentage changes, smoothed and adjusted for distorting factors where appropriate



1. Excludes seasonal food, mortgage interest, rent, rates and water charges motor vehicle licences, products produced by Nationalised industries and petrol.

CHART 4

Movements in underlying average earnings and the tax and price index comparisons with 12 months previously

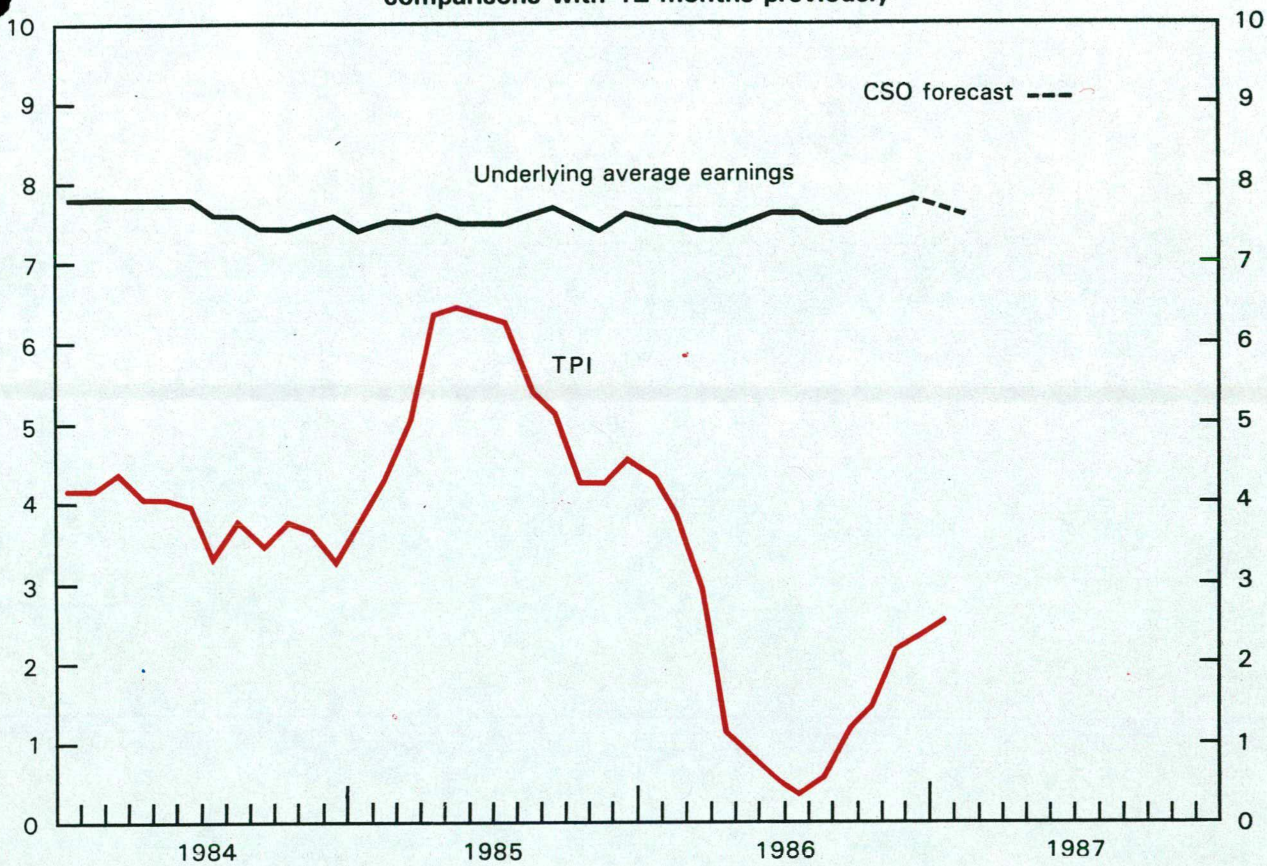


CHART 5

Interest rates

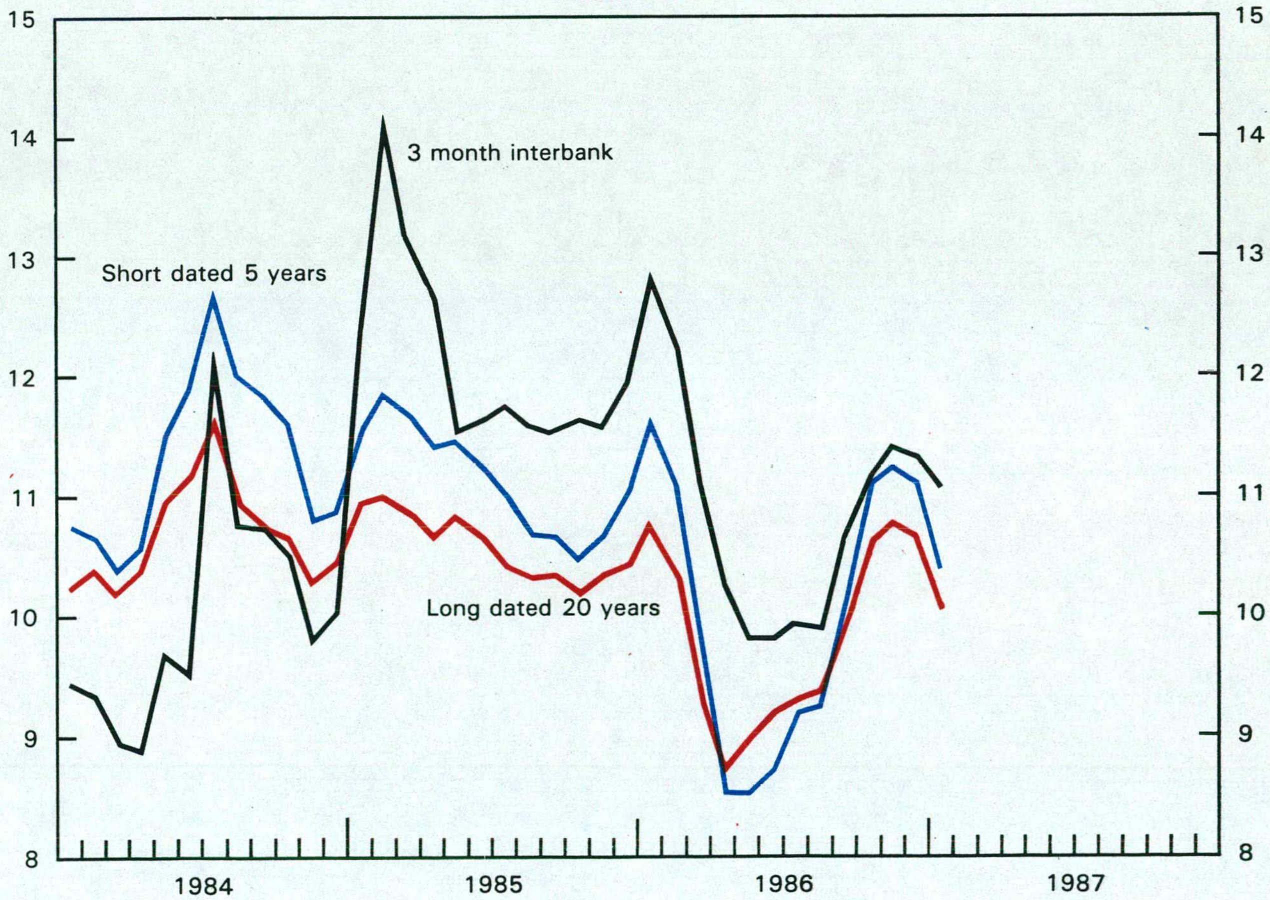
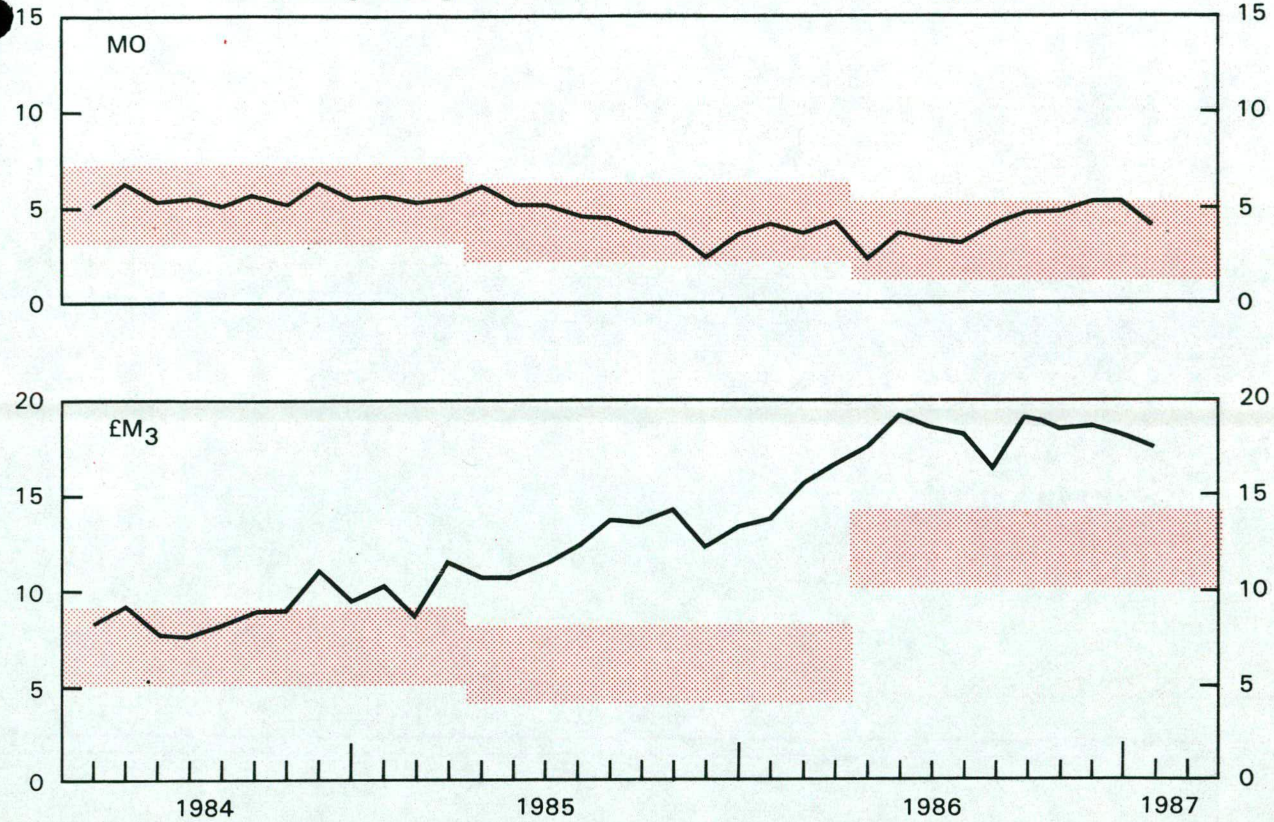


CHART 6

Monetary aggregates

Percentage Change on previous 12 months (not seasonally adjusted)

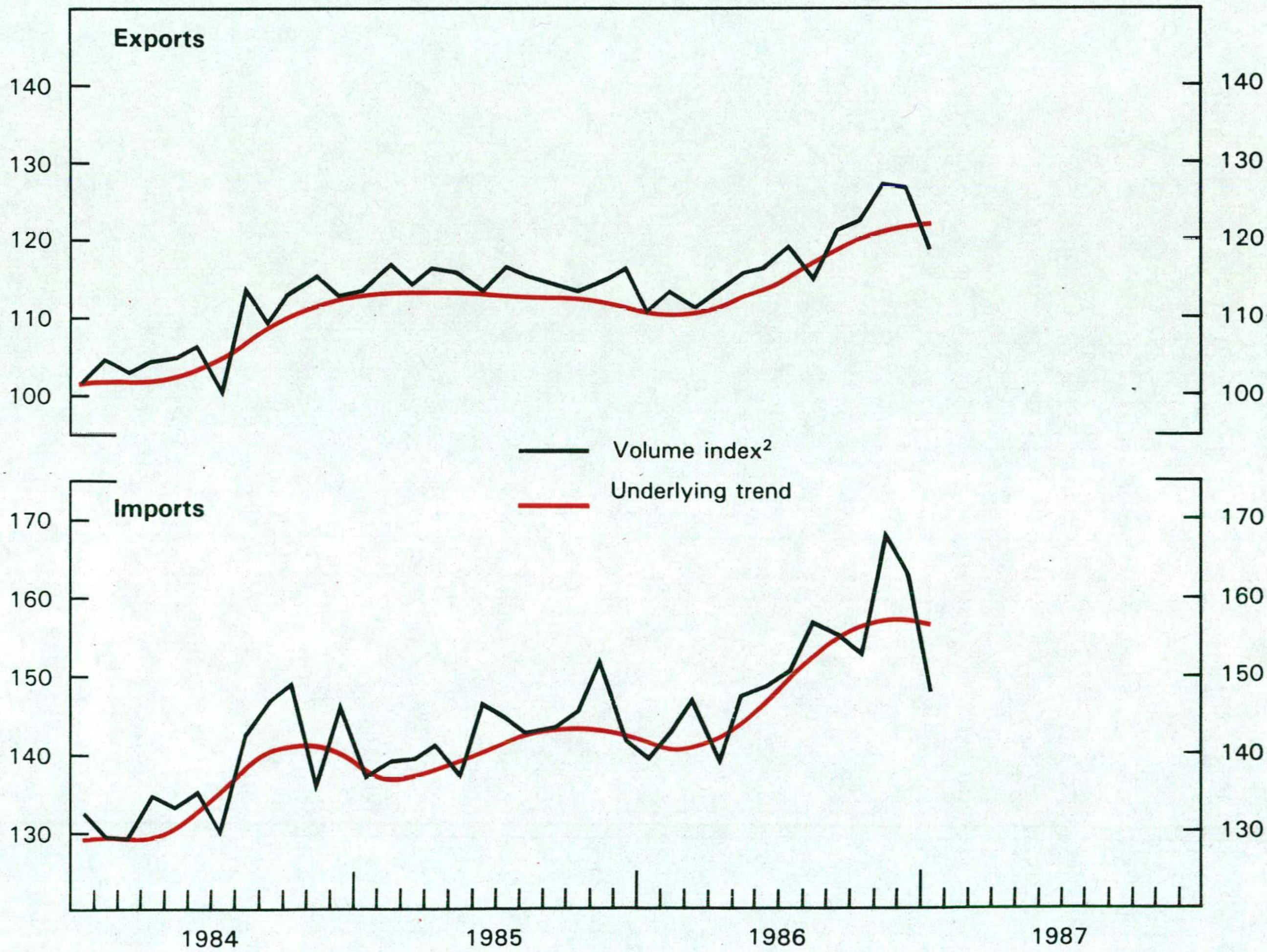


Shaded areas represent announced target ranges

CHART 7

Exports and Imports (excluding oil and erratics[1])

Index 1980 = 100



1. Ships, North Sea Installations, Aircraft, Precious Stones and Silver
2. Seasonally adjusted data, Balance of Payments basis

MR 10/111

RESTRICTED

FROM: CHANCELLOR
DATE: 2 March 1987

MR CORLETT - IR

cc: PS/EST
Mr Cropper
Mr Isaac - IR

PAYROLL GIVING: LITTLEWOODS

Last week's announcement by Littlewoods owed much, I know, to the work you, and Peter Cropper, had done behind the scenes. As you know, I attached considerable importance to introducing more competition among Charity Agencies. I am most grateful for your efforts in helping to bring this about.

NL.

NIGEL LAWSON

P.S. I'm glad, too, to see your latest note about BACS. The Bank [illegible] [illegible] by Barclays, since the genesis of the payroll giving idea was a joint paper by Sir J. Sainsbury and Sir M. Jacomb, Dep'y Chairman of Barclays.

NL.

MR 9/68

SECRET

cc: EST
Sir P Middleton
Sir T Burns
Mr Cassell
Mr C W Kelly
Mr Peretz
Mr Grice
Mr Ross Goobey

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

Rt Hon Robin Leigh-Pemberton
Governor
Bank of England
Threadneedle Street
LONDON
EC2R 8AH

5 March 1987

Dear Robin

Thank you for your letter of 4 March about monetary developments. I broadly share your analysis, and agree that the unpublished band should be left unchanged.

I am sorry we have had to fix the meeting to discuss tactics at a time when you will be in Basle, but given the very strong pressure today I did not feel we could afford to wait too long. No doubt George Blunden and Eddie George will be able to pass on your views.

Yours ever

Nigel

NIGEL LAWSON

psl/16A

cc Chief Secretary
Sir P Middleton
Mr F E R Butler
Mr Anson
Mr Monck
Mr Cassell
Mr Burgner
Mr Turnbull
Mr Waller
Mr Judd
Mr Pratt
Mrs R J Butler
Mr Hyett - T.Sol

SECRET

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

5 March 1987

The Rt Hon Paul Channon MP
Secretary of State for Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1

Dear Paul

ROVER GROUP

Thank you for sending me a copy of your minute to the Prime Minister reporting the outcome of your discussions with Commissioner Sutherland.

As the Prime Minister has noted, matters do now seem to be progressing satisfactorily. It is a pity that we will not have complete certainty of outcome on Budget Day, but I accept your judgement that further pressure to achieve that outcome might well prejudice final Commission agreement. Given, however, that we remain vulnerable to objections from other Member States, I have asked my officials to discuss with yours contingency plans for ensuring that we can make the payment to Rover Group this year without violating the state aids provisions of the Treaty, even if Commission clearance is delayed beyond the end of March. I understand that they believe they have identified an acceptable route.

Subject to final confirmation of those contingency plans, the only major point now for decision is the amount to be included in the Estimate. In the light of your letter, our proposed action would be based on a firm expectation of EC approval for £680 million, and I think that for reasons of Parliamentary propriety that is the figure we must include in the Estimate. I hope therefore you can agree to using that figure rather than £750 million in both the Estimate and the Budget documents. To meet the Parliamentary timetable, we have to finalise details of the Supplementary Estimate, including the amount, by close of play <u>tonight</u>.

I am copying this letter to the Prime Minister and to Geoffrey Howe.

Yours
Nigel

NIGEL LAWSON

23.01/007

CAH

Treasury Chambers, Parliament Street, SW1P 3AG

01-270 3000

Adam Bergius Esq
Chairman
Scottish Committee
Aims of Industry
40 Doughty Street
LONDON
WC1N 2LF

5 March 1987

Dear Mr Bergius

RENTS FOR FISH FARMS

Thank you for your letter of 4 February about the rents that the Crown Estate Commissioners wish to charge salmon farmers in Scotland for the right to use the seabed for fish farming.

The Crown Estate Commissioners are responsible for the management of the Crown Estate and have a general duty under the Crown Estate Act 1961 to maintain and to enhance the value of the Estate and the return obtained from it. They are an automonous body and do not come under the control of any Government Department in their management of the Estate. However, I have consulted them about the questions which you have raised in your letter.

Over the last seven years the Commissioners have charged a nominal rent only of £20 a year to encourage and to support the emerging fish farming industry. The Commissioners consider however that the salmon producing section of the industry has become sufficiently established and successful to be able to pay commercial rents. The Commissioners have, however, decided that they should continue to charge a nominal rent until 1990, of £50 a year for shellfish farms. This recognises the slower growth of this part of the fish farming industry.

Late in 1984 the Chief Valuer (Scotland) began discussions with the National Farmers Union in Scotland to fix a new level of rents to come into effect when the arrangements for nominal rents ended on 31 December 1986. As in other marine dealings the Chief Valuer is required to act as an impartial valuation expert. He is also specifically required by the Crown Estate Act to exclude monopoly value when determining rent levels. The Commissioners do not vary the recommendations of the Valuation Office having given an undertaking to Parliament at the time of the passing of the Crown Estate Act in 1961 that they would accept such valuations. In such circumstances they do not consider that there can be a right of appeal to the Lands Tribunal.

Detailed and extensive discussions between the Chief Valuer (Scotland) and the Union followed at the Union's suggestion, and it was agreed to settle a rental formula which would be capable of application to the whole industry. The formula which was settled last summer was as follows:

a. Basic rent of £50 per tonne.

b. Reduced basic rent of £45 per tonne for farmers producing 50 tonnes or less annually.

c. Basic rents adjusted annually according to movement in Billingsgate price.

d. Low start up rents for first three years.

Since this agreement was reached, the application of a reduced rent has been extended to include farms producing 75 tonnes or less annually; a move specifically designed to help the smaller producer.

The existing arrangements, under which nominal rents only are payable, have been extended for a further six months to 1 July 1987 to allow the Crown Estate time to consider the case for a differential rent for the Outer Isles. Discussions are continuing with the National Farmers Union of Scotland, and the Chief Valuer (Scotland) has recently been asked to consider representations on the matter. The Commissioners expect a conclusion to be reached in time for a new rents package to be implemented in July. However, the rental agreement in prospect does not prevent fish farmers from seeking individual valuations from the District Valuer, in which case the Crown Estate would be obliged to accept his findings - whether higher or lower.

Rents for shore tank systems are at present the subject of negotiations by District Valuers. No rental figures have yet been reported to the Commissioners.

It would be difficult to make direct comparisons with the arrangements which apply in other countries because of different financial and taxation regimes. But the Commissions have found that the impending introduction of commercial rents has not deterred the interest which Norwegian and other Scandanavian concerns are showing in establishing marine fish farmers in Scotland.

Other users of Crown foreshore and seabed are required to pay commercial rents, for example for yacht moorings, jetties, pipelines and harbour works. The Commissioners can see no grounds for treating fish farms any differently.

To sum up, the Commissioners are required by the Crown Estate Act 1961 to act commercially. The Commissioners consider that the fish farming industry has now reached a stage of development where, as a general rule, a commercial rent should be charged for the use of Crown foreshore and seabed for fish farming. The rents are negotiated by the Chief Valuer (Scotland) who acts as an impartial valuation expert; in doing so he is required to exclude monopoly value. In all the circumstances I do not consider that there are grounds on which the Government should consider intervening.

Yours ever
Nigel Lawson

NIGEL LAWSON

RD11.79

CHANCELLOR OF THE EXCHEQUER

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

6 March 1987

Michael Dobbs Esq
Chief of Staff
Conservative Central Office
32 Smith Square
Westminster
SW1P 3HH

Dear Michael

Thanks for pointing this out for me. However, though Kinnock may have said this privately, I am not aware that he or Hattersley have ever made any such public commitment.

Yours ever
Nigel

NIGEL LAWSON

ps7/22L

cc Mr Burgner
Mr Waller
Mr Bent

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

6 March 1987

Sir John Curtiss KCB KBE FRAeS
Director
The Society of British Aerospace Companies Ltd
29 King Street
St James's
LONDON SW1Y 6RD

Dear Sir John

AEROSPACE INDUSTRY'S RECORD TRADE FIGURES

Thank you for your letter of 19 February.

As a major high tech industry, it is vitally important that aerospace should play its full part in the UK economy. I am therefore pleased to hear that the industry secured record exports of £4.74 billion in 1986, and a near doubling to £1.9 billion of its contribution to the nation's trade balance. The members of your Society are to be congratulated on these fine achievements.

With a current order book in excess of £20 billion, I also hope we might look forward to the aerospace industry breaking new records in 1987.

Yours ever
Nigel Lawson

NIGEL LAWSON

RT4.76

CONFIDENTIAL

cc CST
Sir P Middleton
Mr F E R Butler
Mr Byatt
Mr Moore
Mr Culpin
Mr M Williams
Mrs Diggle
Mr Monck

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

6 March 1987

The Rt. Hon. Peter Walker MBE MP
Secretary of State for Energy

Dear Peter

SIZEWELL etc

You mentioned Max Wilkinson's story in Thursday's Financial Times to me after Cabinet.

Quite a lot of it is old material or is presented as speculation. Max Wilkinson is well informed about the electricity industry, as his recent pieces on Sizewell have shown. But although it caricatures points my officials have made to yours, part of the story looks like a leak, which concerns me as much as it evidently does you.

What is quite clear is that if there has been a leak, it did not come from here. Apart from anything else, the Treasury has no motive for providing a story of this kind.

Yours
Nigel

NIGEL LAWSON

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Wilson
Mr Scholar
Mrs Lomax
Ms Sinclair
Mr Cropper
Mr C W Kelly
Mr Jenkins (OPC)
PS/IR

psl/20A

CHANCELLOR OF THE EXCHEQUER

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

6 March 1987

Peter Miller Esq
Chairman
Lloyd's
Lime Street
LONDON EC3M 7HL

Dear Mr Miller

Thank you for your further letter of 3 March. I shall take careful account of the points you have made.

Yours
Nigel

NIGEL LAWSON

CONFIDENTIAL
UNTIL 11.30 A.M MONDAY 9 MARCH then
UNCLASSIFIED

~~5306~~ PUP.

FROM: P DAVIS
DATE: 6 MARCH 1987

1. MR S J DAVIES ✓ SJD
2. CHANCELLOR OF THE EXCHEQUER

cc : PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Monck
Mr Culpin
Mr Sedgwick
Mr Gilhooly
Miss O'Mara
Mr Pickford
Mr Brooks
Mr Hacche
Mr Pickering
Mr Hefford
Mr Cropper
Mr Ross Goobey
Mr Tyrie

Phoned through. e/ zero CR 9/3.

PRODUCER PRICES FOR FEBRUARY

The Producer Price Indices for February will be published at 11.30 a.m. on Monday 9 March. The level of the output price index rose by 0.3 per cent between January and February, and the twelve month rate of change fell to 4.2 per cent from 4.3 per cent in January. Excluding the food, drink, and tobacco industries, the 12 month increase in the output price index to February was 4.4 per cent, rising from the January figure of 4.1 per cent.

PPI
sn-ch-sept

PRODUCER PRICES (PERCENTAGE CHANGE OVER A YEAR EARLIER)

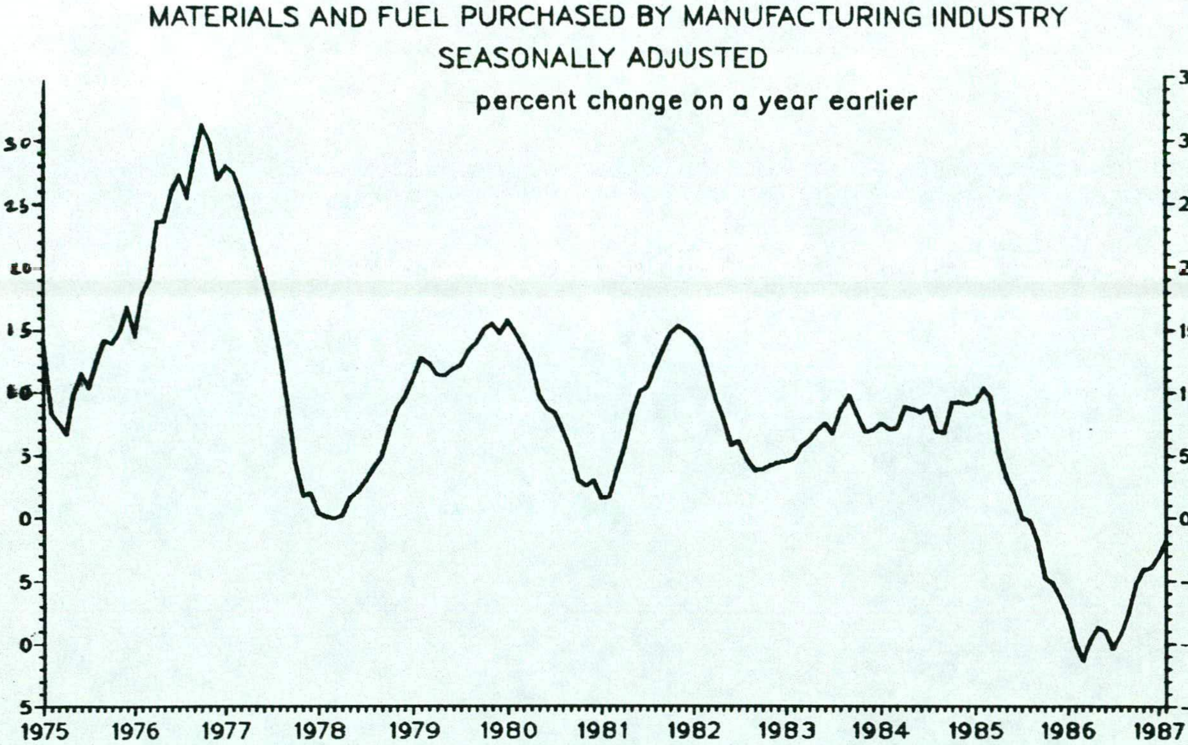
	Output prices		Input Prices		
	All	All excl FDT*	All	All (Seasonally Adjusted)	All excl FDT*
1985 Q3	5.6	6.5	- 0.7	- 0.7	1.2
Q4	5.1	5.9	- 5.4	- 5.5	- 5.1
1986 Q1	5.0	5.0	- 9.5	- 9.7	-11.9
Q2	4.5	4.3	- 9.4	- 9.2	-12.4
Q3	4.4	4.0	- 9.2	- 9.1	-13.1
Q4	4.2	4.0	- 3.9	- 4.4	- 5.6
November	4.2	3.8	- 3.5	- 4.1	- 4.9
December	4.2	4.0	- 3.2	- 3.9	- 4.4
January	4.3	4.1	- 2.3	- 3.1	- 2.5
February	4.2	4.4	- 2.9	- 1.8	- 3.2

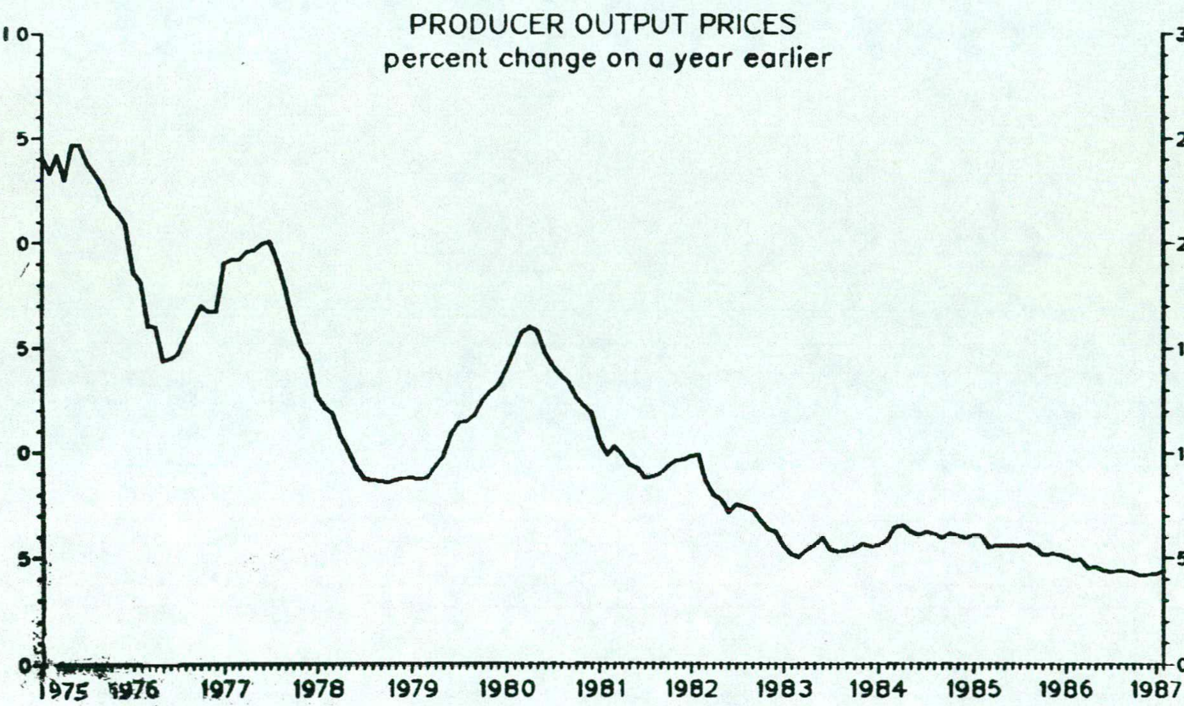
* Excluding the food, drink and tobacco industries.

X 3. The producer price index for materials and fuels purchased by manufacturing industry fell 1.7 per cent between January and February. This fall is almost entirely attributable to seasonal falls in electricity prices. The input price index is now 2.9 per cent below its level of a year ago. Excluding the food, drink and tobacco industries, the producer input price index fell by 2.7 per cent in February from the previous month and was 3.2 per cent below its level in February 1985.

4. I attach two charts showing movements in producer input and output prices since January 1975.

PAUL DAVIS
EA1 DIVISION
X 5398





M : TIREE.MANPUR
D : 9–10–86 G : TIREE.DISMANCOM

FINANCIAL SECRETARY TO THE TREASURY

FROM: J J HEYWOOD
DATE: 6 March 1987

PS/CHANCELLOR

cc PS/Chief Secretary
Sir P Middleton
Mr F E R Butler
Mr Anson
Mr Hawtin
Mr Scholar
Mr Instone
Ms Evans

QL: HOUSING

The Chancellor will be interested in the discussion of QL on Housing legislation.

2. Mr Ridley said that provided policy clearance could be obtained by Easter he believed that it would be possible to bring in a Housing Bill in the 1987/88 session. QL thought that the preparation of legislation on housing would be helped if a public announcement of the Government's plans was made soon after policy clearance was given, and certainly before a General Election.

JH

JEREMY HEYWOOD
Private Secretary

psl/26A

cc Sir P Middleton
Sir T Burns
Mr Monck
Mr Sedgwick
Mr Culpin
Miss O'Mara
Mr S J Davies
Mr Hacche
Mr Hunt

CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

9 March 1987

The Rt Hon The Lord Young of Grafham
Secretary of State for Employment
Department of Employment
Caxton House
Tothill Street
LONDON SW1H 9NF

Dear David

PUBLICATION OF REVISED EMPLOYMENT STATISTICS

I understand that preliminary results of the 1986 Labour Force Survey are now available, and that the Department of Employment will shortly be in a position to publish revised employment statistics. It will be very helpful if I am able to use the revised figures on Budget Day (for example in the Financial Statement and Budget Report). I gather that this is possible, though it involves the new figures being issued before the main body of labour market statistics.

I feel the best procedure will be for the Department of Employment to issue the new figures in a press notice on Budget Day. The reason for bringing forward publication of the figures is so as to include them in the FSBR; a justification which is most clearly established by issuing them on Budget Day.

If the figures were issued before Budget Day, as I understand your officials have argued, it might appear that there was some other reason for publishing them early (eg because the scale of the revisions is so large as to warrant special treatment). In any event, the revisions would attract much more attention if they were published in isolation soon before the Budget.

Yours ever
Nigel

NIGEL LAWSON

Le Ministre d'Etat

Ministre de l'Economie, des Finances et de la Privatisation

Paris, le 9 mars 1987

Chers Nigel,

Merci beaucoup d'avoir bien voulu m'adresser cet amusant souvenir de notre réunion de Paris. Je ne sais pas si j'oserais porter cette cravate devant nos collègues, notamment notre collègue italien.

J'ai été très heureux de vous recevoir et très heureux aussi du succès de notre réunion ; puisse-t-il être durable!

Veuillez-vous croire, cher Nigel, à mes pensées bien cordiales.

Edouard Balladur

Edouard BALLADUR

BALLADUR
→ CH/EX
9/3

Monsieur Nigel LAWSON
Chancellor of the Exchequer

Treasury Chambers

Parliament Street

SWIP 3AG

LONDON

3043/21/JS

CONFIDENTIAL

(Without attachme[nt] to letter)

cc Chief Secretary
Minister of State
Sir P Middleton
Mr F E R Butler
Mr Kemp
Mr Luce
Mr C C Allan
Mr Chivers
Mr Truman
Mr Enderby
Mr Halligan
Mrs Todd
Mr Willis

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

PRIME MINISTER

GEOGRAPHICAL PAY VARIATIONS IN THE NON-INDUSTRIAL CIVIL SERVICE

When we discussed my outline proposals for introducing some geographical variation into civil service pay, you asked for a fuller analysis. I now enclose the report of an inter-departmental working party under Treasury chairmanship, which has been looking at the evidence and considering the possible ways forward.

The working party has identified persuasive evidence of serious problems in recruiting and retaining civil servants in many areas in and around London, and in pockets elsewhere. These lead to costs and inefficiencies, and pay is part of the reason. The question is how to tackle the problem areas without adding too much to the cost of the civil service. The approach recommended is to allow departments to pay extra in parts of the South East (the South East Supplement), and in particular places elsewhere (local pay additions). Although departments would have some detailed discretion, this would be within rules and criteria established centrally which would include limits on the maximum and average payments. For practical reasons the arrangements could not be introduced until at the very earliest, 1 October 1987, (or possibly later). The size of payments suggested in the report would have a full-year cost of around 0.35 per cent of the non-industrial civil service paybill. The 1987-88 cost would be some £8-9 million, or under 0.2 per cent of the pay bill, and that only if the scheme came into full operation from 1 October this year. All costs would, of course, have to be met from Departments' running cost limits. Although in the short-term it can be argued that the costs would be largely additional, the benefits of better balancing of the paybill as between high and low cost areas (so that the first does not drag up the second) should lead to savings.

When drawing up the outline scheme officials have paid particular attention to the need for local consultation between different departments. Recent events at Reading and Livingston have shown all too clearly how essential this is.

The proposals as to control and administration require further detailed consideration and refinement. They are therefore currently being tested in two "dry runs", one involving six major departments across the country, and the other focussing on four specific areas - Cambridge, Glasgow, Guildford and Greenwich to examine how departments would intend to operate the scheme in practice. The detailed arrangements may be modified in the light of these exercises. Even so, any scheme implemented would be regarded as experimental. It would be monitored very closely, with particular attention paid not only to the benefits in terms of lower resignation rates but also to the costs, including the administrative costs involved. It is envisaged that the scheme would be reviewed within two years.

I believe that a scheme along the lines recommended by the working group would be a further important move towards greater flexibility in civil service pay. The proposals are consistent with the wider approach to flexibility which is provided for in the provisional agreement with the IPCS.

As you know, the unions have already been put on notice that we will be bringing forward proposals. Handling will need careful consideration, and I shall wish to return to this when I next report to you on progress on the 1987 pay negotiations. Meanwhile, I hope that you will agree the general approach outlined above, subject to the detailed arrangements being considered further in the light of the dry runs and the views of departments.

CONFIDENTIAL

I am also enclosing a more general report on regional pay variations, in the economy generally, which contains some suggestions for tackling the issue elsewhere in the public services. I would be glad to receive colleagues' views on these suggestions.

Copies of this minute and the enclosures go to members of the Cabinet and to Sir Robert Armstrong.

N.L.

9 March 1987

ps2/62R

CONFIDENTIAL

cc Chief Secretary
Minister of State
Sir P Middleton
Mr Kemp
Mr Monck
Mr Burgner
Mr Moore
Mrs Brown
Mr Chivers
Mr Colman
Mr Culpin
Mr Gilhooly
Mr Halligan

CHANCELLOR OF THE EXCHEQUER

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

10 March 1987

The Rt Hon Paul Channon MP
Secretary of State for Trade
and Industry
1-19 Victoria Street
LONDON SW1

Dear Paul

PAY 1986-87

Thank you for your letters of 16 January in response to mine of 18 December. I was also grateful for John Moore's letter of 25 February on the same subject.

I need not comment on the individual industries in any detail as consultations will take place on them at the appropriate point in the negotiations. On a general point I am pleased to see your and John's support for the principle of moving towards greater regional variation in pay and that several industries have this in mind for the future.

I look forward to seeing the results of British Rail's consideration of regional pay, in time to affect next year's pay round. I would welcome a progress report. In addition, I see some advantage in greater sectoral control over pay costs, particularly in the freight sector as a step towards greater responsibility by sector management for their own bottom line performance.

The results of LRT's tendering of bus services underlines the uncompetitiveness of certain LBL operations. The establishment of two local subsidiary companies with varied pay and conditions is an encouraging response to this lack of competitiveness on which LBL could usefully build.

I was a little surprised to learn that the Post Office are not planning early action to introduce more regional pay variation. I understand that the recruitment and retention situation for several kinds of staff varies considerably up and down the country. Greater regional pay variation might help them cope with these pressures more effectively and more economically than at present.

CONFIDENTIAL

I accept that the timing of such initiatives is often a difficult matter and best left to management. However, I would like to be reassured that Post Office management have at least considered this issue and plan to do something at some stage.

I am copying to the Prime Minister, Cabinet colleagues and Sir Robert Armstrong.

Yours
Nigel

NIGEL LAWSON

PWP Balance of Payments.

[illegible]

FROM: A BOTTRILL

DATE: 12 March 1987

PS/CHANCELLOR

cc: Sir P Middleton
Sir T Burns
Mr Sedgwick
Mr Owen
Mr McLaren

POSSIBLE FUTURE REVISIONS TO INVISIBLES

You will wish to be aware of the attached letter from the Bank of England which warns of possible further revisions to the invisibles estimates for the past when the first quarter balance of payments figures are published in early June. These will reflect the results of last year's inquiry about banks' earnings from financial services which are currently estimated from the 1983 inquiry. Revisions, therefore, could go back to 1983.

2. The estimated earnings by banks for services provided to non-residents have been one of the fastest growing elements of the invisibles account - rising from £0.8 billion in 1983 to £1.9 billion in 1986. The Bank has been calculating earnings from measures of activity in the various markets. They have promised us details. We must hope that results of the inquiry confirm the buoyancy of earnings - or even add to it.

A Bottrill

A BOTTRILL

CONFIDENTIAL

Ministry of Agriculture, Fisheries and Food
Whitehall Place London SW1A 2HH

From the
Minister of State

CHANCELLOR OF THE EXCHEQUER
16 MAR 1987
MST 16/3

28

Rt Hon John Biffen MP
Lord Privy Seal
Privy Council Office
Whitehall
London
SW1A 2AT

16 March 1987

Dear John,

REGISTRATION OF FISHING BOATS

I am writing in Michael Jopling's absence in North America to seek your agreement and that of colleagues, subject to clearance on a number of aspects which I will mention below, to an urgent attempt to secure introduction and enactment this Session as a Private Member's Bill, through the "back of the Chair" (Standing Order 58) procedure, of a Bill to tighten up the conditions for registration as a British fishing vessel, on lines set out in Michael Jopling's letter of 14 November to the Foreign and Commonwealth Secretary.

Since Michael Jopling wrote round in November, the situation has deteriorated further. The number of UK registered fishing boats owned by essentially Spanish companies has increased and despite emergency action which we took towards the end of last year to make it more difficult for these operators to obtain licences for pressure stocks, the number of such licences in their hands has also increased. Our attempt at the end of last year to enforce the licensing condition introduced in 1985 requiring licensed boats to operate from the UK, by revoking the licences of some 36 boats which had flagrantly failed to comply, was blocked by a further judicial review application, which may yet result in a further reference to the European Court of Justice for a preliminary ruling. The fishing industry, whose representatives were of course involved in the working group under Department of Transport chairmanship last year which produced the proposals for legislation, are rapidly losing patience with the Government's failure, as they see it, to make any progress in tackling the serious "quota-hopping" problem. Hence the need for early introduction of a Bill.

In the correspondence following Michael Jopling's letter, it emerged that there were no policy objections to such a Bill, provided that it was "Community-proofed", including bringing the Commission in at an early stage. Certain anxieties on the part of the Secretary of State for Transport have been removed following the settlement reached, under his Presidency of the Transport Council in December, on the European Community shipping

CONFIDENTIAL

CONFIDENTIAL

CONFIDENTIAL

package and I understand that the Secretary of State now fully supports the need for early legislation as do the other Fisheries Ministers.

On the "Community-proofing" point, the proposals were submitted to the Law Officers who asked for the advice of expert counsel. We accordingly sought a Joint Opinion from Mr Francis Jacobs QC and two other Counsel: this was a little longer in being delivered than we had hoped but we were eventually able on 2 March to send to the Law Officers what I understand to be a broadly favourable Joint Opinion of Counsel, so far as it goes. I very much hope therefore that the Law Officers will shortly be able to give the proposals their clearance from the point of view of compatibility with Community law. If so, policy approval, subject to discussion of the draft Bill with the Commission, should follow and I take it from your letter of 20 November that this would also apply to drafting authority.

Meanwhile the Department of Transport have in hand the preparation of draft Instructions to Counsel, which I hope can be completed as a matter of urgency. I understand that approval has been given at official level for Parliamentary Counsel to be approached on the basis of draft Instructions even in advance of formal policy and drafting approval by colleagues. I hope that you can now agree that Parliamentary Counsel should be asked to give this Bill a high priority in view of the extremely tight timetable if it is to be got through this Session.

Once a draft Bill is available we will need to undertake rapid consultation with the Commission and, after final clearance with Legislation Committee, to seek the co-operation of the Opposition in getting the Bill through the House by the end of June. I am confident that the Opposition will recognise the highly desirable nature of this legislation, as they did with the British Fishing Boats Bill in 1983. I foresee no difficulty in obtaining a sponsor for the bill.

I am very conscious that in writing at this stage, particularly before the Law Officers have had time to consider their position, I am departing from normal, orderly procedures and risking your and other colleagues' irritation. But given the urgency of the problem and the shortness of the time available if it is to be dealt with this Session, I thought it important to do everything possible to clear the way for action once the green light is given.

I am copying this letter to the Prime Minister, the Foreign and Commonwealth Secretary and Members of OD(E) Committee, Members of L Committee, the Secretary of State for Northern Ireland, First Parliamentary Counsel and Sir Robert Armstrong.

Yours ever
John

JOHN SELWYN GUMMER

28

PRIVY COUNCIL OFFICE

WHITEHALL, LONDON SW1A 2AT

20 November 1986

LORD PRIVY SEAL

Dear Michael,

SPANISH FISHING VESSELS

I have seen your letter of 14 November to Geoffrey Howe and John Moore's letter of the same date to John Gummer.

I have considerable sympathy with your proposal but in view of the points John Moore makes I am sure that you will agree that it would not be feasible to include the Bill you have in mind on my list of handout Bills for the Ballot on 20 November. That does not preclude a different Private Members route - such as Standing Order 58 (39, on the old numbering) or a Private Peer's Bill - provided this can be accommodated within Parliamentary Counsel's drafting capacity and that the Bill will be suitable for handling in this way. That is something we can judge better when policy approval has been forthcoming and the details of the Bill have been settled. In the meantime I have no objection to instructions being sent to Parliamentary Counsel so an assessment of any drafting difficulties can be made. A final decision on whether the Bill should be given Government support must await this outcome.

Copies go to the Prime Minister, members of OD(E) and L Committees, to the Secretaries of State for Transport and Northern Ireland, to Sir George Engle and to Sir Robert Armstrong.

Yours
John Biffen

JOHN BIFFEN

CH/EXCHEQUER	
REC.	20 NOV 1986
ACTION	MST ~~[illegible]~~ 20/11
COPIES TO	

Rt Hon Michael Jopling MP
Secretary of State for
Agriculture, Fisheries and Food

PUP

SECRETARY OF STATE FOR TRANSPORT

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

The Rt Hon John Selwyn Gummer MP
Minister of State
Ministry of Agriculture, Fisheries
and Food
Whitehall Place
LONDON SW1A 2HH

14 November 1986

Dear Minister,

SPANISH FISHING VESSELS

I promised to let you know whether on reflection I could give you any help with the timing of legislation to deal with Spanish-owned fishing vessels on the UK register, on which I understand Michael Jopling will be writing to colleagues today.

I remain very concerned about the possibility of an adverse reaction by Spain interfering with the adoption of a shipping policy package at the EC Transport Council which I shall be chairing in Brussels on 15 and 16 December. Although I am reassured to know that the Spanish attitude towards the enforcement of fishing quotas is positive I do not think we have any evidence that the particular measure we are contemplating will not generate criticism.

The linkage between the two issues is closer than you may appreciate. In the shipping field we have been resisting strongly demands from Spain that vessels on EC registers should be beneficially-owned in the Community if they are to enjoy the new opportunities that the proposed instruments will generate. Notwithstanding the differences between the regimes for fishing and for shipping, we could well be accused of hypocrisy if we were to announce an ownership requirement in connection with fishing at the very moment that we were forcing Spain to give way on a similar point in the shipping area. (My concern on this point is exacerbated by the sharp contrast between what we are proposing in relation to ex-Spanish fishing vessels on the UK register in near waters as compared with the precisely opposite attitude we are taking in the Falklands.)

We are unlikely to have an opportunity to test how the Spanish Ministry of Transport might view this until I see Senior Caballero, probably on 26 or 27 November. I know you wish to go ahead with a Private Member's Ballot Bill on this issue. The Ballot will be held on 20 November but the deadline for deposition of long and short Titles which effectively commits us to a Bill is 10 December. I can therefore only agree to your going ahead with the preparation for a Ballot Bill on the clear understanding that if I detect a sensitivity on this issue before the deadline for depositing titles, we will abandon the Ballot Bill route. This would of course also mean that there could be absolutely no publicity for the idea either from the Government, the Member or any other party that might be involved, before we have taken our soundings and I have given the green light.

If you think this would be too awkward a line to take with a Member, then I would have to suggest that you go down the route of a Peers Bill which of course does not present the same timing difficulty.

I am copying this letter to the Prime Minister, members of OD(E) and L Committees, to Tom King, and Michael Jopling, to Sir George Engle, and to Sir Robert Armstrong.

Yours Sincerely,

J. Cunliffe

p.p. JOHN MOORE

(approved by the Secretary of State and signed in his absence).

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

Many thanks. I don't think I normally do this & I don't think it sensible to start now. But look for Sir GL to give an oral report when he meets his colleagues (Sir X).

COPY NO 1 OF 4 COPIES

Ch
Want to send something like this?
AA

From: Sir G.Littler
Date: 13 March 1987

CHANCELLOR

c.c. Sir P.Middleton
Mr Scholar
Miss Evans

A BUDGET MESSAGE FOR G6 COLLEAGUES

SECRET

Mr Scholar submitted yesterday a draft telegram for overseas posts summarizing the Budget. It is in terms such that the text could be given to Ministers or officials of other countries who might be interested. For key countries (plus IMF, OECD) we can invite our embassies to arrange this.

2. There is no **need** for more, but I thought you might like to consider whether to send something more personal to your fellow Ministers who shared in the Paris Agreement of last month.

B.L.O.

3. In case the idea appeals to you I have drafted the attached short piece which, as it happens, I shall have an early opportunity to supplement because I am attending a dinner of my G5 colleagues in Paris on Wednesday 18 March and a meeting of G7 Deputies on Saturday 21 March. X

GL

(Geoffrey Littler)

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

DRAFT

DRAFT MESSAGE TO:

Secretary James Baker - Washington DC
Minister Edouard Balladur - Paris
Minister Gerhardt Stoltenberg - Bonn
Minister Kiichi Miyazawa - Tokyo
Minister Michael Wilson - Ottawa

I have today presented to Parliament my Budget for the coming financial year. It is fully consistent with the policies for the United Kingdom sketched in our recent agreement in Paris [and] It will, I [judge] knew, sustain and enhance a performance which is not only giving increasingly satisfactory results in our domestic economy, but also [modestly] contributing to the [right basis for] balance and stability between our currencies and economies which we all seek.

or omit

2. My strategy remains unchanged. I believe that the value of continuity and persistence over the medium term is increasingly acknowledged [here]. I aim to reduce taxes, to improve incentives and to encourage enterprise, [but] all [in] within the framework of [giving priority to] A a sound monetary [conditions which will exert downward pressure on inflation, to constraint of public expenditure, and to a tight limit on public sector borrowing.] policy and a prudent fiscal stance.

3. In 1986 [(compared with 1985) we] recorded output growth [of] was 2.5% - [and entered] the sixth year of steady growth, averaging nearly 3% per year; [we saw the rate of] inflation came down to 3.5% - the lowest figure for almost 20 years; manufacturing productivity continued [its welcome rise of the last few years] to grow fast; and the path unemployment has [been declining over the past six months] now turned down. Given the loss of an estimated £5 billion of earnings on oil trade, the deterioration

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

of our current account balance from a £3 billion surplus to a £1 billion deficit is neither surprising nor worrying. And the buoyancy of public revenue in spite of a loss of £7 billion from the oil sector has been remarkable.

4. The high level of non-oil revenue reflects the sustained overall growth of the economy, [but] a A particularly significant feature is the sharp rise in the yield of corporate taxes. This follows the improvements in the structure of corporate tax I began to introduce three years ago. Corporate profits have been rising fast for several years.

5. It is this buoyancy of revenue, coupled with continued firm control of expenditure, which has enabled me to build my Budget for 1987-88 around a Public Sector Borrowing Requirement of only 1% of GDP (£4 billion) [- which I regard as an appropriate continuing level -] and at the same time reduce taxes by some £2.5 billion, including a reduction from 29% to 27% in the basic income tax rate.

5. I have proposed other tax measures to assist small and growing businesses and to improve labour mobility. [make it more attractive for people to undertake self-help and mobile pension arrangements]. I have also proposed a new tax relief to encourage profit-related pay. And I have taken the opportunity to repeal [the] our Exchange Control Act; , [it] which has [of course] been inoperative since we abolished actual controls in 1979.

6. I expect 1987 to be another year of steady growth with low inflation. Total output should grow by about 3%, with exports and investment up by rather more than that. Inflation may rise temporarily [drift over]

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

to just over 4.5% in the summer but should then fall back to 4% by end-year. The current account of the balance of payments is likely to ~~remain~~ be in small deficit, perhaps by £2.5 billion or around one-half per cent of GDP. [I am targetting growth of narrow money (M0) in the range 2-6%, assuming a broadly stable effective exchange rate, and not this year setting a specific target for any broad money measure.]

7. My monetary policy will be based on a target range for the growth of narrow money (M0) of 2-6%. I am not this year setting a specific target for broad money. My forecasts and projections are based on an assumption that sterling's effective exchange rate remains close to its present level.

8. Overall I judge this to be a constructive stance for the UK in the world economy context. I look forward to seeing you again in Washington.

[for Balladur "later this month"]

(Signed) Nigel Lawson

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

7 of 7

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

COVERING BLO
until after Budget Speech on 17.3.87
then UNCLASSIFIED

FROM: S R KEMP

DATE: 16 March 1987

Miss O'Mara

Could Mr Sedgwick look at the forecast sections particularly carefully?

Mr Odling-Smee
Mr Scholar
Mr Sedgwick
~~Mrs~~ Mr Culpin
Miss Evans
Mr Hudson

BUDGET BRIEF A1

[initials] 14/3

I attach a revised version of your Budget brief. Thank you for your helpful comments. Could you please return the brief to me (99/2), with comments marked in red, by lunchtime today.

2. Please check against latest version of the draft Budget speech, FSBR, press notices etc to ensure consistency and for any additional points and memorable turns of phrase. This will be your final chance to comment.

3. EB will take care of all retyping.

Nigel Pearson
pp S R KEMP

1. ~~Mr Allan~~
~~Any~~ I can't spot anything, on a quick read.
2. PWP
AH
16.3.

BUDGET SECRET

B.L.O.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

A1 BUDGET STRATEGY

[See also Summary of main points (Brief A2), Industry Act forecast for UK economy (B1), briefs in Section C, Alternative budgets (CC4), Income tax: main changes (D1), Effects of Budget on business (F1), Excise duties (G1), Personal tax reform (H3) and briefs in Section J]

Factual

(i) Objective of Government's economic policy

- to defeat inflation

- to maintain vigorous, enterprising economy which will generate sustained growth and increased employment.

(ii) Budget consolidates progress to date.

- Monetary and fiscal policies set to reduce growth of money GDP still further and so bring down inflation.

- Measures to encourage enterprise, efficiency and flexibility, improving prospects for output and jobs.

(iii) 1987 Budget

- updates MTFS to 1990-91, with PSBR maintained at steady 1 per cent of GDP and money GDP growth declining over MTFS period;

- announces £4 billion PSBR for 1987-88, £3 billion lower than in 1986 MTFS;

- maintains public expenditure plans unchanged at levels of 1987 Public Expenditure White Paper;

- proposes cut in taxes of slightly over £2½ billion in 1987-88 (compared with indexed base).

(iv) Further healthy, balanced growth forecast at rate slightly above average for last 5 years. Good prospect of continuing decline in unemployment. Current account deficit of only ½ per cent of GDP in 1987. Inflation by end 1987 back to current levels.

(v) No change in monetary policy.

(vi) Budget reduces basic rate of income tax by 2p to 27p: further substantial step towards 25p.

(vii) Budget encourages personal pension provision through major package of reform.

(viii) Budget introduces tax incentive for profit related pay.

(ix) Budget contains measures to lighten burden on small businesses.

(x) Standstill on main excise duties.

WPU

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

(xi) How the sums add up:

	1987-88 £ billion
Fiscal adjustment in 1986 MTFS	**2**
Increase in general government expenditure	-3½*
Increase in receipts before Budget package	+7*
Fiscal adjustment available pre-Budget	**+5½**
Budget package	-2½
Budget reduction in PSBR	**3**

* Underlying increases, adjusted for classification changes. (Public spending planning total goes up £4½ billion.)

Positive

(i) Government's policies of sound money and free markets bearing fruit. 1987 Budget setting more favourable than for very many years.

- entering seventh successive year of steady growth, averaging approaching 3 per cent annually
- entering fifth year of steady growth and low inflation combined
- public finances sound and strong
- unemployment falling.

(ii) International league:

- UK output growth faster than any other major European country since 1980
- UK growth of manufacturing productivity since 1980 faster than all other industrialised countries and whole economy productivity growth second only to Japan
- UK employment growth since 1983 election greater than rest of EC combined
- UK overseas assets, at well over £100 billion, now second only to Japan (and highest since War).

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

(iii) Government's past prudent policies now permit

- £2½ billion cut in taxes

- £4½ billion increase in public spending, making possible higher provision for priority areas

and

- £3 billion reduction in PSBR

despite

- oil revenues £7½ billion less than in 1985-86.

(iv) Strength of economy particularly remarkable against background of oil price fall.

(v) Outlook

- Healthy, balanced growth in 1987 and beyond, with consumption growth lower and investment and export growth higher than 1986.

- Exports and investment grow significantly faster than economy as whole.

- Unemployment continues to fall gradually.

- Inflation remains low.

(vi) Low inflation, rapidly rising productivity and high profitability present British industry with outstanding opportunity.

(vii) Government continues to attach highest priority to sound money.

(viii) Government remains committed to keeping inflation on unambiguously downward underlying trend, with ultimate objective of price stability.

(ix) PSBR in 1986-87 £3 billion lower than projected in 1986 FSBR, despite drop of more than £1 billion in oil revenues since 1986 Budget forecast.

(x) PSBR in 1987-88 lowest as share of GDP (1 per cent) since 1969-70, even after Budget tax cuts of just over £2½ billion. Projected to stay at that level throughout MTFS period. Share of GDP lower than 1 per cent only twice since 1950.

(xi) People should be left free to spend or save more of their own money. Lower tax economies work better than higher tax economies. So Budget gives priority to reducing income tax.

(xii) Within income tax package, priority given to basic rate reduction as marginal rate for 95 per cent of taxpayers of working age and starting rate for everyone.

(xiii) After Budget tax cuts, real take home pay for family man on average earnings will have risen over 21 per cent under this Government (1978-79 to 1987-88).

WPU

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

(xiv) Significant fall in tax burden of small companies and unincorporated businesses: crucial for future growth and employment.

- Small companies' corporation tax rate cut from 29 per cent to 27 per cent.

- VAT proposals to ease cash flow problems and provide automatic VAT relief for bad debts cover over half of all traders registered for VAT.

- Capital gains tax retirement relief increased.

(xv) Promotion of profit related pay stimulates greater pay flexibility and enterprise, strengthening prospects for employment further.

(xvi) Pensions measures will make it easier for employees to take pensions with them when changing jobs. Good for labour mobility and independence in old age. Gives individuals more choice in provision for retirement.

(xvii) Further measures to streamline tax system, especially for companies.

(xviii) As result of Government action since 1979 to encourage wider share ownership, shareholder numbers trebled.

(xix) Changes to inheritance tax raise threshold by over 25 per cent (to £90,000) and cut number of estates liable by about a third.

(xx) Doubling of blind income tax allowance, introduction of new age allowance for over 80s and further VAT reliefs for charities all demonstrate Government's concern for disadvantaged.

(xxi) No increase in main excise duties.

(xxii) Introduction of duty differential on unleaded petrol will be welcomed on both health and environmental grounds.

Defensive

(i) 1987-88 PSBR too low: No. Domestic demand buoyant and no sign of weakness in money GDP growth. But growth in private sector credit fuelling upward pressure on real interest rates. So right to rein back public sector borrowing.

(ii) Higher public borrowing required to stimulate growth in employment: No. Fallacy that sustained growth impossible without expansionary fiscal policy. Output began to rise in 1981 at very time when PSBR substantially reduced from 5 to 3 per cent of GDP. Economy since grown at rate of approaching 3 per cent a year, with 1 million more jobs since 1983 election. Private sector most likely to thrive when Government restricting own demands on economy.

(iii) Budget does nothing to help unemployment. No.

- Government's prudent management of nation's finances has secured favourable economic climate, enabling 1 million new jobs to be created since last election, with unemployment now on downward trend.

- In 1987-88 spending on employment, training and related measures more than double 1978-79 level in real terms.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

- Income tax package carefully designed to sharpen incentives, encourage enterprise and so improve employment prospects throughout economy.

- Government encouraging pay flexibility necessary to defeat unemployment through tax relief on profit related pay schemes.

(iv) Why reduce borrowing rather than cut tax burden? Government's policy of reducing public sector borrowing as proportion of GDP has brought steady, balanced growth, rising employment and inflation at levels not seen for almost 20 years. Past record offers best guarantee for future that taxes will be cut and reductions will not be reversed.

(v) Tight fiscal policy disguises slack monetary policy: Respective roles of fiscal and monetary policy set out clearly in Lombard Association speech. But monetary policy clearly not slack given evidence from MO and exchange rate and level of real interest rates.

(vi) MTFS revised too often to remain credible element in strategy: Approach of MTFS vindicated by successful performance of economy.

(vii) Chancellor misled country in autumn about size of 1987-88 PSBR. No. Full extent of buoyancy of non-oil revenues not known at that stage. Government does not publish forecast following year's PSBR in autumn. Chancellor simply gave assurance that PSBR would be no greater than 1¾ per cent of GDP.

(viii) Tax cuts less effective in stimulating employment than targeted increases in expenditure: View rests on short term considerations. Income tax cuts have longer term benefits. By improving incentives and stimulating enterprise and efficiency, raise output and create more jobs. Spending decisions must be based on own merits, not short-run effects on employment.

(ix) Irresponsible to cut taxes when current account moving into deficit: No. Despite longer term commitment, Government has not significantly reduced tax burden in 1987-88 because of overriding concern to maintain prudent fiscal stance. Growth of consumers' expenditure expected to be lower in 1987 than 1986 and same as rate of growth of both exports and investment. Forecast shows no increase in rate of growth of imports in 1987.

(x) Increase in non-North Sea tax burden in 1987-88: Overall tax burden does fall slightly, but bigger tax cuts in 1987-88 would not have been prudent. Government remains firmly committed to significant reduction in burden over medium term.

(xi) 1987 Budget reverses policy of shifting burden from direct to indirect tax. No. Budget maintains 1986-87 balance. Right that individual, not state, should decide how own money to be spent. Compared with Budget package, simple revalorisation would have increased share of direct taxes in total.

(xii) Electioneering Budget: Scarcely when

- no significant reduction in 1987-88 tax burden and small increase in non-North Sea tax burden;

- Government borrowing £3 billion less than projected in 1986.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

(xiii) Action on indirect taxes designed to win votes. No.

- Overall, Government increased duties (including VAT rate change) faster than prices since both 1979 and 1983.

- Duty on tobacco up 27 per cent in real terms in first Parliament (fell in real terms under Labour Government) and up 18 per cent in second.

- Duty on beer up 38 per cent in real terms in first Parliament and up 1½ per cent in second.

- Only wine and spirits duties have fallen in real terms and only in second Parliament. On wine, reflects Government's response to EC infraction proceedings; on spirits, reflects compensation given for abolition of stock relief, which hit whisky industry particularly hard.

- Standstill for 1987-88 sensible: foolish to give inflation gratuitous upward nudge at very time when pay settlements at last beginning to decelerate.

(xiv) Government showing callous disregard for nation's health: Tobacco standstill likely to lead to consumption only one per cent higher than if duties revalorised (underlying trend still downward); duty remains almost 20 per cent above level in June 1983 in real terms. Real level of duty on beer (drink which causes most health problems) also up on both 1979 and 1983. Action on unleaded petrol shows Government does take good account of health and environment arguments.

(xv) Reduction in basic rate designed to win votes. No. Further supply side measure which improves incentives for vast bulk of taxpayers. Government's objective of 25p basic rate well known. Another step towards it.

(xvi) Government not acting fast enough to reduce income tax: Reducing taxes as fast as prudently possible. Penal top rates reduced; investment income surcharge abolished. Following 1987 Budget, basic tax thresholds up 23 per cent in real terms and basic rate down 6 percentage points since 1979. Government remains committed to basic rate of no more than 25 per cent.

(xvii) Government abandoned plans for tax reform. Government's commitment to tax reform as strong as ever. Already abolished four direct taxes and cut rates of most of remainder. 1987 Budget consolidates corporate tax reform and streamlines corporation tax system. Other countries now following where UK has led.

(xviii) Government's plans for transferable allowances sunk without trace. **[Not for use before Financial Secretary's speech on 18 March:** Response to Green Paper disappointingly thin. Although majority in favour of Government's proposals, insufficient support to take decision now to go ahead with so far-reaching a reform. Nevertheless, Government considers it important both to give women a fair deal and to remove tax penalties on marriage. Will therefore be considering further and also exploring whether there is any satisfactory half-way house.]

WPU

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

(xix) Budget for rich: No.

- Basic rate cut designed to improve incentives for around 95 per cent of taxpayers of working age for whom basic rate is also marginal rate.

- Less than full indexation of higher rate thresholds means eg married man on £100 a week gains proportionately more in income tax reductions than one earning ten times as much.

- Some Budget measures (eg pensions anti-exploitation measures) specifically directed towards those on high incomes abusing present system.

(xx) Unhealthy emphasis on measures to curb tax avoidance: No reason why the many should subsidise the few able to reduce their tax bill through unjustified or unintended loopholes in existing tax law. Important to ensure tax reliefs properly targeted and achieving intended objectives.

(xxi) Opposition fears of balance of payment crisis well founded: Emergence of temporary deficit unsurprising, following £5 billion loss of earnings on oil. But only represents ½ per cent of GDP in 1987, following cumulative current account surplus of some £20 billion between 1979 and 1985. Need to look at UK's total external position: net overseas assets well over £100 billion, yielding annual income of around £4 billion. Deficit has been in market for some time but sterling continues to rise.

(xxii) Rising inflation demonstrates failure of MTFS: No. Under Labour Government, money GDP growth averaged 19 per cent a year but annual output growth only 2 per cent. Since last election money GDP growth averaged about 8 per cent a year and annual output growth about 3 per cent.

(xxiii) Inflation rising again: May edge up over summer. But should be back to 4 per cent by end of year. Short term fluctuations inescapable but remains Government's prime objective to keep inflation on unambiguously downward underlying trend.

(xxiv) Paucity of measures implies imminent election: No implication for election date. Budget contains many important measures. 1987 Finance Bill likely to be similar in length to previous years.

Contact point: Miss M O'Mara (EB) 270 4549

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

ps2/13R

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

16 March 1987

The Rt Hon Sir Keith Joseph, Bt, CH, MP
House of Commons
LONDON
SW1

Dear Keith

Thank you for your letter of 9 March. I am most grateful to you for taking the time to write.

I am sure the "little Neddies" should be harnessed to assist in the very worthwhile project on which you and your group have embarked. Equally, I agree that this in no way prejudices the wider question of the future of NEDC/NEDO.

I am copying this letter to the Prime Minister.

Yours

Nigel

NIGEL LAWSON

PPS Chancellor
12/2

SAM BRITTAN/JOHN KAYE/ALEXANDER CHANCELLOR - COMMENTS ON CHANCELLOR

Transcript from: BBC Radio 4, Today, 17 March 1987 (Peter Hobday)

Well in a few hours time we'll all know what's in that battered red despatch box, hoisted aloft by the Chancellor as he greets the cameras lined up outside No. 11 Downing St. But what about the man himself - Peter Day has been talking to people who know him well or who've studied him closely.

INTERVIEWER: (Peter Day) It's Mr Lawson's fourth Budget. Four Budgets is often the allotted span for a Chancellor in office. By what criteria does one assess a Chancellor - Samuel Brittan, friend of Mr Lawson and influential economic commentator on the Financial Times.

BRITTAN: How far he has stood up to the Prime Minister, how far he has stood up to the prejudices of his own Party and how far he has provided an environment in which the rest of us can get on with our affairs.

INTERVIEWER: Mr Brittan thinks the economy is in fair shape, but to what extent is that due to Mr Lawson?

BRITTAN: Government has much less to do with the performance of the economy than people realise. I think his main contribution has been his handling of a fall in the oil price which has not produced the doom which people who thought Britain was largely an oil economy thought it would bring. And his handling of interest rate and exchange rate policy has been quite subtle. But I don't think, and I don't think he thinks, that Chancellors produce miracles.

INTERVIEWER: Mr Lawson's first Budget in 1984 was hailed as a milestone in tax reform, an aspect of policy closely followed by John Kaye even now that he's moved from the Institute for Fiscal Studies to the London Business School.

KAYE: It's been a disappointing story that this Chancellor started with a commitment to tax reform and to making the tax system better and simpler, stronger than perhaps any of his predecessors, that now 3, 4 Budgets on now nothing much seems to have been achieved. One of the things the first Budget demonstrated is how strong the climate for tax reform actually now is. That by labelling it a reform Budget he managed to get probably the best reception for any Budget for the last 10 years for the 1984 measures.

INTERVIEWER: So why did things petre out after that?

KAYE: There really wasn't a coherent strategy behind it. If things were to go further in 1985 it had to be by bashing pension funds and mortgage interest relief. And you don't have to be very sensitive, either to political or administrative considerations, to know that just wasn't going to happen. And it didn't.

INTERVIEWER: Professor John Kaye. One man with close experience of Mr Lawson in two separate worlds is Alexander Chancellor, formerly Parliamentary commentator for the Daily Mail, now that paper's City editor.

ALEXANDER CHANCELLOR: Nigel Lawson's an interesting man because he used to be actually one of the great wits in the House of Commons some years ago. He's now become rather pedestrian, not to say a little pompous, and so the impact of his Budget depends not so much on the way he puts it over but on the content - which I suppose is fair enough. He is of course a little more lively than Sir Geoffrey Howe - this is not difficult to be.

INTERVIEWER: Broadcasting the Budget has forced the Chancellor to spell things out a little more hasn't it?

ALEXANDER CHANCELLOR: Yes a bit more and therefore I'm afraid it's added to thelength of the Budget speeches, whichare already excessively long. Not long by Gladstonian standards or something like that shall we say. But Budget speeches could always be trimmed I think by about 50%. And Nigel Lawson, if he recalls his dys as a City editor in Fleet St, would have siezed anything written of that sort of length and cut its contents by about half and said it would have greatly improved its readability;.

INTERVIEWER: How does the City rate Mr Lawson as Chancellor?

ALEXANDER CHANCELLOR: I think on balnce the opinion is that he's, really he's not bad at all. I mean in particular his innovations in trying to introduce a share owning democracy are very welcome. Bul there are more stern minded individuals in the City who say that what we ought to have by this stage is inflation at zero and we ought to have interest rates at about 4 1/2 or 5%. There's no reason why it shouldn't be so. The Government has just not been determined enough on the score of getting inflation down and getting interests down.

-----@

RCD

PPS Chancellor
12/V

A; Ai; B; C; Ci
RC; SP; GS; MG; SW; RE;

LAWSON HAPPY WITH STERLING, BACKS LATEST RATE CUT NRHH
BY STEN STOVALL, REUTERS

LONDON, MARCH 18 - CHANCELLOR OF THE EXCHEQUER NIGEL LAWSON SAID HE WAS CONTENT WITH THE CURRENT LEVEL OF STERLING AND WELCOMED TODAY'S ANNOUNCEMENT OF A FURTHER HALF POINT CUT IN BRITISH BANK BASE LENDING RATES TO 10 PCT.

HOWEVER, HE SAID HE WANTED TO SEE A GRADUAL APPROACH TO DECLINES IN DOMESTIC U.K. INTEREST RATES, ALTHOUGH OPTIMISM IN FINANCIAL MARKETS MIGHT PUSH FOR BIG MOVES QUICKLY.

HE TOLD A BRIEFING OF ECONOMIC JOURNALISTS THAT "I DON'T THINK WE SHOULD RUSH ANYTHING." LAWSON STRESSED THE THEMES OF "GRADUALISM AND STEADINESS" AS ECONOMIC POLICY.

18-MAR-1220 MON902 MONE

P

CONTINUED ON - NRHI

REUTER MONITOR 1358

LAWSON HAPPY =2 LONDON NRHI

LAWSON ACKNOWLEDGED THAT TODAY'S FALL IN BASE RATES WAS IN RESPONSE TO HIS BUDGET FOR FISCAL 1987/88, UNVEILED YESTERDAY TO PARLIAMENT, WHICH SET A LOWER TARGET FOR THE KEY PUBLIC SECTOR BORROWING REQUIREMENT (PSBR) OF 1.0 PCT OF GDP.

LAWSON SAID THE TWO SEPARATE HALF POINT CUTS IN BASE RATES THIS MONTH WERE "PERFECTLY CONSISTENT" WITH MONETARY CONDITIONS IN BRITAIN.

HE SUPPORTED THAT BY SAYING THE NARROW MO MONEY SUPPLY AGGREGATE WAS "SAFELY INSIDE" ITS FLUCTUATION BAND OF TWO TO SIX PCT SET FOR BOTH 1986/87 AND 1987/88. IN HIS BUDGET, LAWSON SET NO EXPLICIT TARGET RANGE FOR THE BROADER STERLING M3.

18-MAR-1240 MON922 MONE

CONTINUED FROM - NRHH

P

CONTINUED ON - NRHJ

REUTER MONITOR 1358

LAWSON HAPPY =3 LONDON NRHJ

TURNING TO THE QUESTION OF BRITAIN EVENTUALLY JOINING THE EXCHANGE RATE MECHANISM OF THE EUROPEAN MONETARY SYSTEM (EMS), LAWSON REPEATED THAT "IT IS MOST UNLIKELY WE WILL ENTER BEFORE THE NEXT ELECTION."

HE SAID BRITAIN WAS KEEPING THE SUBJECT OF FULL EMS MEMBERSHIP UNDER CONSTANT REVIEW. BUT HE WOULD NOT INDICATE WHAT THE CHIEF CONSIDERATIONS FOR THIS WERE FOR THE GOVERNMENT.

PRIME MINISTER MARGARET THATCHER LATE LAST YEAR SAID A DECISION ON WHETHER OR NOT TO JOIN DEPENDED ON THE STRENGTH OF THE U.K. ECONOMY. BUT SHE LATER SAID SUCH A MOVE DEPENDED ON OTHER EMS COUNTRIES SCRAPPING RESIDUAL CAPITAL CONTROLS.

18-MAR-1249 MON929 MONE

CONTINUED FROM - NRHI

P

CONTINUED ON - NRHK

REUTER MONITOR 1358

LAWSON HAPPY =4 LONDON

NRHK

ALTHOUGH LAWSON CRITICISED WHAT HE SAID WAS "THE CURRENT WAVE OF ELECTION FEVER" IN BRITAIN, HE ADDED "IT IS MORE LIKELY THAT THERE WILL BE AN ELECTION THIS YEAR" THAN NOT.

HE SAID HE SUPPORTED AN EARLY ELECTION ONLY BECAUSE IT WOULD CLEAR THE AIR. "IDEALLY, WE (THE GOVERNMENT) SHOULD HAVE A FULL TERM," BUT EVENTS COULD FORCE A PREMATURE POLL, LAWSON SAID.

THE GOVERNMENT, WHICH HAS BEEN IN POWER SINCE 1979, MUST CALL AN ELECTION BY JUNE 1988. SPECULATION IS RISING FOR EITHER A JUNE OR AN EARLY AUTUMN ELECTION, POLITICAL SOURCES SAID.

THE DECISION TO CUT BASIC TAX BY ONLY TWO PENCE IN 1987/88 "WAS THE RIGHT BALANCE, ECONOMICALLY AND POLITICALLY," HE SAID.

18-MAR-1302 MON948 MONE

CONTINUED FROM - NRHJ

LAWSON HAPPY =5 LONDON

NRHL

LAWSON'S DECISION TO RESTRICT THE CUT IN THE STANDARD RATE OF TAX TO TWO PENCE SURPRISED MANY ANALYSTS, WHO HAD PREDICTED THAT WITH THE TREASURY'S COFFERS FILLED WITH TAX REVENUE HE MIGHT HAVE CUT BASIC RATE TAX TO 25 PENCE -- HIS LONG-TERM GOAL.

BUT IT WAS BEING PRAISED TODAY BY POLITICAL ANALYSTS AS A SHREWD MOVE WHICH, WHILE ADVANCING TOWARDS THAT AIM, COULD NOT BE SEIZED UPON BY OPPOSITION PARTIES AS AN OVERT BRIBE TO THE ELECTORATE.

LAWSON TOLD JOURNALISTS HE HAD BEEN SURPRISED BY HOW MUCH THE PSBR HAD UNDERSHOT HIS ORIGINAL ASSUMPTION OF 7.1 BILLION STG FOR 1986/87 -- BY SOME THREE BILLION STG.

18-MAR-1318 MON963 MONE

CONTINUED FROM - NRHK

P

CONTINUED ON - NRHM

REUTER MONITOR 1358

LAWSON HAPPY =6 LONDON

NRHM

RETURNING TO CHANGING LEVELS OF INTEREST RATES, LAWSON STRESSED THAT "THEY ARE NOT AN OBJECTIVE (FOR THE GOVERNMENT) - THEY ARE AN INSTRUMENT OF POLICY." CONSEQUENTLY THE TREASURY HAD NO PRECISE TARGET FOR DOMESTIC BORROWING LEVELS, HE SAID.

BUT THERE MAY BE INTEREST RATE CONSEQUENCES FROM CHANGES IN THE LEVEL OF GOVERNMENT BORROWING, HE ADDED.

LAWSON SAID HE DID NOT THINK THAT THE U.K.'S RELATIVELY HIGH LEVEL OF REAL INTEREST RATES HAD HURT INVESTMENT IN BRITAIN.

HE SAID CONDITIONS CREATED BY LONDON'S ROLE AS A LEADING FINANCIAL CENTRE HAD CAUSED STERLING INTEREST RATES TO BE HIGHER IN REAL TERMS THAN IN OTHER COUNTRIES.

18-MAR-1335 MON984 MONE

CONTINUED FROM - NRHL

P

CONTINUED ON - NRIS

REUTER MONITOR 1358

LAWSON HAPPY =7 LONDON

NRIS

THREE FACTORS HAD CAUSED THE HIGHER LEVEL IN RELATIVE INTEREST RATES IN BRITAIN, LAWSON SAID.

FIRST, CONTROL OF CREDIT IN BRITAIN RESTED ON INTEREST RATES ALONE, DUE TO THE FREEDOM OF ITS FINANCIAL MARKETS.

HE SAID THE SECOND REASON WAS POLITICAL UNCERTAINTY CAUSED BY PROPOSED SPENDING PLANS OF THE OPPOSITION LABOUR PARTY.

THIRDLY, HE SAID "WE DO NOT HAVE AS LONG A TRACK RECORD OF LOW INFLATION" AS DID THE U.S., JAPAN AND WEST GERMANY.

LAWSON FORESAW LONDON BECOMING THE WORLD'S PRE-EMINENT FINANCIAL CENTRE, BECAUSE IT WAS MORE INTERNATIONAL IN CHARACTER AND MORE FAVOURABLY PLACED IN TIME ZONES THAN NEW YORK OR TOKYO.

18-MAR-1344 MON001 MONF

CONTINUED FROM - NRHM

P

REUTER

REUTER MONITOR 1358

PPS Chancellor
RS

cc: A; A; ; B
RC; SP; NT; MG; SW; RE; GS

NI5349 5 HHH 200

CAUTIOUS LAWSON'S PATH OF GRADUALISM

CHANCELLOR NIGEL LAWSON TODAY DEFENDED HIS CAUTIOUS APPROACH IN THE BUDGET AND SAID THE WAY FORWARD WAS THROUGH GRADUAL CHANGE.

HE HAD THE CHANCE YESTERDAY TO SLASH INCOME TAX FROM 29P TO 25P BUT OPTED INSTEAD FOR A 2P CUT COMBINED WITH £3 BILLION OFF GOVERNMENT BORROWING.

THAT PAID IMMEDIATE DIVIDENDS TODAY WITH A -1/2PERCENT CUT IN INTEREST RATES AND THE PROSPECT OF MORE TO COME.

IN A BRIEFING TO JOURNALISTS AT 11 DOWNING STREET MR LAWSON REITERATED HIS 25P TARGET FOR INCOME TAX BUT ADDED: ''I THINK THE ECONOMY HAS DIFFICULTY IN ADJUSTING TO ABRUPT CHANGES OF ANY KIND, WHETHER OIL SHOCKS, WAGE SHOCKS OR TAX SHOCKS.''

THE BEST APPROACH WAS ''GRADUALISM'' AND HE CONSIDERED A 2P CUT WAS ''THE RIGHT BALANCE''.

HE WAS ''REASONABLY RELAXED'' ABOUT THE DATE OF A GENERAL ELECTION, ALTHOUGH HIS PERSONAL PREFERENCE WAS FOR A FULL TERM IN GOVERNMENT.

MR LAWSON STRESSED, HOWEVER, THAT HIS BUDGET PACKAGE PROVIDED THE RIGHT POLICITAL AND ECONOMIC BALANCE AND THAT THERE WAS A CASE FOR GOING TO THE COUNTRY EARLY.

''THE PROSPECT OF THIS ABSURD PRE-ELECTION FEVER GOING ON ALL THE TIME THROUGH TO JUNE, 1988, IS PRETTY APPALLING.''

--

181328 MAR 87

RD11.94

PWP

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

18 March 1987

The Editor
Official Report
House of Commons
LONDON
SW1

Dear Sir,

The Chancellor of the Exchequer appreciated the prompt production of the Budget Statement in Hansard. But he has asked me to write to you to draw your attention to a few minor errors in the Hansard text and to ask for them to be corrected for inclusion in the bound volume. The errors are:

(i) Column 815, "THE ECONOMIC BACKGROUND" - full stop after "I start with the economic background."

(ii) Column 815, "THE ECONOMIC BACKGROUND" - "Nineteen Eighty-six" should read "Nineteen eighty-six".

(iii) Column 819 "BUSINESS AND ENTERPRISE" - paragraph 3, lines two and three, "Corporation Tax" should read "corporation tax".

(iv) Column 820, line 47 - "ofr" should read "for".

(v) Column 821, line 44 - "to something" should read "do something".

I should be grateful for confirmation that the bound volume of the Official Report would be amended accordingly. Many thanks for your help.

Yours sincerely,

Andrew Hudson

A P HUDSON

RP

FROM: P J CROPPER
DATE: 18 MARCH 1987

MISS O'MARA

cc P/S Chancellor
P/S Permanent Secretary

BACKBENCH BRIEF

May I thank you and your team for the good tempered way in which you dealt with the questions I raised in the course of preparing the above - at a time when all of you were already at full stretch.

PJC

P J CROPPER

3219/35

RP

FROM: P J CROPPER
DATE: 18 MARCH 1987

MR SCHOLAR

cc P/S Chancellor
P/S Permanent Secretary

BACKBENCH BRIEF

May I thank you and your team for the help you gave me in eliminating gremlins from the above, and ask if you will do me the honour of accepting a copy.

PJC.

P J CROPPER

Debbie - Personal folder.

CONFIDENTIAL

FROM: P J CROPPER
DATE: 18 MARCH 1987

CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr Ross Goobey
Mr Tyrie

BACKBENCH FINANCE COMMITTEE 17 MARCH 1987

Attached is Note of the Meeting of Conservative Backbench Finance Committee held on Tuesday 17 March.

P J CROPPER

3219/34

CONFIDENTIAL

CONSERVATIVE BACKBENCH FINANCE COMMITTEE
TUESDAY 17 MARCH 1987

Chancellor to speak about the Budget. 150 present. There was general approval, and no perceptible criticism.

Terence Higgins said it was absolutely right not to do more than 2p. There was a good balance of tax, spending and borrowing. The Conservatives must not fall into the trap of suggesting Labour would only reverse the cut from 29p to 27p. They would need much more than that.

Tony Beaumont Dark welcomed the prospect of lower interest rates.

Sir John Farr welcomed the end of the Exchange Control Act.

Sir Anthony Grant welcomed a wholly responsible budget. He warned of the dangers of protectionism.

Sir Hugh Rossi wondered why basic rates not thresholds.

Norman St John Stevas felt the budget would be good for business confidence.

Richard Holmes. The racing industry salutes you.

Richard Alexander asked when the old age pension could be increased.

Ian Gow hoped there would continue to be decelerating monetary growth.

Toby Jessel asked what was the answer to those who said imports would flood in.

Sir Peter Hordern asked if a paper could be prepared, putting together the Increases in Public Expenditure and the Results of this Budget.

Nicholas Winterton approved of the Budget.

Patrick Cormack hoped that a lot would be made of PRP during the debates.

Andrew Rowe hoped we would be able in due course to reduce high marginal tax rates on part-time workers.

Sir Geoffrey Johnson Smith was a little perplexed by the treatment of the higher rates.

P J C

18/3/87

TAKEOVER OF DTI

BF PEM Weekend

PERSONAL

From: SIR PETER MIDDLETON

Date: 19 March 1987

Ch
PEM Weekend or Wednesday? AA

Yes

CHANCELLOR

[NB NO COVERING NOTE]

DEPARTMENTAL RESPONSIBILITY FOR FINANCIAL SERVICES

... I attach a note setting out the possible implications of taking over some of the DTI's responsibilities in the financial services area. Insurance is something of a problem, but on the basis of the knowledge we presently possess, I think the line is drawn in the right place. That knowledge is not very detailed however and there could be some obvious fault at an operational level which I have completely failed to spot.

2. Simply taking on these new possibilities would involve an additional burden on senior management in the department. This would just about be manageable, but it would be best if we could shed something. The obvious possibility is the CCTA which would fit quite neatly with a DTI which covered industry (apart from financial services) and technological developments.

3. The time might also be ripe to combine Energy with the DTI. With gas gone and electricity on the way, there is not much case for a separate department. And if financial services come here a combined DTI/DEn should be perfectly manageable.

4. I doubt whether putting science with the DTI is a real starter, and suggesting it might put the Prime Minister off the whole idea. I gather she has said on more than one occasion

that she could not quite face the pure scientists if they were given to feel that their main role was as an adjunct to industry - much though she sympathises with the general idea.

5. Perhaps we could have a word about this on Wednesday.

RB

pp P E MIDDLETON

298/11

MANAGEMENT IN CONFIDENCE

RESTRUCTURING THE REGULATION OF FINANCIAL SERVICES

1. Responsibility within Whitehall for the regulation of financial services is divided between the Treasury (to whom the Bank is answerable) and the DTI. In terms of financial institutions, the Treasury/Bank have regulated those that take deposits while the DTI have regulated those that deal in securities and those offering insurance services. This distinction may have had some logic in the past; it has little today. The breakdown of the functional boundaries within the financial sector, culminating in the Big Bang, has created a new situation. The Treasury/Bank has taken on responsibility for regulating dealers in certain securities (gilt-edged) and are clarifying the locus of responsibility for supervising the wholesale money markets. But with the disappearance of the boundary between banks and securities houses the old division of departmental responsibilities needs a fundamental reassessment.

Securitisation (here or later)

Rationale for Change in Whitehall

2. Whitehall must adjust to the changes taking place in financial markets. The fact that the UK has been ready to modify its regulatory framework to keep pace with these changes has given London and the UK financial services industry generally an edge over its competitors. But, given the pace of change, making the present structure work is going to be hard going. The various regulatory bodies - the Bank, the Building Societies Commission and the SIB and its associated SROs - will have to work very closely together to develop common standards and to avoid unnecessary overlap.

3. Over the past few years, Whitehall departments involved in this area have been preoccupied with legislation. With the passing of the Banking Bill, the main legislative effort should, for the time being, be over. Whitehall's main job for the next few years will be to promote co-ordination between the various domestic regulators - essential if the new framework

is to have a reasonable lease of life - and to secure better international co-operation on supervisory issues. The underlying objective will be to ensure the stability of the financial system at a time when rapid change is creating new and unfamiliar risks.

4. Against this background, the present division of responsibilities between the Treasury and the DTI (see attached table), largely the product of historical accident, is becoming increasingly illogical and untenable. In the past there may have been some sense in separating the regulation of deposit taking from the regulation of dealing in securities, and tying the latter in with company law. But today no regulatory boundary within the financial services sector is likely to make much sense; probably the only tenable distinction for the future will be between financial services on the one hand and commerce and industry on the other.

5. If responsibility for financial markets were concentrated in one department Whitehall would be better placed to co-ordinate the efforts of different domestic regulators, and to play a positive part in promoting international co-operation. It would also be in a better position to monitor the adequacy of the present legislative framework, to fill in the gaps, as and when necessary, and, eventually, to plan for a more integrated system of supervision.

What is posn in other G5 - re US/Germ?

6. The natural locus for this work is the Treasury. In most other countries, the Ministry of Finance has departmental responsibility for regulating securities as well as banking: examples include Japan, Switzerland and France. The Treasury's responsibility for macro-economic and monetary policy means that it is necessarily concerned with the operation and stability of financial markets. For the same reason, the alternative of concentrating supervisory responsibilities in the DTI is likely to lead to duplication of effort, since the Treasury is bound to retain a major interest in the health of the financial system, whatever the formal position. And in practice the Bank will have a major role to play in co-ordinating the

efforts of different domestic regulators over the next few years. It would be wasteful of time and resources for the Bank to try and duplicate with the DTI the sort of relationship it has with the Treasury.

Practicalities/Resources

7. The attached organisation chart shows the present structure at DTI. We would envisage transferring work currently done in DTI by the Financial Services Division (one Under Secretary and four Assistant Secretaries - though this may reduce anyhow as the Financial Services Act is implemented), and the Insurance Division (one Under Secretary and four Assistant Secretaries - plus a large HEO/EO complement and corresponding caseload). It is difficult to see how insurance can be separated off from other financial firms. (The DTI's present responsibilities for the direct regulation of the insurance business is unaffected by the Financial Services Act; EC directives may constrain the extent to which this responsibility can be delegated to eg the SIB.)

8. We see no case for transferring the Companies Division, or the work of Companies House, much of which is to do with non-financial companies. Decisions about Companies Act investigations would therefore stay with the Secretary of State. It would be for consideration whether decisions about comparable investigations into financial firms, under the Financial Services Act, should be transferred to the Chancellor.

9. As far as the Treasury is concerned, this work would probably require an extra Deputy Secretary, and at least one additional Under Secretary, and maybe two, depending on how far the amalgamation of DTI Financial Services Division and the Treasury Financial Institutions and Markets Division allowed staff savings. It would also involve the Treasury in executive type work that it has hitherto avoided and bring with it responsibility for troublesome areas such as Lloyd's. All this would radically change the character of its role in supervision, but for the reasons given above the benefits of such a change should outweigh the costs.

1315/31

REGULATION OF FINANCIAL SERVICES: DEPARTMENTAL RESPONSIBILITY

Sector	Regulator	Legislation	Sponsor Dept
Banks	Bank of England	Banking Act	HMT
Gilt edged market	Bank of England (delegated from SIB)	Financial Services Act	HMT
Wholesale money and foreign exchange market	Bank of England	Non-statutory*	HMT
Building Societies	Building Societies Commission	Building Societies Act	HMT
Friendly Societies	Registry of Friendly Societies	Friendly Societies Act	HMT
Securities (Stock Exchange; licensed dealers; unit trusts etc)	SIB/SRO's	Financial Services Act	DTI
Insurance			
- gen insurance business	DTI	Insurance Companies Act	DTI
<u>Others</u>			
- Lloyd's	Lloyd's	Lloyd's Act	DTI
- Takeovers	Takeover Panel	Non-statutory* (Companies Act/ Financial Services Act)	DTI

* may require legislation in time.

DEPARTMENT OF TRADE AND INDUSTRY - LINE ORGANISATION

To replace Department of Trade and Industry Organisation Chart Revised 2/86

This chart is not intended to show the relative status of posts

The Rt Hon Paul Channon MP Secretary of State

- The Rt Hon Alan Clark MP Minister for Trade
- Geoffrey Pattie MP Minister of State for Industry and Information Technology
- Giles Shaw MP Minister of State for Industry
- Michael Howard QC MP Parliamentary Under Secretary of State for Corporate and Consumer Affairs
- John Butcher MP Parliamentary Under Secretary of State for Industry
- Lord Lucas of Chilworth Parliamentary Under Secretary of State for Trade and Industry

Sir Brian Hayes Permanent Secretary

D M Dell	Regional Organisation	RO	
	Investment and Development	ID	F R Mingay
	Industrial Financial Appraisal	IFA	J A Knox
		IDU	P Mason A Bray J Bellamy
	Quality Design and Education	QDE	Mrs P A Denham
A J P Macdonald	Air	Air	M J Michell
	Electronics Applications	LA	J H Major
	Information Technology	IT	W B Willott
	Telecommunications and Posts	TP	R J Priddle
	Radiocommunications	RR	A J Nieduszynski
B W Oakley	Alvey Directorate	AD	
R Gibson	British National Space Centre	BNSC	J C Leeming
D Roith Chief Scientist and Engineer	Patent Office	Pats	P J Cooper
	Research and Technology Policy	RTP	A Williams
R Mountfield	Chemicals, Textiles, Paper, Timber, Miscellaneous Manufacturing and Service Industries	CTPS	P M S Corley
	Minerals and Metals	MM	B Murray
	Shipbuilding and Electrical Engineering	SEE	D R C Durie
	Vehicles	V	M J A Cochlin
	Mechanical Engineering and Manufacturing Technology	MMT	J L Cammell
H H Liesner	General Policy	GP	S W Treadgold
J Caines	Financial Services	FS	B J G Hilton
	Companies	C	A A Duguid
	Consumer Affairs	CA	C Newton
	Insurance	I	T Muir
	Insolvency Service	InsS	M Clark
C W Roberts Chief Executive BOTB (Mr Roberts reports to Sir James Cleminson on operational matters and to Sir Brian Hayes on managerial matters)	Projects and Export Policy; Overseas Trade 1	OT1(PEP)	C B Benjamin
	Overseas Trade 2	OT2	A C Hutton
	Overseas Trade 3	OT3	A J Hunter
	Overseas Trade 4	OT4	A R Titchener
R Williams	European Commercial and Industrial Policy	ECIP	J F Mogg
	International Trade Policy	ITP	A J Lane

British Overseas Trade Board Chairman Sir James Cleminson

Insolvency Service: Official Receivers' Offices

Regional Organisation -

N East	R W Simpson wef 1.1.86
N West	M Baker
Yorks & H'Side	E Wright
E Midlands	K J Green
W Midlands	A J Pryor
S West	D B Lodge
S Eastern	A Beaumont

Industrial Research Establishments

- National Physical Laboratory Dr P Dean
- National Engineering Laboratory Dr D A Bell
- Warren Spring Laboratory Dr J S S Reay
- Laboratory of the Government Chemist Dr R F Coleman

National Weights and Measures

- Laboratory Dr P B Clapham

Revised 11/86

- Mr Dell has overall responsibility for the management of all Regional Offices. They report to him directly on industry matters, to the Department of Energy on energy matters and to Mr Roberts on export and BOTB matters.

55:1

pmp

FROM: MISS M O'MARA
DATE: 23 MARCH 1987

MR TYRIE 15/3/2

cc Mr Culpin
Mr C W Kelly
Mr Hudson
Mr Pickering
GH/01

MR RIFKIND'S REACTION TO THE BUDGET

As I think you noticed during the Chancellor's meeting on First Order Questions this morning, the attached press release from Mr Rifkind, issued on 17 March, referred to "the expected fall in interest rates" and the "likely falls in interest rates and mortgage rates" as ways in which Scotland would benefit from the Budget!

2. As far as I am aware, this press release was cleared with no one in the Treasury. We certainly did not see it in EB. Should someone speak to the Scottish Office, pointing out the danger of such remarks and asking them to ensure that in future all such material is cleared with us in advance? I am not sure whether this would come better on the special adviser net or at Private Office level.

MOM

MISS M O'MARA

- Not very professional of the S. Office.
- I think this should be done through the private office net. It is an 'official' not 'political' matter.
- I also think the Chancellor should be made aware of this.

AGT. 23.iii.

cc. PS/CX
Miss O'Mara
Mr Culpin
Mr Hudson
Mr Pickering.

X

Alex

For what it's worth, I agree with X, unless Mr Rifkind's release was wished on him by a Spec. Adviser, in which case we want to go in at both levels.

AH

32/80

Scottish Information Office, New St. Andrew's House, Edinburgh

PA PA file

Telephone: 031 244 1111

0379/87

ISSUED BY TELEX 17.3.87

SECRETARY OF STATE WELCOMES BUDGET MEASURES FOR SCOTLAND

The Rt Hon Malcolm Rifkind QC MP, Secretary of State for Scotland, has commented on the effect of the Budget for Scotland.

He said: "This excellent budget is particularly good for Scotland.

"For the North Sea oil industry it is especially good news. Together with the early repayment of advance petroleum revenue tax announced last autumn today's tax reliefs will stimulate new activity in the North Sea and will help safeguard existing jobs and create new ones. I am glad that the Chancellor has been able to respond positively to the representations made to him by Alick Buchanan-Smith and myself.

"The VAT concessions for small businesses will provide a welcome boost to the continued development of this important sector which is vital to Scotland's economic progress and future employment prospects.

"I am delighted that once again the Chancellor has recognised the importance to Scotland of the whisky industry by not increasing excise duty.

"Scots in rural areas will especially welcome the decision not to increase road tax or petrol duty.

"This budget demonstrates the success of the Government's strategy of sustained economic growth and low inflation.

"The expected fall in interest rates as a result of this budget will benefit industry in Scotland as elsewhere in the United Kingdom and will have a particularly beneficial effect on farmers. There is also likely to be a fall in mortgage rates which will be good news for Scotland's increasing numbers of home buyers.

"This year we have already had £4.5 billion extra spending announced on health, education, housing and other areas of public expenditure. Now we have substantial reductions for Scotland's taxpayers, help for the North Sea oil industry and for Scotch whisky as well as likely falls in interest rates and mortgage rates. All in all the best budget that Scotland and Great Britain has seen for years."

Alistair McNeill: 031 244 4955
March 18, 1987

3

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 4887
GTN 215)
(Switchboard) 01-215 7877

C/content with press ~~briefing~~ notice? CR 23/3

OK

Prup

Mr A Allan
Principal Private Secretary
Chancellor of the Exchequer
H M Treasury
Parliament Street
LONDON
SW1 3AG

23 March 1987

I am attaching a copy of the draft Press Notice on the Current Account. of the United Kingdom Balance of Payments in February. The draft was agreed earlier today at the usual interdepartmental meeting.

Publication is set for Thursday 26 March at 11.30 am and I should be grateful if you would arrange for the Notice to be cleared by 12.00 noon Wednesday 25 March and to inform me accordingly.

A copy of this letter and draft Press Notice is being sent to Sir Peter Middleton and Mr King, H M Treasury.

Yours sincerely

pp W E BOYD

Ch
Looks like Ford / GM effect may be quite strong:
Passenger Motor Cars: % volume changes 3mnth/3mnth
Imports -20%
Exports +16%

good news

AA

REVISED DRAFT

COPY 3
No. (19)

SECRET AND PERSONAL until release of press notice
on 26/3/87 at 11.30 am

THE CURRENT ACCOUNT OF THE UNITED KINGDOM

BALANCE OF PAYMENTS

FEBRUARY 1987

The current account for February, seasonally adjusted, is estimated to have been in surplus by £376 million compared with a surplus of £73 million in January. In February, exports - seasonally adjusted on a balance of payments basis - were valued at £6933 million and imports at £7157 million so that trade in goods was in deficit by £224 million.

The balance on invisibles is projected to be in surplus by £600 million, a large surplus on the transactions of the private sector and public corporation being partly offset by a deficit on Government transactions.

DECEMBER TO FEBRUARY 1987

In the three months ended February 1987, the current account showed a surplus of £0.2 billion compared with a deficit of £0.7 billion in the previous three months. There was a deficit on visible trade of £1.6 billion in the latest three months compared with a deficit of £2.5 billion in the three months ended November. The surplus on invisibles in the latest three months is projected at £1.8 billion.

CURRENT ACCOUNT

TABLE 1 — **£ million, Seasonally adjusted**

	Current Balance	Visible Trade: Balance	Visible Trade: Exports fob	Visible Trade: Imports fob	Invisibles Balance b
1985	+ 2946	-2178	78111	80289	+ 5124
1986	- 1099	-8253	72843	81096	+ 7154
1985 Q4	+ 613	- 171	19135	19306	+ 784
1986 Q1	+ 602	-1227	18164	19391	+ 1909
Q2	- 94	-1551	17786	19337	+ 1457
Q3	- 931	-2873	17553	20426	+ 1942
Q4	- 756	-2602	19340	21942	+ 1846
1986 Sept	- 184	- 831	6103	6934	+ 647
Oct	- 100	- 715	6294	7009	+ 615
Nov	- 384	-1000	6569	7569	+ 616
Dec	- 272	- 887	6477	7364	+ 615
1987 Jan	+ 73 a	- 527	6204	6731	+ 600 a
Feb	+ 376 a	- 224	6933	7157	+ 600 a
Sept-Nov 1986	- 668	- 2546	18967	21512	+ 1878
Dec-Feb 1987	+ 178 a	- 1637	19615	21251	+ 1815 a
Jan-Feb 1987	+ 450 a	- 750	13137	13888	+ 1200 a

a Invisibles for January and February 1987 are projections.

b Monthly figures are one third of the appropriate calendar quarter's estimate or projection. Information relating to credits and debits can be found in Table 3.

SECRET and personal
until release of press notice on 26 MAR 87 at 11.30 a.m.

SECRET AND PERSONAL until release of press notice on 26/3/87 at 11.30 am

VISIBLE TRADE IN FEBRUARY 1987

There was a deficit on visible trade in February of £224 million compared with a deficit of £527 million in January. At £326 million the surplus on oil was £46 million less than in January while the deficit on non-oil trade was reduced by £349 million.

At £6933 million, exports in February were £729 million (12 per cent) higher than in January. It now seems clear that the exceptional weather conditions in January reduced the value of exports for that month and there has been an element of catching up in the February figures. Exports of oil were little changed; exports of the erratic items increased by £47 million. Excluding oil and the erratic items, exports increased by 13 per cent between January and February.

Total imports were valued at £7157 million in February which was £426 million (6½ per cent) higher than in January. Although this represents a recovery from the low January level, the strength of that recovery was by no means as great as for exports. It is possible that there is still some catching up from the bad weather to come but it seems more likely that the value of imports has fallen somewhat from the high levels at the end of last year. Higher imports of oil and of the erratic items together accounted for about £100 million of the rise in February. Excluding these, imports were 5½ per cent higher than in January.

B

SECRET AND PERSONAL until release of press notice on 26/3/87 at 11.30 am

RECENT TRENDS

Visible balance

In the three months ended February 1987 there was a deficit on visible trade of £1.6 billion - a surplus on trade in oil of £1.0 billion offset by a deficit on non-oil trade of £2.6 billion. Between the three months ended November 1986 and the latest three months the visible trade balance improved by £0.9 billion - the surplus on oil increased by £0.1 billion and the deficit on non-oil trade was reduced by £0.8 billion.

Exports

Exports amounted to £19.6 billion in the three months ended February, £0.6 billion (3½ per cent) more than in the previous three months. Exports of oil increased by £0.3 billion between the two periods while exports of the erratic items fell by £0.1 billion. Excluding oil and the erratic items, exports were up 2½ per cent in the latest three months.

By volume, exports grew by 2 per cent in the latest three months to a level 10 per cent higher than in the same three months a year ago. Excluding oil and the erratic items exports grew by 2 per cent in the latest three months. The growth in the underlying level of export volume appears to have continued into February.

Imports

Total imports were valued at £21.3 billion in the three months ended February, £0.3 billion (1 per cent) less than in the previous three months. Imports of oil increased by £0.2 billion between

SECRET AND PERSONAL until release of press notice on 26/3/87 at 11.30 am

the two periods while imports of the erratic items fell by £0.2 billion. Excluding oil and the erratic items imports fell by 1 per cent in the latest three months.

By volume, imports fell by 3 per cent in the latest three months but were 11 per cent higher than in the same period a year ago. Excluding oil and the erratic items, import volume fell by 2½ per cent in the latest three months. The latest figures suggest that the underlying level of non-oil import volume may have stabilized in recent months.

Terms of trade and unit values

The terms of trade index fell by 2 per cent between the three months ended November and the latest three months with the export unit value index rising by 2 per cent and the import unit value index rising by 4 per cent. Compared with the same period a year ago the export unit value index was unchanged while the import unit value index increased by 2 per cent. As a result the terms of trade index is now 2 per cent lower than a year ago.

Export unit values for fuels increased by 13 per cent between the three months ended November and the latest three months while the unit value index for non-oil exports increased by 1½ per cent. Within the total for non-oil exports the unit values for manufactures also increased by 1½ per cent.

The import unit value index for fuels increased by $9\frac{1}{2}$ per cent in the latest three months while the index for non-oil imports rose by 3 per cent. Import unit values for semi-manufactures were up by $2\frac{1}{2}$ per cent and those for finished manufactures were up by 3 per cent.

Analysis by area

Exports to the developed countries increased by 5 per cent between the three months ended November and the latest three months; largely due to a 21 per cent increase in deliveries to North America. Exports to Western Europe rose by 1 per cent and exports to the other developed countries grew by $2\frac{1}{2}$ per cent. Exports to the developing countries were down 2 per cent over the latest three months.

Imports from the developed countries were down 3 per cent in the latest three months, spread fairly evenly across the major area groupings. Imports from the developing countries fell by $2\frac{1}{2}$ per cent; a 20 per cent increase in arrivals from the oil exporting countries being offset by a $6\frac{1}{2}$ per cent fall elsewhere.

NOTES TO EDITORS

REVISIONS

1 Estimates of visible trade are derived from a continuous and comprehensive coverage of Customs documents. Revisions to the basic data are infrequent and usually small. Larger revisions, particularly relating to recent periods, occur in the annual review of seasonal adjustment calculations which takes effect in the press notice covering the January figures.

2 Estimates of the invisibles account are based on quarterly and annual inquiries addressed to a sample of those engaging in the relevant transactions. In some parts of the account the information available is incomplete and subject to significant errors of estimation. Monthly figures of the invisibles balance are quarterly estimates and projections, expressed at a monthly rate. For the most recent months, the figures are projections - rounded to the nearest £100 million to emphasise their likely margins of error - which are superseded by figures from the quarterly balance of payments estimates published in early March, June, September and December. If there is strong evidence from early quarterly information that the first quarterly estimates will differ substantially from the latest published projections, a revised set of projections is included in the monthly press notice prior to the issue of the quarterly estimates. A short article on estimates and projections of the monthly invisible balance was published in the December issue of Economic Trends. This article is reproduced in the standard notes(see paragraph 4 below).

MONTHLY REVIEW OF EXTERNAL TRADE STATISTICS

3 The Monthly Review supplements the information contained in this Press Notice. It gives longer historical runs of data and contains charts, tables on the UK Balance of Payments, UK exports and imports on an Overseas Trade Statistics basis, and certain international comparisons. The Monthly Review is available from the Department of Trade and Industry at the address given below for an annual subscription of £38 which includes the annual supplement. Individual copies are priced at £3, (£6 for the annual supplement).

STANDARD NOTES

4 The standard notes describe the differences between the Balance of Payments (BOP) and the Overseas Trade Statistics (OTS) basis of compilation. Copies can be obtained from the address below.

AREA (tables 11 and 15)

5 Low value consignments ie items of an individual value less than £475, are not analysed by country and are therefore excluded from the area data in tables 11 and 15.

6 In addition the method of seasonal adjustment leads to further differences between the sum of areas and figures for total trade.

Enquiries about the Standard Notes, and the Monthly Review, should be addressed to S2A, Room 255, Department of Trade and Industry, 1 Victoria Street, London SW1H OET, Telephone: 01-215 4895.

INDEX OF TABLES

Table 2

CURRENT BALANCE, VISIBLE TRADE AND INVISIBLES
(Balance of Payments basis)

£ million seasonally adjusted

		Current Balance	Visible Trade: Exports fob	Imports fob	Visible Balance	of which Oil	of which Non-Oil	Invisible Balance[b]
1985		+ 2946	78111	80289	- 2178	+ 8104	- 10282	+ 5124
1986		- 1099	72843	81096	- 8253	+ 4153	- 12407	+ 7154
1985	Q4	+ 613	19135	19306	- 171	+ 1984	- 2155	+ 784
1986	Q1	+ 682	18164	19391	- 1227	+ 1889	- 3116	+ 1909
	Q2	- 94	17786	19337	- 1551	+ 772	- 2324	+ 1457
	Q3	- 931	17553	20426	- 2873	+ 646	- 3519	+ 1942
	Q4	- 756	19340	21942	- 2602	+ 846	- 3447	+ 1846
1986	June	- 126	5867	6478	- 612	+ 237	- 849	+ 486
	July	- 12	5970	6629	- 659	+ 230	- 889	+ 647
	Aug	- 735	5480	6863	- 1383	+ 159	- 1542	+ 648
	Sept	- 184	6103	6934	- 831	+ 258	- 1088	+ 647
	Oct	- 100	6294	7009	- 715	+ 226	- 941	+ 615
	Nov	- 384	6569	7569	- 1000	+ 354	- 1354	+ 616
	Dec	- 272	6477	7364	- 887	+ 266	- 1153	+ 615
1987	Jan	+ 73 a	6204	6731	- 527	+ 371	- 898	+ 600 a
	Feb	+ 376 a	6933	7157	- 224	+ 326	- 549	+ 600 a
Dec-Feb 1986		+ 1654	18814	18951	- 137	+ 2051	- 2188	+ 1791
Sept-Nov 1986		- 668	18967	21512	- 2546	+ 837	- 3383	+ 1878
Dec-Feb 1987		+ 178 a	19615	21251	- 1637	+ 963	- 2600	+ 1815 a
% Change								
Latest 3 months on previous 3 months			+ 3½	- 1				
Same 3 months one year ago			+ 4½	+ 12				

a Invisibles for January and February 1987 are projections.

b Monthly figures are one third of the appropriate calendar quarter's estimate or projection.

Table 3

INVISIBLES

£ million seasonally adjusted

		All Sectors: Credits	Debits	Balance	of which: Services	Interest Profits Dividends	Transfers	Private Sector and Public Corporations[d]: Credits	Debits	Balance
1983		65225	61255	+ 3970	+ 3654	+ 2420	- 2104	60600	52903	+ 7697
1984		76872	71206	+ 5666	+ 3837	+ 4145	- 2316	71994	62108	+ 9886
1985		80167	75043	+ 5124	+ 5708	+ 2937	- 3521	75799	64910	+10889
1986		75880	68726	+ 7154	+ 5319	+ 4256	- 2421	71063	59049	+12014
1985	Q1	21657	20574	+ 1083	+ 1174	+ 931	- 1022	20487	17842	+ 2645
	Q2	20228	18714	+ 1514	+ 1565	+ 708	- 759	19267	16451	+ 2816
	Q3	19383	17640	+ 1743	+ 1555	+ 1121	- 933	18216	14951	+ 3265
	Q4	18899	18115	+ 784	+ 1414	+ 177	- 807	17829	15666	+ 2163
1986	Q1	18921	17012	+ 1909	+ 1210	+ 804	- 105	17634	14976	+ 2658
	Q2	18356	16899	+ 1457	+ 1197	+ 880	- 620	17129	14467	+ 2662
	Q3	19212	17270	+ 1942	+ 1432	+ 1330	- 820	17980	14624	+ 3356
	Q4	19391	17545	+ 1846	+ 1480	+ 1242	- 876	18320	14982	+ 3338

d ie excluding general Government transactions and all transfers.

SECRET and personal
until release of press notice on 26 MAR 87 at 11.30 a.m.

EXPORT AND IMPORT UNIT VALUE AND VOLUME INDEX NUMBERS

(Balance of Payments basis)

Table 4

Indices 1980 = 100

		Unit Value (Not seasonally adjusted)			Volume (seasonally adjusted)	
		Exports	Imports	Terms of Trade[e]	Exports	Imports
1985		143.5	145.2	98.8	118.7	126.0
1986		136.6	134.0	101.9	123.1	133.9
1985	Q4	140.5	138.2	101.6	119.6	128.0
1986	Q1	139.0	137.6	101.0	117.5	124.9
	Q2	134.8	131.5	102.6	121.9	128.8
	Q3	134.3	130.2	103.1	122.6	138.5
	Q4	138.1	137.0	100.8	130.5	143.4
1986	June	134.9	130.1	103.7	121.6	131.2
	July	133.3	129.0	103.4	125.7	136.2
	Aug	134.3	129.4	103.8	115.9	139.9
	Sept	135.3	132.2	102.3	126.2	139.3
	Oct	137.6	135.6	101.5	127.0	139.6
	Nov	138.1	136.8	100.9	132.8	146.7
	Dec	138.7	138.5	100.1	131.6	143.9
1987	Jan	140.4	140.1	100.2	125.0	130.9
	Feb	140.8	143.2	98.4	137.8	137.5
Dec-Feb 1986		140.0	138.1	101.4	119.4	123.9
Sept-Nov 1986		137.0	134.9	101.6	128.6	141.8
Dec-Feb 1987		139.9	140.6	99.6	131.5	137.5
% Change						
Latest 3 months on						
- previous 3 months		+ 2	+ 4	- 2	+ 2	- 3
- same 3 months one year ago		-	+ 2	- 2	+ 10	+ 11

e Export unit value index as a percentage of the import unit value index.

VALUE AND VOLUME OF EXPORTS AND IMPORTS EXCLUDING THE MORE ERRATIC ITEMS[f]

(Balance of Payments basis)

Table 5

seasonally adjusted

		Value £ million fob		Volume Index 1980 = 100	
		Exports	Imports	Exports	Imports
1985		73819	76749	123.1	133.7
1986		67459	77528	126.0	142.4
1985	Q4	17940	18665	123.2	137.1
1986	Q1	17094	18484	121.6	132.1
	Q2	16238	18440	123.0	136.8
	Q3	16367	19550	126.5	147.2
	Q4	17759	21054	133.0	153.3
1986	June	5390	6223	122.3	140.0
	July	5522	6388	128.8	146.1
	Aug	5246	6615	121.9	149.4
	Sept	5600	6547	128.8	146.2
	Oct	5826	6700	130.2	148.5
	Nov	5997	7254	134.9	156.6
	Dec	5936	7100	133.9	154.7
1987	Jan	5758	6470	129.3	140.2
	Feb	6441	6867	141.0	147.0
Dec-Feb 1986		17705	18213	123.4	132.0
Sept-Nov 1986		17423	20501	131.3	150.4
Dec-Feb 1987		18135	20437	134.7	147.3
% Change					
Latest 3 month on					
- previous 3 months		+ 4	- ½	+ 2½	- 2
- same 3 months one year ago		+ 2½	+ 12	+ 9	+ 12

f These are defined as ships, North Sea installations, aircraft, precious stones, and silver.

SECRET and personal until release of press notice on 26 MAR 87 at 11.30 a.m.

TRADE IN OIL[9]
(Balance of Payments basis)

seasonally adjusted

	Balance of Trade in oil	Exports of Oil					Imports of Oil				
		Total	Crude Oil [SITC (REV 2) 333.0]			Rest of Division 33	Total	Crude Oil [SITC (REV 2) 333.0]			Rest of Division 33
..	£ million fob	£ million fob	£ million fob	million tonnes	Avg value per tonne £ fob	£ million fob	£ million fob	£ million fob	million tonnes	Avg value per tonne £ fob	£ million fob
1985	+ 8104	16134	13006	79.6	163.4	3128	8029	4234	26.9	157.6	3796
1986	+ 4153	8221	6294	82.1	76.7	1927	4068	2321	33.7	68.9	1747
1985 Q4	+ 1984	3687	2984	20.4	146.0	703	1703	1061	7.4	143.7	642
1986 Q1	+ 1889	3024	2429	22.2	109.3	594	1134	722	6.7	107.1	412
Q2	+ 772	1783	1211	18.6	65.1	572	1011	550	7.7	71.7	461
Q3	+ 646	1529	1120	19.7	57.0	408	882	432	9.7	44.4	450
Q4	+ 846	1886	1533	21.6	71.0	353	1041	617	9.6	64.5	424
1986 June	+ 237	530	367	5.6	65.3	164	293	146	2.5	59.3	147
July	+ 230	554	396	6.9	57.7	158	324	182	4.2	43.8	143
Aug	+ 159	440	330	6.4	51.9	111	282	140	3.3	42.4	142
Sept	+ 258	534	394	6.4	61.2	140	276	111	2.3	48.3	166
Oct	+ 226	629	511	7.2	71.4	118	403	201	3.2	63.5	202
Nov	+ 354	632	528	7.5	70.6	104	279	178	2.8	62.8	101
Dec	+ 266	625	494	7.0	71.0	132	359	239	3.6	66.8	121
1987 Jan	+ 371	723	599	7.4	81.1	124	352	212	2.8	75.8	140
Feb	+ 326	751	599	7.1	84.2	151	425	241	3.0	81.2	184
Dec-Feb 1986	+ 2051	3523	2864	22.4	127.7	659	1472	1003	7.8	128.8	468
Sep-Nov 1986	+ 837	1795	1434	21.1	68.0	362	958	489	8.3	59.0	469
Dec-Feb 1987	+ 963	2099	1692	21.5	78.9	407	1136	691	9.3	74.1	444
% Change Latest 3 months on											
- previous 3 months		+ 17	+ 18	+ 2	+ 16	+ 13	+ 19	+ 41	+ 13	+ 25	- 5
- same 3 months one year ago		- 40	- 41	- 4½	- 38	- 38	- 23	- 31	+ 20	- 42	- 5

[9] Trade in petroleum and petroleum products. These figures differ from those published by the Department of Energy which are on a time of shipment basis (see paragraph 8 of the standard notes).

SECRET and personal
until release of press notice on 26 MAR 87 at 11.30 a.m.

TRADE IN GOODS OTHER THAN OIL

(Balance of Payments basis)

	Total								Excluding Erratics[f]			
	Value, £ million, fob (seasonally adjusted)			Unit value index 1980 = 100 (not seasonally adjusted)			Volume index 1980 = 100 (seasonally adjusted)		Value, £ million fob (seasonally adjusted)		Volume index 1980 = 100 (seasonally adjusted)	
. .	Balance of non oil trade	Exports	Imports	Exports	Imports	Terms of Trade[e]	Exports	Imports	Exports	Imports	Exports	Imports
1985	- 10282	61977	72259	141.8	141.8	100.0	110.6	133.0	57685	68719	114.9	142.8
1986	- 12407	64621	77028	145.1	141.5	102.6	115.2	140.5	59238	73460	117.7	151.1
1985 Q4	- 2155	15448	17604	140.6	136.4	103.1	111.4	135.3	14253	16963	114.6	146.8
1986 Q1	- 3116	15140	18257	143.0	140.0	102.1	108.2	133.8	14071	17350	111.9	143.3
Q2	- 2324	16003	18326	144.2	139.0	103.7	114.7	135.1	14455	17429	115.1	145.2
Q3	- 3519	16024	19544	145.3	140.5	103.4	114.7	143.5	14839	18668	118.5	154.3
Q4	- 3447	17454	20901	148.1	146.4	101.2	123.1	149.5	15873	20013	125.3	161.7
1986 June	- 849	5336	6185	144.8	138.8	104.3	116.2	137.8	4860	5930	116.6	148.8
July	- 889	5416	6305	144.0	139.3	103.3	116.5	139.0	4968	6064	119.2	150.7
Aug	- 1542	5040	6581	145.9	140.1	104.2	108.5	145.0	4805	6334	114.8	156.5
Sept	- 1088	5569	6658	145.9	142.0	102.7	119.1	146.6	5065	6271	121.4	155.6
Oct	- 941	5665	6607	147.5	145.0	101.7	119.2	142.2	5197	6298	122.1	153.0
Nov	- 1354	5937	7291	148.1	146.4	101.2	125.5	156.1	5365	6975	127.3	168.7
Dec	- 1153	5852	7004	148.6	147.7	100.6	124.6	150.2	5311	6741	126.5	163.4
1987 Jan	- 898	5481	6379	149.5	148.4	100.7	114.6	136.5	5035	6118	118.5	148.0
Feb	- 549	6183	6732	149.5	151.3	98.8	131.0	142.2	5690	6442	134.0	153.8
Dec-Feb 1986	- 2188	15291	17479	141.8	138.1	102.7	109.7	131.3	14182	16742	113.4	141.6
Sep-Nov 1986	- 3383	17171	20555	147.2	144.5	101.9	121.3	148.3	15628	19543	123.6	159.1
Dec-Feb 1987	- 2600	17516	20116	149.2	149.2	100.0	123.4	143.0	16036	19301	126.3	155.1
% Change Latest 3 months on												
- previous 3 months		+ 2	- 2	+ 1½	+ 3	- 2	+ 1½	- 3½	+ 2½	- 1	+ 2	- 2½
- same 3 months one year ago		+ 15	+ 15	+ 5	+ 8	- 2½	+ 12	+ 9	+ 13	+ 15	+ 11	+ 9½

f These are defined as ships, North Sea installations, aircraft, precious stones, and silver.

e Export unit value index as a percentage of the import unit value index.

SECRET and personal until release of press notice on 26 MAR 87 at 11.30 a.m.

EXPORTS BY COMMODITY
(Overseas Trade Statistics basis)

Table 8

£ million, fob, seasonally adjusted

	Total	Food beverages and tobacco	Basic Materials	Fuels	Total Manufactures	Manufactures excluding erratics[h]								
							Semi-manufactures excluding precious stones & silver(PS)			Finished manufactures excluding ships, North Sea installations and aircraft (SNA)				
						Total	Total	Chemicals	Other	Total	Passenger Motor Cars	Other Consumer	Intermediate	Capital
SITC (REV 2)	0-9	0+1	2+4	3	5-8	5-8 less SNAPS	5+6 less PS	5	6 less PS	7+8 less SNA	j	j	j	j
1985	78392	4971	2128	16795	52506	48473	18458	9412	9046	30015	1343	5257	13475	9940
1986	73009	5478	2046	8683	54595	49697	18758	9692	9066	30939	1362	5712	13682	10183
1985 Q4	19225	1202	501	3862	13125	11994	4501	2327	2174	7493	322	1309	3398	2463
1986 Q1	18198	1228	500	3177	12799	11838	4427	2289	2137	7412	299	1317	3343	2453
Q2	17832	1284	443	1922	13644	12214	4607	2394	2213	7607	340	1391	3353	2523
Q3	17632	1394	542	1614	13582	12506	4800	2470	2330	7706	362	1470	3407	2467
Q4	19347	1571	561	1970	14570	13139	4924	2539	2386	8215	361	1534	3579	2740
1986 Dec	6518	488	197	653	4943	4414	1608	816	791	2806	129	511	1215	952
1987 Jan	6238	455	216	760	4615	4194	1508	761	746	2686	161	513	1115	897
Feb	6955	486	225	781	5125	4674	1738	901	836	2936	133	616	1235	953
Sept-Nov	18944	1583	552	1882	14325	12968	4976	2567	2408	7993	353	1519	3505	2616
Dec-Feb	19711	1429	638	2194	14683	13282	4853	2479	2374	8429	423	1639	3565	2802
* % change	+ 4	- 9½	+ 16	+ 17	+ 2½	+ 2½	- 2½	- 3½	- 1½	+ 5½	+ 20	+ 8	+ 1½	+ 7

h These are defined as ships, North Sea installations (together comprising SITC (REV 2) 793), aircraft (792) precious stones (667), and silver (681.1).

j Based on the United Nations Broad Economic Categories end-use classification.

EXPORTS BY COMMODITY: VOLUME INDICES
(Overseas Trade Statistics basis)

Table 9

INDICES 1980 = 100, seasonally adjusted

	Total	Food beverages and tobacco	Basic Materials	Fuels	Total Manufactures	Manufactures excluding erratics[h]								
							Semi-manufactures excluding precious stones & silver(PS)			Finished manufactures excluding ships, North Sea installations and aircraft (SNA)				
						Total	Total	Chemicals	Other	Total	Passenger Motor Cars	Other Consumer	Intermediate	Capital
SITC (REV 2)	0-9	0+1	2+4	3	5-8	5-8 less SNAPS	5+6 less PS	5	6 less PS	7+8 less SNA	j	j	j	j
Weights	1000	69	31	136	735	658	252	112	141	406	18	71	170	147
1985	119.3	119.2	106.1	171.7	110.8	115.7	118.9	133.3	107.5	113.6	99.4	111.6	121.2	107.6
1986	123.6	129.6	117.1	175.5	114.0	116.9	121.9	139.4	108.1	113.8	93.2	117.5	120.4	106.9
1985 Q4	120.4	115	105	175	112	115	118	136	105	114	95	111	123	107
1986 Q1	117.6	119	111	178	107	112	115	131	103	109	89	109	117	103
Q2	122.1	120	102	170	115	116	120	138	106	113	95	116	119	107
Q3	124.4	134	126	174	113	118	125	143	111	113	97	122	120	102
Q4	130.5	146	129	179	120	123	127	146	112	120	91	123	126	115
1986 Dec	132.1	140	142	178	123	124	125	142	110	123	97	121	129	122
1987 Jan	126.0	128	159	187	112	116	117	131	106	115	119	121	114	114
Feb	138.0	139	149	182	126	129	134	154	118	126	99	149	126	118
Sept-Nov	129.0	148	125	178	118	121	129	148	114	116	91	123	123	109
Dec-Feb	132.0	136	150	182	120	123	125	142	112	122	105	130	123	118
% change	+ 2½	- 8½	+ 20	+ 2½	+ 1½	+ 1½	- 3	- 3½	- 2½	+ 4½	+ 16	+ 5½	-	+ 8½

h These are defined as ships, North Sea installations (together comprising SITC (REV 2) 793), aircraft (792) precious stones (667), and silver (681.1).

j Based on the United Nations Broad Economic Categories end-use classification.

SECRET and personal until release of press notice on 26 MAR 87 at 11.30 a.m.

Table 10

EXPORTS BY COMMODITY: UNIT VALUE INDICES
(Overseas Trade Statistics basis)

INDICES 1980 = 100 not seasonally adjusted

	Total	Food beverages and tobacco	Basic Materials	Fuels	Total Manufactures	Manufactures excluding erratics[h]: Total	Semi-manufactures excluding precious stones & silver (PS): Total	Chemicals	Other	Finished manufactures excluding ships, North Sea installations and aircraft (SNA): Total	Passenger Motor Cars	Other Consumer	Intermediate	Capital
SITC (REV 2)	0-9	0+1	2+4	3	5-8	5-8 less SNAPS	5+6 less PS	5	6 less PS	7+8 less SNA	j	j	j	j
Weights	1000	69	31	136	735	658	252	112	141	406	18	71	170	147
1985	143.4	134	140	155	143	142	135	139	132	147	162	147	150	141
1986	136.5	140	123	81	147	148	138	141	135	154	182	157	157	146
1985 Q4	140.4	134	130	140	142	142	134	137	131	148	163	149	151	141
1986 Q1	138.9	136	128	113	145	145	137	142	133	150	166	153	153	144
Q2	134.7	141	124	74	146	147	138	142	134	153	179	156	156	145
Q3	134.2	140	120	62	148	148	137	140	135	155	186	156	159	146
Q4	138.0	142	121	72	151	150	139	141	138	157	198	161	160	148
1986 Dec	138.6	142	119	73	151	151	141	142	140	158	198	161	160	148
1987 Jan	140.0	142	121	81	152	152	141	143	139	158	201	163	160	149
Feb	140.7	142	123	84	152	153	141	144	139	159	198	163	162	149
Sept-Nov	136.9	142	121	70	150	150	139	141	137	157	196	160	160	147
Dec-Feb	139.8	142	121	79	152	152	141	143	140	159	199	163	161	149
% change	+ 2	-	-	+13	+ 1½	+1½	+2	+ 1½	+ 2	+ 1	+ 2	+ 1½	+ ½	+ 1½

[h] These are defined as ships, North Sea installations (together comprising SITC (REV 2) 793), aircraft (792) precious stones (667), and silver (681.1).

[j] Based on the United Nations Broad Economic Categories end-use classification.

Table 11

EXPORTS BY AREA
(Overseas Trade Statistics basis)

£ million, fob, seasonally adjusted

	Total[K]	Developed Countries: Total	European Community	Rest of W Europe	North America Total	North America USA	Other	Developing Countries: Total	Oil exporting countries	Other	Centrally planned economies
1985	78392	62787	38226	7438	13332	11519	3791	13876	5952	7924	1587
1986	73009	57709	35004	6963	12128	10380	3614	13139	5495	7644	1721
1985 Q4	19225	15431	9341	1833	3339	2833	918	3211	1363	1848	402
1986 Q1	18198	14493	8634	1745	3195	2737	919	3219	1389	1830	437
Q2	17832	13799	8328	1710	2880	2494	881	3451	1551	1900	446
Q3	17632	13944	8498	1709	2829	2432	909	3215	1317	1897	368
Q4	19347	15474	9545	1799	3225	2717	905	3254	1238	2016	470
1986 Dec	6518	5231	3175	628	1140	930	287	1004	385	619	177
1987 Jan	6238	4855	2923	479	1130	964	323	1125	440	685	138
Feb	6955	5743	3320	687	1392	1223	344	1099	393	706	157
Sept-Nov	18944	15084	9359	1768	3024	2606	933	3287	1275	2012	425
Dec-Feb	19711	15830	9418	1795	3662	3116	955	3228	1218	2010	472
% change	+ 4	+ 5	+ ½	+ 1½	+ 21	+ 20	+ 2½	- 2	- 4½	-	+ 11

K See paragraph 5 of Notes to Editors.

SECRET and personal
until release of press notice on 26 MAR 87 at 11.30 a.m.

IMPORTS BY COMMODITY

(Overseas Trade Statistics basis)

Table 12

£ million cif seasonally adjusted

						Manufactures excluding erratics[h]								
							Semi-manufactures excluding precious stones & silver(PS)			Finished manufactures excluding ships, North Sea installations and aircraft (SNA)				
	Total	Food beverages and tobacco	Basic Materials	Fuels	Total Manufactures	Total	Total	Chemicals	Other	Total	Passenger Motor Cars	Other Consumer	Intermediate	Capital
SITC (REV 2)	0-9	0+1	2+4	3	5-8	5-8 less SNAPS	5+6 less PS	5	6 less PS	7+8 less SNA	j	j	j	j
1985	85027	9337	5388	10664	58312	54934	19611	6901	12710	35322	4165	8884	11623	10649
1986	86066	10067	4988	6294	62833	59472	20713	7346	13367	38759	4809	10177	12706	11067
1985 Q4	20462	2291	1227	2321	14290	13695	4902	1703	3199	8793	1065	2216	2864	2647
1986 Q1	20495	2452	1211	1729	14732	13883	5010	1797	3213	8873	1116	2275	2862	2619
Q2	20467	2419	1211	1522	14914	14087	5024	1795	3229	9063	1136	2412	2979	2537
Q3	21836	2564	1190	1502	16041	15199	5207	1831	3376	9992	1279	2653	3268	2792
Q4	23269	2632	1376	1541	17146	16303	5472	1922	3549	10832	1279	2838	3597	3118
1986 Dec	7785	925	472	511	5711	5447	1835	639	1195	3613	405	972	1179	1057
1987 Jan	7122	793	457	469	5279	5030	1710	625	1085	3320	375	787	1111	1046
Feb	7452	895	481	568	5407	5128	1854	679	1175	3274	307	904	1077	986
Sept-Nov	22937	2566	1333	1508	16895	15938	5413	1904	3510	10525	1268	2755	3494	3008
Dec-Feb	22359	2613	1410	1548	16396	15605	5398	1943	3455	10207	1088	2663	3367	3090
% change	- 2½	+ 2	+ 5½	+ 2½	- 3	- 2	- ½	+ 2	- 1½	- 3	- 14	- 3½	- 3½	- 2½

h These are defined as ships, North Sea installations (together comprising SITC (REV 2) 793), aircraft (792) precious stones (667), and silver (681.1).

j Based on the United Nations Broad Economic Categories end-use classification.

IMPORTS BY COMMODITY: VOLUME INDICES

(Overseas Trade Statistics basis)

Table 13

INDICES 1980 = 100 seasonally adjusted

						Manufactures excluding erratics[h]								
							Semi-manufactures excluding precious stones & silver(PS)			Finished manufactures excluding ships, North Sea installations and aircraft (SNA)				
	Total	Food beverages and tobacco	Basic Materials	Fuels	Total Manufactures	Total	Total	Chemicals	Other	Total	Passenger Motor Cars	Other Consumer	Intermediate	Capital
SITC (REV 2)	0-9	0+1	2+4	3	5-8	5-8 less SNAPS	5+6 less PS	5	6 less PS	7+8 less SNA	j	j	j	j
Weights	1000	124	81	138	626	543	217	63	154	326	42	94	96	94
1985	124.6	114.4	102.2	86.2	140.7	154.4	143.9	176.1	130.6	161.4	127.9	139.5	172.8	187.1
1986	132.8	123.5	108.7	93.4	148.2	163.0	152.0	188.0	137.2	170.4	131.6	158.3	187.0	183.1
1985 Q4	126.6	116	105	86	143	159	147	177	135	166	126	146	178	191
1986 Q1	123.5	124	104	70	140	153	147	182	133	157	126	144	170	172
Q2	127.1	120	105	85	143	157	149	187	134	162	125	154	181	169
Q3	138.1	125	106	112	152	168	155	191	140	176	142	165	193	185
Q4	142.4	125	119	106	158	174	157	192	142	186	133	170	205	205
1986 Dec	142.2	133	124	103	156	174	156	191	142	186	122	176	201	209
1987 Jan	130.3	116	124	92	144	160	145	183	130	170	110	144	187	204
Feb	132.9	130	124	104	145	160	156	198	138	163	91	162	179	183
Sept-Nov	141.7	123	117	106	157	172	157	192	143	182	135	166	200	199
Dec-Feb	135.1	127	124	99	149	165	152	191	137	173	108	161	189	199
% change	- 4½	+ 3	+ 6½	- 6½	- 5½	- 4½	- 3	- 1	- 4½	- 5	- 20	- 3	- 5½	-

h These are defined as ships, North Sea installations (together comprising SITC (REV 2) 793), aircraft (792) precious stones (667), and silver (681.1).

j Based on the United Nations Broad Economic Categories end-use classification.

SECRET and personal until release of press notice on 26 MAR 87 at 11.30 a.m.

IMPORTS BY COMMODITY: UNIT VALUE INDICES
(Overseas Trade Statistics basis)

INDICES 1980 = 100 not seasonally adjusted

	Total	Food beverages and tobacco	Basic Materials	Fuels	Total Manufactures	Manufactures excluding erratics[h]: Total	Semi-manufactures excluding precious stones & silver (PS): Total	Semi-manufactures: Chemicals	Semi-manufactures: Other	Finished manufactures excluding ships, North Sea installations and aircraft (SNA): Total	Finished: Passenger Motor Cars	Finished: Other Consumer	Finished: Intermediate	Finished: Capital
SITC (REV 2)	0-9	0+1	2+4	3	5-8	5-8 less SNAPS	5+6 less PS	5	6 less PS	7+8 less SNA	j	j	j	j
Weights	1000	124	81	138	626	543	217	63	154	326	42	94	96	94
1985	143.1	137	130	172	141	141	133	139	130	146	152	147	155	134
1986	132.5	136	113	97	143	144	133	141	130	152	170	148	158	141
1985 Q4	136.3	132	116	155	137	137	130	137	127	143	156	143	148	131
1986 Q1	135.6	134	116	132	140	141	132	140	128	148	165	145	152	138
Q2	130.1	135	113	96	140	142	131	139	128	148	169	144	153	139
Q3	129.1	136	111	78	142	144	132	139	129	152	168	147	159	141
Q4	135.1	139	115	84	149	150	136	144	133	159	178	155	167	147
1986 Dec	136.5	140	116	84	151	152	138	146	134	161	182	156	168	149
1987 Jan	137.7	139	116	90	151	153	139	148	135	162	189	155	168	150
Feb	138.2	138	118	95	151	153	138	148	135	162	187	155	167	152
Sept-Nov	133.3	138	113	82	147	148	135	142	132	157	174	153	165	144
Dec-Feb	137.4	139	117	90	151	152	138	148	135	162	186	155	168	150
% change	+ 3	+ ½	+ 3	+ 9½	+ 3	+ 3	+ 2½	+ 3½	+ 2	+ 3	+ 7	+ 1½	+ 1½	+ 4

h These are defined as ships, North Sea installations (together comprising SITC (REV 2) 793), aircraft (792) precious stones (667), and silver (681.1).

j Based on the United Nations Broad Economic Categories end-use classification.

IMPORTS BY AREA
(Overseas Trade Statistics basis)

Table 15

£ million cif seasonally adjusted

	Total K	Developed Countries: Total	European Community	Rest of W Europe	North America: Total	North America: USA	Other	Developing Countries: Total	Oil exporting countries	Other	Centrally planned economies
1985	85027	71665	41474	12102	11709	9926	6379	11327	2815	8512	1893
1986	86066	73285	44506	11864	10054	8468	6861	10514	1877	8637	1856
1985 Q4	20462	17515	10384	3012	2496	2076	1623	2545	672	1874	401
1986 Q1	20495	17651	10564	3088	2352	1970	1647	2376	498	1878	422
Q2	20467	17360	10566	2729	2420	2030	1645	2540	460	2080	466
Q3	21836	18569	11426	2896	2512	2138	1735	2670	408	2262	456
Q4	23269	19705	11950	3151	2771	2331	1833	2928	511	2418	511
1986 Dec	7785	6475	3903	1049	942	773	500	1024	196	828	146
1987 Jan	7122	6146	3800	907	807	683	632	853	167	687	150
Feb	7452	6330	3868	1100	787	655	575	907	150	758	160
Sept-Nov	22937	19495	11808	3173	2662	2262	1852	2861	426	2434	506
Dec-Feb	22359	18950	11571	3055	2536	2112	1788	2784	512	2273	456
% change	- 2½	- 3	- 2	- 3½	- 4½	- 6½	- 3½	- 2½	+ 20	- 6½	- 10

K See paragraph 5 Notes to Editors.

COMMODITY ANALYSIS OF VISIBLE TRADE
(Balance of Payments basis)

£ million, seasonally adjuste

SITC (R2)	Food Beverages and Tobacco 0 + 1			Basic Materials 2 + 4			Fuels 3		
	Exports fob	Imports fob	Visible Balance	Exports fob	Imports fob	Visible Balance	Exports fob	Imports fob	Visible Balance
1985	4932	8522	- 3591	2144	4795	- 2651	16795	10233	+ 6562
1986	5439	9256	- 3817	2058	4410	- 2353	8683	5865	+ 2819
1985 Q1	1202	2157	- 955	571	1311	- 740	4876	3388	+ 1488
Q2	1277	2157	- 880	537	1241	- 704	4481	2474	+ 2007
Q3	1260	2126	- 866	532	1173	- 641	3576	2134	+ 1442
Q4	1194	2083	- 889	504	1070	- 566	3862	2237	+ 1625
1986 Q1	1219	2242	- 1023	504	1092	- 588	3177	1637	+ 1540
Q2	1271	2209	- 937	445	1076	- 631	1922	1419	+ 503
Q3	1383	2372	- 989	545	1020	- 475	1614	1368	+ 246
Q4	1565	2433	- 868	564	1223	- 658	1970	1441	+ 530

SITC (R2)	Semi-Manufactures 5 + 6			Finished Manufactures 7 + 8			Total Manufactures 5 - 8		
	Exports fob	Imports fob	Visible Balance	Exports fob	Imports fob	Visible Balance	Exports fob	Imports fob	Visible Balance
1985	20051	19949	+ 102	32221	35324	- 3103	52271	55273	- 3002
1986	20946	21559	- 613	33540	38324	- 4784	54486	59883	- 5397
1985 Q1	5026	4848	+ 178	7956	9200	- 1244	12982	14048	- 1066
Q2	5207	5076	+ 131	8208	9101	- 893	13415	14177	- 761
Q3	4865	5125	- 260	7962	8379	- 417	12827	13504	- 678
Q4	4952	4900	+ 53	8096	8645	- 549	13048	13545	- 497
1986 Q1	4851	5292	- 441	7925	8745	- 819	12777	14037	- 1260
Q2	5221	5177	+ 43	8395	9047	- 653	13615	14224	- 609
Q3	5290	5361	- 71	8230	9898	- 1668	13520	15259	- 1739
Q4	5585	5729	- 144	8990	10634	- 1645	14575	16363	- 1788

Monthly data at this level of detail are published in the Monthly Review of External Trade Statistics.

OVERSEAS DEVELOPMENT ADMINISTRATION
ELAND HOUSE
STAG PLACE LONDON SW1E 5DH

Telephone 01-213 5409

From the Minister

24 March 1987

Alex Allan Esq
Private Secretary to the Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

CH/EXCHEQUER
REC. 25 MAR 1987
~~ACTION~~ MR P. DAVIS 25/3
COPIES TO CST, FST, EST, MST
SIR P. MIDDLETON
SIR G. LITTLER
MR F.E.R. BUTLER
MR MOUNTFIELD
MR CROPPER

Read with much interest. Speech does not however mean unnecessary assistance. N.

Dear Alex,

"IDEALISM AND SELF-INTEREST: BRITAIN'S AID PROGRAMME"

The Chancellor of the Exchequer may be interested to see the speech made by Mr Chris Patten on the British aid programme at Chatham House on 18 March. ... I attach a copy. Mr Patten is also sending the speech to all Conservative MPs and to the Opposition Whips' offices.

I am copying this letter to the Private Secretaries to : the Chief Secretary, The Secretary of State for Trade and Industry, and the Minister for Trade.

Yours ever
Martin Dinham

M J Dinham
Private Secretary

"IDEALISM AND SELF INTEREST:
BRITAIN'S AID PROGRAMME"

SPEECH BY MR CHRIS PATTEN MP,
MINISTER FOR OVERSEAS DEVELOPMENT, AT THE
ROYAL INSTITUTE FOR INTERNATIONAL AFFAIRS,
CHATHAM HOUSE, 18 MARCH 1987

I recalled the other day, the great Lord Salisbury's advice that it was difficult enough to go about doing what was right, without trying to go around at the same time doing good. That is a salutary reminder of the perils of infusing foreign policy with notions of morality, let alone with a Manicheean view of world history.

But while I concede that history is littered with some unhappy examples of the consequences of do-gooding, do-gooding itself seems to me a preferable and less calamitous pursuit than do-badding. What is more, as a mildly optimistic Tory, I recognise the existence of Original Virtue as well as Original Sin. So I do not have any difficulty in accepting Edmund Burke's argument that "We have obligations to mankind at large, which are not in consequence of any special voluntary pact. They arise from the relation of man to man, and the relation of man to God".

/I could

I could point to three clear obligations which affect our external relations - first, to do all we can to prevent the destruction of our planet in a nuclear holocaust; second, to guard and protect our natural habitat from abuse; and third, to join the other more fortunate nations of the world in fighting deprivation, disease and squalor and in working to overcome the poverty, degradation and drudgery from which tens of millions still suffer today.

It is self-evident that in discharging the first two of these obligations, we are serving not only a broader moral purpose but also our self-interest. I believe that is also true of the third obligation which provides the ethical framework for our aid programme. We should not be coy about the extent to which to do what is right can also be to do what is good for Britain.

Naturally, I do not go so far as to suggest that because there is an ethical backdrop to our aid efforts, any increase in them must by definition put us in a morally superior position.

/There are

There are other calls on the public purse. There are other moral considerations for politicians and governments. And there are practical arguments to think about too - an enfeebled donor economy will be of little help to aid recipients.

Nor do I agree that any aid programme will by definition be money well spent. Palpably that is nonsense. Aid is in a sense interference - interference in the ebb and flow of natural market forces. This interference can be good and it can be bad. That proposition is true of the welfare state and it is true of aid policy. But while it is wrong to argue that aid will always be good, it is equally wrong to suggest the opposite. It is, in particular, preposterous to contend that countries which follow virtuous policies don't need aid, and that those which have not been so upright don't deserve it. There are some parts of the world where history, climate and environment - or even all three - make it extremely difficult to be economically virtuous. A helping hand is certainly not out of order.

What do we gain in Britain by offering such assistance?

/First

First, we have a little more influence than would otherwise be the case. Second, we help to create, with judiciously applied assistance, larger markets for our own goods. Third, while it is far from certain that prosperity will breed peace and contentment, it is more likely to be the case that acute need may generate trouble. A higher economic growth rate can be a wonderful healer of wounds. Fourth, our aid effort - at least partly the result of generosity of spirit - helps to add a dimension to our national life which makes this a more agreeable country in which to live. Two examples of this which I would cite are the activities of our non-governmental organisations (as professionally effective and pioneering as any in the world) and the presence in our universities and training institutions of so many young people from other countries; some 16,000 of them are here with the help of the British taxpayer.

Let me summarise my starting point.

/There can be

There can be a moral argument for an aid programme, and I don't think that things have yet come to such a pass that we need to apologise for this touch of idealism. This is a case, if ever there was one, where virtue can bring its own reward. But the accent is on the word "can". Aid is not always helpful to the donor, let alone - more importantly - to the recipient. It is sad that some of the more broadly based arguments for aid were discredited in the 1960s and 1970s by bad examples of its use. Not-so-white elephants, cathedrals in the sand, corruption milking compassion - we have some misjudgements and blunders to put plainly behind us in order to go on building, as I would like to do, a wide body of support for a growing aid programme.

Given these general principles, how is Britain's aid programme organised and what are its purposes?

/We spend in all

We spend in all about £1.3 billion a year on aid. This budget was cut from 1979 to 1982 when public spending on other programmes was being squeezed too. Since then, it has risen in real terms. That increase has been secured over the next three years with an increase in cash terms over this year's provision of £48 million for 1987/88, £88 million for 1988/89 and £128 million for 1989/90. We have the sixth largest aid programme in the world - I shall argue that it is one of the most effective - and the third largest in Europe. We spend about the same proportion of our GNP on aid as the average of other OECD countries. A much higher proportion of our aid - 80 per cent - goes to the poorest countries than is the case for the OECD as a whole.

There is a twenty-year-old UN target for official development assistance of 0.7 per cent GNP. We have never reached it. Nor have most others. Like other countries, we retain it as an objective. I do not in any way resile from that aim in pointing out that it is not necessarily the most perfect instrument for judging performance.

/It is

It is not a very accurate output measure; it does not tell us anything about effectiveness. It does not take account of the relative wealth of donors. It can lead to perverse conclusions about achievement. A country with a high growth rate and an aid programme which rose year by year (though not quite so fast as economic growth as a whole) could consistently miss the UN target, whereas a country whose aid grew much less rapidly would meet the target if its growth rate was depressed or actually fell. I only make these obvious points in order to buttress the case for considering aid performance against other criteria as well as the UN target.

I am told - it will be my only distantly political reflection of the day - that others intend, if they have the chance, to increase our aid programme within five years to the size of the UN target. As a demonstration of firmness of purpose, I have even been asked by proponents of these policies if I could please give some general notion of how much such a commitment would cost.

/We are

We are clearly dealing with a serious endeavour. I will only say, with what may be regarded as massive understatement, that seeing is believing. For what it's worth, the precise cost of hitting the UN target over a Parliament would naturally depend on the overall growth rate, but I guess that a figure in excess of £1.5 billion would be about right. For my own part, my modest ambition is to make the quality of our aid programme the best advocate of its steady growth as our economy strengthens. I believe in sustainable development at home as well as abroad.

About 4 in every 10 pounds of our aid budget goes through multilateral organisations, and the rest is spent through our country to country programmes and through a wide variety of British institutions operating overseas. I think it is important to try to keep a bilateral programme of at least this size, since we can directly ensure its quality. Our multilateral contributions have increased since we joined the European Community. We provide about 20 per cent of the Community's aid programme;

/this contribution

this contribution amounts to about £200 million a year. We must work to achieve higher quality in all these multilateral programmes as well as in our own.

That is why I believe the reform of the EC Food Aid Regulation, which we played a leading role in securing before Christmas, was so important. I shall return to that later.

There have been a number of other useful developments on the multilateral stage in the last year. The 12.4 billion dollar 8th Replenishment of the International Development Association - the soft loan arm of the World Bank - was good news for the poorest countries. Our contribution will total about 800 million dollars. The conclusion of agreements on 66 indicative programmes under the Lomé convention should ensure that the work financed under the £5$\frac{1}{4}$ billion latest tranche of the European Development Fund will be closely monitored and effectively spent, over 90 per cent of it in Africa, and most of that for agricultural development. We shall be contributing over £850 million.

/While I remain

While I remain committed to the enhancement so far as possible of our bilateral programmes, I accept that sometimes we can get the best value and make the most progress through multilateral operations. We intend, for example, to put most of our assistance for combating AIDS in poor countries into the programme being put together by the World Health Organisation. This makes more sense, in an area where sensitivities are acute and experience limited, than fragmenting our international efforts in bilateral programmes. We are also keen supporters of UNICEF's work to spread immunisation and oral rehydration therapy. Our contribution to UNICEF over the past year has been at its highest ever level.

Our aid programme, whatever its size, will - I judge - always be justified on four main grounds, some more overt than others. There are political, commercial, humanitarian and developmental arguments for aid. They are all inter-related. It is often difficult to disentangle one from the others.

/The developmental

The developmental considerations naturally beg questions of definition. In my view, you have to consider not necessarily whether the aid recipient is immediately better off as a result of your programmes, but whether the growth in the recipient's economy, or the life of the project you have supported, is sustainable as well as beneficial in the longer term. That brings in a number of factors from environmental impact to training and institution building. In so far as the balance between development and the other factors - political, commercial and even humanitarian - is distorted, the developmental objective is more than likely to be undermined.

Let me run through each of the four factors briefly and give some indication of how they affect our aid programme.

/There have

There have always been political reasons for aid. The extreme example is the client state. There are some national aid programmes today which are manifestly determined to a great extent by largely political factors. I do not believe that is true of our own programme, but political factors do count as I shall shortly explain.

At its crudest, the political argument for aid is that one should be seeking goodwill, or even acquiescence and dependence, above all else. It does not seem to me unreasonable to seek goodwill through aid. It is not a crime to be popular. But if goodwill were the only thing to take into account, we would over the last few years have devoted a substantial portion of our aid budget to proposals which served the immediate interests of influential individuals or groups as against the interests of the wider population within developing countries; the construction of multi-lane highways between Prime Minister's constituencies and international airports might be an example. You cannot always give people what they first ask for, nor should you seek to do so regardless of all else.

/It is a pity

It is a pity, however, if an aid programme does not bring in its train at least a modicum of goodwill and understanding.

Without being immaturely sensitive - we have had our tails tweaked many times over the centuries, mostly ignored it and lived to tell the tale - without too much sensitivity, it does not appear outrageous to take some account of a recipient country's behaviour in disbursing aid.
I am often, and rightly, reminded that I am dealing with sovereign governments.
I have to point out that we too are a sovereign government and have to carry public support for what we do and for the money we spen

There are three more specifically political aspects of our aid programme - out of several - to which it may be worth referring.

First, two-thirds of our bilateral aid goes to Commonwealth countries. That is a wholly justified way of targeting our programme.
It recognises a hundred years or more of shared history. It recognises, in many cases too, shared values and a similarity of institutional arrangements. It was a group of Zambian chool children who reminded me last week of the date of Commonwealth Day.

/An aspect

An aspect of our Commonwealth links on which I think we should aim to build is the support we give to the training of Commonwealth citizens, and to the development of the institutional infrastructure in Commonwealth countries through manpower assistance. These contributions to development are literally priceless.

A second area where politics and aid come together is that of human rights. Recent experience in Cambodia and Ethiopia has shown how difficult it can be to strike a balance between humanitarian impulses on the one hand and the support of regimes which trample over human rights on the other.

Last summer, under our Presidency, the European Community agreed a statement, specifically linking human rights considerations with the disbursement of aid. Ethiopia provides a practical example of how we have tried to put that policy into operation drawing a line - which is far from easy - between help to those in desperate need and support of indefensible policies.

/For example,

For example we contributed substantial help towards famine relief in 1984 and 1985; but we will not give aid to resettlement and villagisation programmes, which have been subject to abuse. We are particularly pleased that the European Community's agreed programme on Ethiopia under Lomé is tied so explicitly to freeing the agricultural market.

Another example of the influence of political considerations can be seen in Southern Africa.

It is wholly right that, given our doubts in the European Community about the efficacy of further, much more restrictive measures to encourage both a peaceful dialogue in the region and the dismantling of the iniquitous apartheid system, we should seek to place greater emphasis on positive help for those states which are in the front-line geographically, politically and economically.

/We shall

We shall, therefore, through the Southern African Development Co-ordination Conference and through our bilateral programmes, do more to assist the region develop a greater measure of economic independence from South Africa. We have spent, through bilateral and multilateral programmes, over £700 million - about one billion dollars - in the region in the last 5 years. We will sustain a major programme in Southern Africa, enhanced by the grants I announced during my two visits over the last few weeks.

We are also contributing through our own programmes and through those of the European Community to the training and education of non-whites in South Africa. Through these two channels, we should be spending about £5 million next year.

The commercial reasons for aid can be considered on both a macro and a micro level. I assume that no one would argue with the proposition that if we help to build up the economies of poorer countries, we create potential markets for our own trade.

/There should

There should also be little controversy about the possibility of incalculable commercial benefits in the longer term of close links - whether educational or institutional - between this country and, say, other countries of the Commonwealth. More open to argument is the proposition that aid creates tens of thousands of jobs in Britain. Spending on other programmes, or tax cuts of equivalent scale, could presumably be said to create jobs too. There are, therefore, stronger arguments for aid than this.

Far more dispute, however, attends the two main micro-level propositions - first that it is perfectly reasonable to tie the disbursement of part of our aid to other countries to the purchase of British goods, and second, that in credit-worthy countries aid can quite properly be used to support trade packages.

/There is, of

There is, of course, a view that aid should be pure, that the choice of where the recipient spends it - given an agreed purpose - should be left to that country, and that to oblige the recipient to spend the money to purchase products or expertise from the donor's country devalues and distorts the aid. I cannot accept that there would be anything particularly pure about allowing the recipient to use aid from this country, which is justified on developmental grounds, for the purchase of Japanese or Taiwanese goods and equipment. What is important is the explicit condition in that sentence. If a project or programme is sound, and if British goods are reasonably competitive, then I do not believe that tying should of itself be regarded as objectionable. On the other hand, we must provide value for money; aid is not a subsidy for uncompetitive exporters.

/This is where

This is where we run into another fusillade of criticism. We are sometimes thought by commercial interests to be too "niminy-piminy" about developmental quality. "Just give us the money", they appear to suggest, "and let us get on with the job". This is not a very well-considered approach. No one, I assume, is suggesting that the aid programme should be used as a sort of slush fund export subsidy. Unless we can point to the developmental quality of our overall programme, we will weaken the justification for doing as much as we do already to support Britain's commercial interests. I also suspect that a false distinction is sometimes drawn between what is commercially sound and what is developmentally sound. To adapt Gertrude Stein, a good project is a good project is a good project. We are more likely to increase our share of growing markets if what we do is seen to be characterised by excellence.

/The Aid and

The Aid and Trade Provision, introduced by the last Labour Government and increased by the present Government, supports about £250 million worth of business each year, in the ratio of about £1 of aid to £3 of straight commercial deal. Our new soft loan mechanism, introduced in 1985 at a low initial cost which will grow steadily over the next few years, could support about the same quantity of trade again. These instruments, taken together with the tying of British aid, mean that we do about as much as anyone else to secure appropriate commercial benefit from our aid programme. We do neither more nor less than we should.

There is obviously a danger that growing international competition in trade will produce equal competition in aid. This really would distort what donors should be aiming to do. I therefore welcome the efforts being made through the OECD to negotiate restrictions and fairer rules on the aid and trade front.

/We want more

We want more transparency about aid and trade deals and a higher minimum grant element in these packages which should take account of the relative strength of currencies. I hope we can reach agreement on these matters this year, but it will be hard pounding.

The third reason for aid is humanitarian. Our Disaster Unit is at the heart of our efforts to bring early relief to those affected by calamities, both natural and man-made. The Disaster Unit, for example, was the channel of our immediate response to the appeal by non-governmental organisations for help in Mozambique. We have given over £3 million so far to that appeal.

The emergency in Mozambique is partly a result of drought, more a result of civil strife. But there is another cause too - the management of Mozambican agriculture and the Mozambican economy over a number of years. This raises a good example of how a humanitarian impulse can help destroy rather than enhance development.

Food aid is vital to keep millions alive. But it can be fatal if recipients become completely dependent on it. In Mozambique, the Agriculture Minister - while understanding the need for more food aid in the short term - recognised it quite properly as a sign of failure. He wanted to talk to me about what we could do to help make food aid unnecessary in the future.

I believe that food aid has provided a spurious moral justification for the surplus-producing agricultural policies of Europe, North America and Japan. The results of these surpluses have been expensively and cumulatively disastrous. Prices on world markets are depressed by subsidised surpluses. Self-reliance is undermined. Plenty in the temperate countries adds to the misery already caused by poverty, drought and disaster elsewhere. And while European governments have pushed up prices, too many African governments have held them down. Incentives for local farmers have been cut. Production has slumped. Marginal land has turned into desert.

Last year's World Bank Development Report shows the full depressing result of subsidising agriculture in rich countries and taxing it in poor ones. The poor have become poorer. Perhaps the most eloquent statistic is that in the drought year of 1984 140 million of the total African population of 530 million were fed entirely with grain from abroad.

Fortunately the tide of opinion in Africa and in the donor countries has started to turn. In several countries agricultural productivity has begun to rise as market oriented policies have been introduced. Coarse grain output rose by a third in 1985 and by a further 3.3 per cent last year. Ten countries have exportable surpluses of coarse grain. Only a small handful - and these include war-torn Mozambique and Angola - have not experienced this growth in food output.

More effort is being given now by donors for agricultural programmes and support services in Africa.

/We spent

We spent about £31 million ourselves on agriculture-related projects in Africa under our bilateral programme in 1985 in addition to our technical cooperation in this sector; and we are ready to increase the level of our support significantly.

In addition we are contributing about one fifth of the £4.8 billion programme for Africa under Lomé III, and most of this - as I have said - will be spent on agriculture. I intend to see that our excellent research institutes play an increasingly important part in our support for agricultural development, for example in the area of plant protection, improved varieties ofplants,and soil and water conservation.

As you will know, we took a leading role in the reform of Europe's food aid during our Presidency of the European Community. This was an initiative first launched by my predecessor, Tim Raison. Food aid should now provide what recipients need rather than what we in Europe wish to get rid of.

/I hope that

I hope that in due course we have equal success in tackling the surplus problem. The benefits of doing so would far exceed any conceivable increase in aid flows.

The issue of how we try to help countries is of course not straightforward. There are, after all, deep political divisions about what best contributes to the development of our own economy. How donors can most effectively help in the process of development in other countries and in other continents is even more controversial. I believe that there is also a conceptual issue of profound importance.

The whole notion of developed countries helping those which are developing can too easily imply a dangerously inexact and inappropriate model, whose application on occasions in the past has proved ruinous.

/We assume that

We assume that our own path to development - the evolution of advanced capitalist economies through the fires of the Industrial Revolution - has to be followed at break-neck pace by other countries with totally different social structures, resources, climates and ecosystems. Among the casualties of this approach is the environment of the countries on which it is visited. Sustainable development means nurturing what will grow organically in the country receiving assistance. Forced implants which take little or no account of the indigenous social and physical environment on which they are imposed will rarely succeed.

I explained in a speech to the Royal Geographical Society a few weeks ago how we are attempting to take account of the environmental impact in our aid programme. I will not traverse that ground again today, but will only say that this must be in the van of our work. We have developed a pretty effective methodology; we must do even better. I should like to think that in this area, our programme can become "state of the art".

/As we

As we prepare for a noisy domestic argument in the coming months about the right way to manage the British economy, it is interesting to observe how many aid recipient countries have turned their backs on State socialist solutions and chosen to take a more balanced course with greater emphasis on market forces, the reduction of deficits and bureaucracy, elimination of controls and privatisation of parastatals. We are offered at home options which many of us will seek to demonstrate would put us back on the expressway to the benefactions of the IMF. Structural adjustment packages in Africa are, meanwhile, setting a score of countries on a route away from dependence on their creditors and towards greater growth and economic self-reliance. Few, any more, travel down Walworth Road.

It is ludicrous to see structural adjustment as being imposed on unwilling aid recipients by bloated Western capitalists. Only the "War on Want" publicity department could possibly believe that these days. Policies are being changed because previous policies were unsustainable.

They had not worked and will not work. There is little point in "sticking to the carcasses of dead policies". Mr Gorbachev is the latest convert to that further example of Lord Salisbury's wisdom. I do not of course pretend that Adam Smith and Milton Friedman are now bestriding the African continent. But a more balanced and market-oriented approach - as exemplified in the Action Programme adopted at the UN Special Session on Africa - is being followed in an increasing number of countries. This must be a development which is profoundly in the interests of the West and of all who believe in freedom. We must therefore do all we can to help aid recipients make the painful adjustments which are sometimes necessary. Aid should be used to assist the passage along the path of virtue.

For our part, we will devote a greater share of our aid budget in the coming year to policy reform in Africa. We have already given programme aid to support adjustment to The Gambia, Ghana, Zambia, Malawi, Somalia and Tanzania. I hope the list will lengthen.

Some people argue that we are only interested in structural adjustment so we can be debt-collectors They say the poor are squeezed so our loans can be repaid. Others argue that debt service payments by African countries are twice as great as the flow of famine relief to the continent. Both sets of criticism miss the mark by a wide margin. Our support for structural adjustment helps create stronger self-sustaining economies, better able to meet the financial obligations they have contracted. Western countries have provided substantial help to ease Africa's debt problems. Many countries' debts have been rescheduled. The UK has helped even more directly by writing off £260 million owed by 13 low-income African countries. This is part of the debt relief of about £1 billion we have made available globally to the poorest countries. In addition, new capital has been provided. In 1985, OECD countries' aid for Africa was worth $8 billion : 2½ times the repayment of debt principal and interest. The UK gave Africa £380 million in that year, more than 16 times the amount of aid debt repaid to us. Debt problems are very serious. But it helps no one to exaggerate them or underplay our response.

/Structural

Structural adjustment raises the question of support for the private sector in aid recipient countries. This poses some obvious difficulties when one is considering government-to-government programmes. I hope to say more about this subject in the coming months. In the meantime there are four main ways in which we help private enterprise: first, through seeking to persuade governments to create the kind of atmosphere, with minimum rules and regulations, in which private enterprise can flourish; secondly, in helping to improve public services and the necessary infrastructure, railways, roads, power supplies, education, administration and the rest; next, by providing investment resources in the form of loans or equity - primarily through the Commonwealth Development Corporation - to assist private enterprise where private sources of credit are not sufficient or forthcoming; and lastly, by providing training in technology, management and business advice.

/We are admirably

We are admirably served by the Commonwealth Development Corporation which will, I hope, be able to play an even more effective role in strengthening the private sector in the countries in which it operates as well as contributing generally to long-term economic development.

Also in the area of private sector development, I have decided that we should contribute £400,000 to the African Management Services Company and £300,000 to the African Project Development Facility both of which are being set up by the International Finance Corporation to improve the quality of management and project design in the African private sector.

Let me conclude telegrammatically by indicating with an all-too-abbreviated laundry list what I believe should be some of our other priorities for the future. We have got to try to involve people in aid recipient countries far more in the projects which are supposed to be helping to improve the quality of their lives.

/That is vital

That is vital if we are going to secure environmental objectives - the conservation of wild-life, for example, or the avoidance of environmental degradation. People are not simply the objects of development; they are also its instrument.

It is equally vital to involve people if we are going to pay proper regard to the role of women in development. I am against setting up special bureaux or units for this. Just as we seek to consider environmental impact in all we do, so we must also remember - always remember - the women's role. One area of special concern to me is that only 15 per cent of those on our training programmes are women. We are talking to the sponsor governments and asking them to nominate more women for our training schemes.

The need to encourage greater participation and involvement by individuals in the development process adds another powerful argument to the case for working more through non-governmental organisations. They will usually be better at the micro level than donor governments.

/Over the past

Over the past three years, we have more than doubled our support to the Joint Funding Scheme under which we co-finance NGO projects, from £2.3 million to £5.3 million. I intend to increase the grant further next year by a further 13 per cent. This is money extremely well spent - as is our grant of more than £6 million to Voluntary Services Overseas, a grant which has increased by over 50 per cent over three years. It will rise by a further 12 per cent next year. We should aim to develop the Joint Funding Scheme substantially.

Primary health care is one of the areas where the NGOs can make an especially effective contribution. We have decided to make primary health care the priority in our health and population programmes. It makes more sense than building expensive facilities which put a strain on the current resources of the recipient. I am particularly attracted to those health projects which move laterally into literacy programmes. I am sure that there is a close linkage between female literacy rates in particular and effective health and population programmes.

/To sustain

To sustain development, these sort of linkages have to be carefully worked out. Another obvious example is that between on the one hand project aid or sectoral aid (on which we are putting greater emphasis in the energy, communication and agriculture domains) and on the other, training and institution building. We must help make governments, and the instruments of government, work more effectively.

Our Scientific Units - the Tropical Development Research Institute and the Land Resources Development Centre - can make a large contribution here. We will shortly be merging these units with the intention that the new institute will play a more central role in our activities. The present Units form part of a £20 million research programme on renewable resources which also has links with the wealth of expertise in Britain. They are a great national asset.

/For the time being

For the time being, my laundry list will close. I hope it is clear from what I have said that I do not think we have any shortage of work. There is a lot to be getting on with. That is one reason, apart from temperament, why I have little sympathy for those Cassandras who think that the problems are too dire for us to contemplate, that they are inherently insoluble, or that we can only tackle them when we have succeeded in completely changing the world.

There are plenty of examples of success stories in development. It is little more than 40 years since many hundreds of thousands died in the Bengal famine; hardly anyone felt then that we could prevent it. India's record - and the growth since those days of an internationa awareness of development issues - are two of the many things that have happened in the intervening years which should provide some encouragement.

I don't doubt that there are important and complicated international issues that will have to be unscrambled if economic development is to be easier for the poor and continued prosperity more assured for the better off. The new round of trade talks launched recently come to mind straightaway. But we cannot wait for perfect conditions before tackling some of the issues that I have mentioned today.

I have no clear idea of where global discussions on trade, debt, agricultural production, exchange rates and so on are going to lead us.

"I do not ask to see the distant scene; one step enough for me" - which, not least since the lines are from a hymn by Cardinal Newman, may be a fitting and not entirely sacrilegious way to end a talk entitled "Idealism and Self-Interest".

pmr

FROM: A C S ALLAN

DATE: 25 March 1987

MR SCHOLAR

cc Sir P Middleton
Sir T Burns
Mr Sedgwick
Mr Odling-Smee
Mr Peretz
Mr Turnbull
Mr C Evans

TCSC: QUESTIONS FOR OFFICIALS

The Chancellor has seen the list of questions for officials, under cover of Miss Evans' note of 23 March. He had the following points:

(i) He gave the "official" gloss on the Prime Minister's remarks about the British economy not being strong enough to join the ERM in his interview with the Wall Street Journal (copy attached).

(ii) On Professor Brown (question 12), the limitations of his work can easily be spelt out.

ACSA

A C S ALLAN

Monday, 15 December 1986

THE WALL STREET JOURNAL
EUROPE

Lawson Says He Doesn't Want To See Sterling Decline Further

1=

By PETER NORMAN
Staff Reporter of THE WALL STREET JOURNAL

LONDON

BRITAIN'S CHANCELLOR of the Exchequer Nigel Lawson said he doesn't want to see the pound fall further on foreign exchange markets and said the government is "always" prepared to raise interest rates when necessary to maintain its anti-inflationary policy.

In a wide-ranging interview with The Wall Street Journal/Europe, Mr. Lawson also said he believes Britain will become a full member of the European Monetary System by joining the exchange-rate mechanism that limits fluctuations between most European Community currencies. "The question is when," he said. "It's a difficult issue. The government's view is that the time is not yet right. But the balance of argument has been swinging in the direction" of joining.

PRIME MINISTER MARGARET THATCHER, who is reportedly the main obstacle to Britain becoming a full member of the Deutsche mark-dominated currency block, was quoted recently as saying she considers the British economy too weak to join the EMS. In the interview, Mr. Lawson said he thinks the prime minister was misunderstood. "I don't think she meant that at all," he said. "She was saying we haven't got as strong an economy as the Germans have, and that is undoubtedly true."


Nigel Lawson

The 54-year-old chancellor said he was untroubled by signs of growing problems for the British economy. Despite double-digit interest rates, a revival of inflation and forecasts that Britain's current account balance of payments will move into deficit next year, he said the government would continue its present policy "because it's the policy that within reasonable margins is bringing the desirable results."

OVER THE PAST FIVE YEARS, he said, growth in the British economy and living standards has outstripped that of the country's major European competitors. Citing Britain's record of lowering inflation from a 21% annual rate in the second half of 1979 and increased output, productivity, industrial profitability, investment and exports in the past five years, he said: "you have to go a very, very long way back to find a period in which the British economy has been doing as well as it has been." Even unemployment – at 3.2 million in October – is coming down now, he said.

He admitted that Britain "is a country slow to change." The labor market remains too rigid, he said, and "there is room for a great deal of improvement in the standard and quality of British management." But Britain isn't incapable of changing, he insisted, saying many substantial improvements have occurred since the Conservative Party came to power in 1979. "It's almost a transformation, and I think that this is one of the difficulties we face in the election" that must be fought during the next 18 months. "The changes have been so great that people tend to forget what it was like in the 1970s" before Margaret Thatcher took power, he said.

In Mr. Lawson's view, Britain's refusal so far to become a full member of the EMS hasn't sapped the country's influence in international monetary affairs. "I think we have clout in international discussions that transcends economic strength because of our enormous international presence," he said. "It's not simply a matter of history and experience, but the fact that today our net overseas assets are second only to Japan. They are bigger than those of Germany, the U.S. and France."

He said Britain will play a leading part in tackling the problem of agricultural surpluses in the years ahead. "This is going to be one of the biggest if not *the* biggest problem of the next five

Please Turn to Page 22, Column 1

Lawson Says He Doesn't Want To See Sterling Decline Further

Continued From Page 9

years," he said. "It is a problem of enormous dimensions and intractability. The huge surpluses are increasingly expensive to finance and have a very damaging effect on poorer countries which depend on exports of primary products."

But what about those niggling worries nearer home?

The annual rate of inflation in Britain has risen in recent months from its low point of 2.4% in the summer to 3.5% in November and many analysts in the City, London's financial district, predict it will continue up, perhaps beyond 5%. The Treasury forecasts that the current account balance of payments, which tallies the nation's trade in goods, services and certain unilateral transfers, will lurch into the red next year for the first time since 1979 with a deficit of £1.5 billion ($2.14 billion). And interest rates – with bank base rates set at 11% – are higher than in any other major industrialized country.

The chancellor insisted that the long-term trend of inflation is downward. "Inflation never comes down in a straight line," he said. "There tends to be a cyclical pattern in inflation that is broadly connected with the trade cycle." In this cycle, he noted, the low point of inflation has been lower than in the previous cycle and "the high point will be lower."

Fall in Oil Price

Britain's probable shift into a balance-of-payments deficit also doesn't appear to worry the chancellor. He said the deterioration in the current account largely reflects the fall in the oil price at the beginning of this year. "We lost overnight half the value of our oil exports and we are a substantial oil exporter."

Meanwhile the £1.5 billion current account deficit forecast by the Treasury for 1987 is "relatively small", he said. "Its about 0.5% of our gross domestic product or slightly less. And that's after five or six years of accumulated surplus of £21 billion and before the full beneficial effects on trade of the depreciation of sterling against the other major currencies." Over the past year, the pound has lost about 16% of its value against a trade-weighted basket of currencies, falling sharply against the Japanese yen, the Deutsche mark and other European currencies.

Mr. Lawson also had a ready explanation for Britain's interest rates, which currently exceed the traditionally sky-high rates of Italy. The looming election is playing a role, including "particularly ill-founded concern in some quarters" that the government might change its policy to win votes. The high interest rates partly reflect Britain's unit labor costs, which have risen at faster rates than those of the nation's major international competitors. Another factor, he said, has been the extensive liberalization of Britain's financial markets which has left the government with short-term interest rates as the main instrument to influence monetary policy.

But the chancellor brushed off suggestions in a recent parliamentary report that uncertainty about British economic policy – including the government's recent decision to boost its planned spending by about £5 billion in each of the next two fiscal years beginning April 1 – could be unsettling financial markets and helping to keep interest rates high.

"I would suggest that the fact that our interest rates are high instead of indicating some change of policy – demonstrates that we are pursuing an anti-inflationary tight monetary policy in order to keep control of inflation and eventually to get it down further," he said. "There's no lack of clarity in the policy. The philosophy is clear. The policy is clear. The track record is clear."

In the area of tax overhaul, Mr. Lawson said the government has achieved "more in the way of sensible tax reform" in the present legislative period since 1983 than "I can recall in any previous Parliament." Some of the British steps anticipated the recent U.S. tax restructuring. Corporate taxes were cut to 35%, providing an incentive for foreign companies to invest in Britain, and several tax breaks were abolished to lower the general level of taxes. Additionally some taxes, such as a levy on development land, a surcharge on investment income and the so-called national insurance surcharge that acted as a tax on jobs, were abolished completely.

Public Expenditure

"But the way of the tax reformer is hard," Mr. Lawson said, noting that the U.S. has a great advantage over Britain in that it has traditionally enjoyed lower tax rates, which are reflected in the new U.S. tax bill. "That derives directly from public expenditure as a small share of national output," he said, adding that Britain plans to continue reducing the share of public spending as a proportion of gross domestic product to make room for tax cuts in the years ahead.

"But there has been a big difference between us and the Americans," Mr. Lawson said. "We were prepared initially not only to get a grip on public expenditure but to put taxation up in order to reduce the grossly excessive budget deficit that we inherited. The Americans have not done that and that has caused problems for them."

Mr. Lawson's remarks preceded his weekend meeting with U.S. Treasury Secretary James Baker. The chancellor denied that Mr. Baker's efforts to increase international monetary cooperation between the Group of Five countries – the U.S., Japan, West Germany, Britain and France – had stalled following the success of the Plaza agreement of September 1985 to reduce the value of the dollar.

Persuading Japan

The Plaza agreement was "a very major development of a kind you wouldn't expect to happen very often," Mr. Lawson said. Its major achievement, he said, was persuading Japan to accept that the yen was undervalued and should rise in value to reduce the dominant role played by exports in the Japanese economy.

Your reference

Our reference

Her Majesty's Stationery Office

HMSO

The Macaulay Press
Unit 2a
Tideway Industrial Estate
87 Kirtling Street
London SW8 5BP

Telephone 01-211 5418

GTN Code 211

Fax-Gp3: 01-211 7703

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
H M Treasury
Parliament Street
London SW1P 3AG

25 March 1987

Dear Chancellor

I write to acknowledge your letter of the 20 March in which you thank us for the work we did on this years budget papers.

I have passed on your thanks to all of the staff concerned who very much appreciate the thoughts expressed in such a personal way.

I would also like to thank you for the appreciative comments you have made to me personally and would like to respond and say that I am pleased and proud to have served you and your predecessor over the last eight years.

Yours Sincerely

Ronald M. Gair.

Ronald M Gair
Works Manager

BANK OF ENGLAND
LONDON EC2R 8AH

Mon only

E.A.J. GEORGE
EXECUTIVE DIRECTOR

24 March 1987

PERM. SEC'S. OFFICE
RECEIVED
25 MAR 1987

Action	Sir T Burns.
Copies To	Mr Cassell
	Mr Peretz
	Mr Odling-Smee
	Mr Lavelle
	Mr Grice
	Mr J. Cave
	Mr Sedgwick
	Mrs Lomax
	Mr MG Richardson
	Mr CW Kelly
	Prof B. Griffiths (No 10)

Mon policy

Sir P Middleton KCB
H M Treasury
Parliament Street
London
SW1P 3AG

Dear Peter,

I enclose our regular monthly note on interest rates over the next few weeks for our meeting on Friday morning.

Yours ever,

Eddie.

1. Published band.
2. Stockcuts ... as long as Mon & ... objectives not at risk
3. Re-org of the monetary report
4. Role of M0
5. Structure of gilt sales (not too slow: dilemma)
6. Intervention (long term) objective if so
7. Funding

Part of Plaza agreement
1 Sympathetic on effects 73.
2 Expenses on DM 3.
3. Bands
4. Sterling ...
73 7¼
5. Avoid ...

DCE
$
£

Oil

Nominal gilts

Sep. Oct

11 50
1¼

£ millions

INTEREST RATES OVER THE NEXT FEW WEEKS

1 The unpublished band for interest rates on bills with up to 14 days to maturity stands at 9-11%. Within the band we have reduced our dealing rate by a total of 1% over the last month in two 1/2% steps: we are now buying band 1 bills at 9 7/8%.

Market conditions

2 Oil prices have recovered over the last month: UK Brent for delivery a month hence currently stands at around $18.

3 In the foreign exchange markets, the dollar strengthened gradually against the Deutsche Mark for a period after the G6 meeting to a peak of DM 1.8715 on 11 March, but fell back on market concern about official intervention and is now lower than at the time of the G6 meeting. Over the same period the dollar has weakened against the yen, moving closer to and finally through the Y150 level.

4 Over the last month there has been persistent upward pressure on the sterling exchange rate combined with downward pressure in interest rates and bond yields. The immediate impetus to these developments has come from the optimism about the economy surrounding the Budget, the fact that interest rates in the UK are higher than in other industrial countries, and from changing perceptions of the political situation. But there are in addition suggestions that these pressures in part represent a fundamental "re-rating" of the UK economy, in particular by Japanese investors, whose interest in gilts could strengthen when their new accounting year begins on 1 April. If this is so, the pressure could last beyond the immediate conjuncture.

5 Sterling has appreciated markedly since the G6 meeting. This reflects both market perceptions that the pound was less likely to be affected by post-G6 intervention than the Deutsche Mark or the yen, and official resistance to lower UK interest rates, as well as the more general factors mentioned in the previous paragraph. Having reached 72.7 on the morning of Monday 12 March the rate fell back on the first 1/2% cut in interest rates, but it recovered most of the lost ground on the Budget and firmed a little when interest rates fell by no more than 1/2% after the Budget. Total intervention since the G6 meeting has been $4 billion. Changes in exchange rates since G6 are shown in the table below.

	£/ERI	£/$	£/DM	£/Yen	$/DM	$/Yen
20 February (day before G6)	69.1	1.5283	2.7914	234.67	1.8265	153.55
24 March	72.4	1.6215	2.9382	240.87	1.8120	148.55
% change	+4.8	+6.1	+5.3	+2.6	-0.8	-3.2

6 In the money market a 1% post-Budget cut in interest rates was all but fully discounted on Monday and Tuesday of last week, and following the 1/2% cut that actually took place, a further cut of 1/2% or possibly more is expected before long. The one, three and twelve month interbank rates stand at 9 15/16%, 9 21/32% and 9 3/8% respectively.

7 The gilt-edged market has seen strong demand over the last month, particularly since the Budget, and yields have fallen sharply since the last meeting, as the table below shows. Gross and net official sales for March so far are 620 and 80 respectively.

	5 years	10 years	20 years	Index-linked (2024 maturity)
26 February (date of last meeting)	9.87	9.87	9.74	3.22
23 March	8.68	8.88	8.84	3.16
Change	-1.19	-0.99	-0.90	-0.06

Monetary conditions (monetary figures seasonally adjusted unless otherwise stated)

8 M0 fell by 0.8% in February, nearly all on account of notes and coin in circulation; its 12-month growth rate fell to 4.1%. £M3 went up by 2.2% and its 12-month growth rate went up to 19.2%. These and other recent changes in the monetary aggregates are shown in the table below.

Recent growth rates of the monetary aggregates

	February	Latest 12 months
M0	- 0.8%	+ 4.1%
nib M1	+ 1.6%	+ 10.6%
M1	+ 0.6%	+ 20.8%
M2	+ 0.6%	+ 12.3%
£M3	+ 2.2%	+ 19.2%
PSL2	+ 1.2%	+ 12.9%

9 The British Airways share sale is not thought to have distorted any of the aggregates in February.

10 Total notes and coin outstanding fell by 140 in February. During 1986, notes and coin held by banks went up much faster than notes and coin in circulation with the public, but this trend has ceased since the turn of the year.

11 Among the broad aggregates, much of the rise of 2.2% in £M3 was accounted for by time deposits and CDs, many of which were taken up by building societies. The 12-month growth rate of PSL2, which peaked at 15% in June 1986, has now fallen back to below 13%.

12 Among the counterparts to the rise in £M3, the PSBR was 230 and there was defunding of 470 (partly accounted for by a reduction of 230 in holdings of gilts by the non-bank private and overseas sectors), so that there was underfunding of 710 on the wide definition.

13 Bank lending to the private sector went up by 2,910, not much less than in the final 3 months of 1986. Some of the borrowing may have been undertaken on a short-term basis in order to buy CDs in the expectation of a capital profit when the general level of interest rates fell: if so, it may be expected to reverse.

14 Net mortgage lending by building societies in February, at 1,230, remained relatively subdued. Retail inflows into the societies were 950; the difference was made up by wholesale borrowings. Nevertheless three large societies have reduced their mortgage rates, by 1-1 1/8%, to 11 1/4%, anticipating a further cut in the general level of interest rates to below 10%.

15 The three-month forecast is for M0 growth of 0.4% this month, 0.3% in April and 0.5% in May. This would leave the 12-month growth rate little changed at 4.2% at end-May. £M3 is expected to grow at around 1 1/2% a month over the three months (with bank lending averaging about £2 1/4 billion a month), and on that basis its 12-month growth rate would fall back quite sharply to 15.7% by the end of May, as the very rapid growth in the spring of 1986 drops out of the comparison. Over the same period the 12-month growth rte of PSL2 is expected to fall to 11.4%.

16 The twelve month increase in the rpi was 3.9% in February, unchanged from last month. Manufactured output prices rose by 1/4% in February, and their twelve month rate of increase is now 4 1/2%. Input prices were unchanged over the month, but their twelve month change now shows a fall of only 1 3/4%, compared with 4% two months ago. The Department of Employment's estimate of the twelve month increase in underlying earnings in manufacturing reverted to 7 3/4% in the year to January, much the same as it has been over the last year. Inflationary expectations as revealed in our sample of stockbrokers' circulars are little changed from last month. They show inflation peaking at around 4 3/4% in the third quarter then falling back slightly to 4 1/2% in the final quarter. Pre-tax real interest rates have fallen to around 5% on a three month horizon and 4 1/2% on a twelve month horizon, mainly reflecting the fall in inter-bank deposit rates.

Conclusions

17 The evidence from this month's money figures is mixed. A second successive monthly fall in M0 is encouraging, though it may partly reflect the behaviour of the banks rather than the public. The £M3 and bank lending figures taken on their own are disappointing, but PSL2 growth was more modest.

18 In the real economy, output continues to show signs of responding to the persistent strength of demand. The price situation is not much changed, except that lower mortgage rates are likely to forestall the step rise in the 12-month rate of increase in the RPI that would otherwise have occurred in the middle of this year.

19 Given the continuing strength of demand and credit growth, the case for a further reduction in interest rates is weak. However should the exchange rate continue to strengthen, a dilemma would emerge between the desire to maintain steady monetary conditions and the external competitiveness of the economy.

20 This dilemma could emerge very quickly, and the immediate response would have to be decided on tactical grounds in the light of the surrounding circumstances. But if the exchange rate strength persisted, it would become necessary to formulate a longer-term response, the nature of which would depend on the desirability from the external viewpoint of building up the reserves, given that additional funding would be needed if the domestic monetary consequences were to be contained.

Bank of England

24 March 1987

Meena
Thanks. RP
T.

1010N

J C TOWNEND
HEAD OF WHOLESALE MARKETS
SUPERVISION DIVISION

Telephone: 01 601 4019

BANK OF ENGLAND
Threadneedle Street
London
EC2R 8AH

25 March 1987

PPS

Mr Kuczys

Mrs J R Lomax
Under Secretary
H M Treasury
Parliament Street
London
SW1P 3AG

Dear Rachel,

I fear that the telephone conversation recorded by Kuczys which you sent to me rang no bells here but we will keep it in mind for future reference.

Yours ever

John

ps3/45K

RESTRICTED

FROM: A W KUCZYS
DATE: 11 March 1987

PS/SIR P MIDDLETON

cc Mr Kemp
Mr Cassell
Mrs Lomax
Mr Gilhooly

NOTE OF TELEPHONE CONVERSATION

I had a telephone call from a member of the public this afternoon, who would not give her name.

2. About a week to ten days ago, she had overheard a telephone conversation, through a crossed-line. The conversation appeared to be between someone representing a teachers' union, and a money broker. It was about the investment of £49 million through a US bank (Amex). Apparently the broker said that routing the investment in the way he proposed was "a way of getting a quick £3 million in your back pocket". If anything went wrong, it would be "between the (English) bank and the (English) insurance company". The caller said she did not know whether this implied any wrong-doing, but it sounded odd and she passed the information on to the authorities on that basis.

AWK

A W KUCZYS

Thanks
Budgen hid me last night
1. CHM gov welcome
2. O-Sine brilliant
3. Party pov

M.

CHANCELLOR OF THE EXCHEQUER
HONI SOIT QUI MAL Y PENSE

BIF Alex 27/3

CE
PWP
TCSC

Ch

TCSC officials

(1) Lots on monetary & XR policy, particularly attempts to get officials to say level of private sector credit growth disturbing (David Perlotz irritated Terence Higgins with a bit of a stodgy performance).

(2) Only one budget question (CGT on life assurance)

(3) Budgen tried to get Michael to say underlying rate of inflation over 5% (no revalorisation, cut in mortgage rates etc)

(4) PSBR = 1% GDP is change of policy? Oddlers denied this.

Michael seemed to think all went reasonably well, with no hostages to fortune.

AA.

Alex — Sorry any assistance — do you have the other versions.

defective.

This is strange It only ~~goes up to~~ has the pages listed here Where are the rest?

pup

2-26, 35, 40

WEDNESDAY 25 MARCH 1987

Members Present:

Mr Terence L Higgins, in the Chair
Mr Tony Banks
Mr Anthony Beaumont-Dark
Mr John Browne
Mr Nicholas Budgen
Mr Brian Sedgemore
Mr John Townend
Mr Richard Wainwright
Mr John Watts

EXAMINATION OF WITNESSES

MR M SCHOLAR, Under Secretary, Fiscal Policy Group, HM Treasury, MR D PERETZ, Under Secretary, Monetary Group, HM TReasury, MR P SEDGWICK, Under Secretary, Forecast and Analysis, MR J ODLING-SMEE, Under Secretary, Medium Term and Policy Analysis, HM Treasury, and MR A TURNBULL, Under Secretary, General Expenditure Policy, HM Treasury, called in and examined.

Chairman

1. Mr Scholar, you and your colleagues are most welcome this afternoon to the beginning of our annual festivities, and we are grateful to you and your colleagues for coming along. I should perhaps mention, since this is a public session, that we shall be taking evidence from the Governor of the Bank of England in public tomorrow at 4.45 and from the Chancellor of the Exchequer on Monday at the unusual time of 2.15. You will appreciate that the pressure of time this year is very considerable because we always seek to produce a report for the benefit of the House ahead of the second reading of the Finance Bill and between now and then the recess intervenes. The result is we have very little time both to take evidence and to draft a report

ahead of the recess, and will need to have it available immediately afterwards. This does mean we are up against time, and that is the explanation for the somewhat unusual timing of the evidence which we shall be taking. Thank you all very much for coming. Perhaps I might invite you in the traditional way to introduce your colleagues, and then we might go straight to questioning. I presume there is no initial statement you wish to make, given that the House has been debating the matter for some days.

(Mr Scholar) Thank you, Mr Chairman. On my left is Mr Peretz of the Monetary Group of the Treasury. On his left is Mr Sedgwick of the Forecast and Analysis Group. On my immediate right is Mr Odling-Smee of the Medium Term and Policy Analysis Group, and on his right is Mr Turnbull of the General Expenditure Policy Group.

Chairman: Thank you very much. We would like to start clarifying some points as far as monetary policy and the exchange rate is concerned.

Mr Sedgemore

2. I wonder if you could help us with the rising fog of monetary indicators - M0, M1, PSL1, PSL2, DCE, and no doubt several others. Let us start with M0. This Committee has in the past argued that it is of little consequence in assessing the state of monetary conditions, that it is of limited importance as a measure of transactions demand because of the increasing growth of cheques and credit cards, and we have asserted, as I believe other people have, that it lags behind rather than anticipates growth in money GDP, so why do the Treasury continue to use it as a monetary indicator and should we not be looking at an alternative?

(Mr Peretz) I think a lot of the arguments are set out in the Budget documents, and have been set out at rather greater length in various statements, including the Chancellor's Lombard Association

Lecture last year, which was perhaps the longest and most extended explanation of monetary policy. Taking M0, I think we accept that in some ways it is not an ideal narrow aggregate, and some of the reasons are set out in the Red Book as to why other possible narrow aggregates are not very useful, such as non-interest-bearing money — which you might think would be useful. But what has been true in practice is that M0 has proved a fairly reliable indicator of monetary conditions and reliable guide to policy over quite some period of time.

Chairman

3. Before or after the event?

(Mr Peretz) Before the event, I think I would say, Mr Chairman. As to the question of whether it is lagging or not, I would refer you to ~~read~~ the article we produced in the May/June Treasury EPR ~~of~~ last year, which presented a piece of work which looked at whether the relationship between M0 and money GDP was more stable if you looked at it lagged by a period. ~~and~~ On the whole it seemed that if you took the relationship between M0 one year and money GDP the next, that shows a slightly more stable relationship than between M0 and money GDP in the same year. So I think if anything the evidence is that money GDP follows M0. I should add to that that M0 does have a useful practical advantage in that it is an indicator which is actually available very quickly after the event, whereas the figures we get or the indications we get of money GDP ~~actually~~ follows some months after it has actually happened. For M0 we have a reading of some ~~times~~ kind almost every week. It is quite quickly available after the end of each month, so that even if you thought that it was a coincident indicator rather than one which was leading, it would still be a very useful one.

Mr Sedgemore

4. For what years? You say these figures - I have not read

this article, I must confess - show that money GDP follows M0. What period does that study cover?

(Mr Peretz) This was the EPR article published in May/June last year. It goes back to 1975, and ~~also~~ covers the period 1975-85.

5. And there is a constant relationship, is there?

(Mr Peretz) No, there is not a constant relationship. I do not think anybody would want to pretend that there are exact relationships which follow precisely. But it is true that M0 has shown a ~~much~~ more stable relationship than ~~almost~~ any of the other monetary aggregates, narrow ones or broad ones, and therefore I think as a practical matter it has a track record which we need to look at. We are not the only country to look at narrow aggregates; the Swiss targets their version of M0; and the principal German target, which is Central Bank money, in fact consists as to 50 per cent or so of notes and coin. So we are not all that extraordinary in international terms either.

6. If we could look at the cheques and credit card side of this, does their increasing use matter in terms of monetary conditions, either in terms of monetary conditions or in terms of wider economic policy? Would it matter if plastic cards became 110 per cent of income?

(Mr Peretz) It clearly is true that things like that, which you might call technical innovation, affect the velocity of M0. But our experience has been that they affect it in a fairly steady way rather than in jumps in particular years, so it has been a regular and fairly steady effect, which ~~teams with~~ appears in the velocity trend. There is a chart, 2.2, in the Red Book, which shows the M0 velocity trend over a number of years, and shows just how stable it has been. It is not a straight line, but it is not a bad version of a straight line.

7. So you are happy that as far as monetary indications are concerned, the growth of plastic cards does not matter, because it is not big enough to change velocity of circulation?

(Mr Peretz) One of the reasons why we look at a range of indicators rather than just one is that it is clear that almost any single indicator can be subject to distortions from time to time. As I say, up to now that has not happened for M0. But I think one can be confident that as long as one was looking at a range of evidence, if it did happen, you would spot that it was doing something slightly peculiar from the other evidence.

8. Are there any wider economic implications about the growth of personal debt and plastic cards? I repeat what I said just now: does it matter if personal debt largely from the use of plastic cards became 110 per cent of income?

(Mr Peretz) Personal borrowing is one of the factors that goes to affect the growth of the broader aggregates of money, and the broader aggregates of liquidity, and certainly I think again ~~all~~ the Budget documents make it clear that we continue to pay attention to those. But they have proved very difficult to interpret in recent years because ~~of~~ the rapid growth of personal borrowing combined with a build-up of personal ~~financial~~ assets of roughly the same rate and magnitude, and these ~~things~~, to the extent they are liquid assets, appear to be liquid assets which are willingly held. and insofar as that is true, it is not ~~because that~~ not a matter of particular concern .....

9. How do you pay attention to them - in relation to which broader money indicator?

(Mr Peretz) We look at a range of broader aggregates. Last year we had a target for sterling M3, and for many years before that, but that is not the only ~~one.~~ broader aggregate. I think there is a paragraph in the

Red Book which says that the broader aggregates~~,~~ which include building society liabilities as well as bank liabilities, may ~~prove~~ be slightly less erratic than those which ~~are~~ contain just bank liabilities. That is not particularly surprising since to some degree banks and building societies are now operating in very much the same market, competing with each other.

10. Are we still taking any notice of the ~~MRI?~~ £M3? I thought the Chancellor said we were not.

(Mr Peretz) I think the Chancellor said very clearly he was still.

11. It says here in the Red Book at 2.14, "If the underlying growth of M0 threatens to move significantly outside its target range in 1987-88 there is a presumption that the Government will take action on interest rates unless other indicators clearly suggest that monetary conditions remain satisfactory." What are these "other indicators" and how would they have to behave to prevent an increase in interest rates?

(Mr Peretz) ~~As~~ There is a range of indicators we look at, apart from broad money and various measures of narrow money and the exchange rate, which are in a sense the three most important indicators, as highlighted in the Red Book. ~~we~~ We look at quite a range of evidence. Movements in asset prices, house prices, the stock exchange, can produce valuable evidence about monetary ~~positions~~ conditions. The most up-to-date information about inflation itself, which includes producer prices as well as consumer prices. Movements in the oil price which is clearly one of the important factors which affects the exchange rate, ~~appropriate movements in the exchange rate and to~~ And to some extent movements in the interest rates themselves, and how our rates compare with rates abroad and interest rate differentials. I do not want to give the impression that that is a complete list, but perhaps I have said enough to give some indication of the range of things that are taken into account. As to paragraph 2.14 I think this paragraph really does mean precisely what it says, very much the answer I gave earlier on to Mr Sedgemore. ~~that~~ M0 has proved quite a reliable indicator for in a number of years, so we would need some persuading that it was telling us wrong things but, if the range of other evidence said it was giving us a misleading message, then we would do precisely what it says in that paragraph.

12. I am simply puzzled as to what you said because you have got to deal with cause and effect and you have got to deal with time lags. M0 goes outside its range and then you look at these other indicators which apepar to be stable. I take it you are saying something like that it is not changing very much so there is no need to start changing policy on interest rates, but if the purpsoe of M0 is actually to give you a trigger that something is going wrong, then what is the point of this statement? If it goes outside the range, do you then suddenly say "We are going to ignore the trigger"?

(Mr Peretz) I think what it would create is precisely what it says in the paragraph, a presumption that something is going wrong unless the other evidence were pointing clearly in the other direction.

13. The other evidence could only give a static analysis, it cannot give a dynamic analysis. You could not tell whether the evidence was going to point in no direction at all until it happened, until the time had passed.

(Mr Peretz) Well, these things do not happen instantaneously, I think that is ~~an initial~~ one point. Indeed, it would be quite wrong to react to every single week's or month's reading of a particular aggregate because there are obviously random fluctuations and variations in some of these things.

14. Are you really telling us it is an intuitive process, you have lots of indicators, and somebody sits down and does not take any notice of M0 , M3 or broad money but "intuits" some kind of balance between them? Is it in fact some kind of curious art none of us understands?

(Mr Peretz) No, but I am saying at the end of the day it is a matter of judgment. There are a number of - really three principal - things the ~~Government says that the~~ Government takes into account in making decisions in assessing monetary conditions, and then taking decisions on interest rates: the movement in M0 as judged against its target range, the behaviour of the exchange rate, and the behaviour of broad money, which has proved difficult to interpret in recent years but is still something very much which has to be taken into account. Then there is a range of other evidence I tried to give you an indication of we would also look at. It would be ~~a very~~ foolish to ignore any ~~that. I think it~~ is information we think ~~which~~ is useful.

Mr Townend

15. Short term interest rates are still rather higher than most of our industrial competitors'. In view of the state of the market and the strength of sterling in recent weeks, why has the Government been so reluctant to allow a significant drop?

(Mr Peretz) There have been two half-percent cuts in ~~the~~ base rates in the last two weeks. I think the way I have ~~the Government~~ ~~tried to explain the way~~ ~~actually tried to explain the way~~ the Government makes decisions about interest rates. It has been ~~much more~~ fully set out, for example, in the Lombard Association speech and elsewhere. ~~and~~ They aim to keep interest rates at a level, on average, that keeps monetary conditions tight enough to maintain downward pressure on inflation. There are sometimes also, I should say, tactical market issues ----

Chairman

16. The acoustics in this room are very bad. It is extremely difficult for the people behind you to hear. Could you please speak up?

(Mr Peretz) Sometimes also tactical decisions to be made about how best to achieve the level of interest rates - the level which the Government have judged right. But the ~~rate~~ level of interest rates today - I do not think I can say more than this - reflects the Government's current judgment both of monetary conditions and market pressures. Beyond that I would say the Government's stated intention has been to operate ~~the~~ policy in a ~~very~~ cautious manner, and not to take any risks with inflation.

Mr Townend

17. It is one of the reasons given in paragraph 2.15, which says, "Private sector borrowing has been rising and is now over 10 percent of GDP... It has clearly contributed more than public borrowing to upward pressure on real interest rates." Is it really the level of private sector borrowing which is keeping interest rates higher?

(Mr Peretz) That is certainly one of the factors that has affected the level ~~at which it~~ is. of interest rates.

Chairman

18. What estimates have you of relevant elasticity as far as that is concerned as to the relationship between short term interest rates and private borrowing?

(Mr Peretz) I do not think it is really a question of necessarily setting interest rates at a level that restrains borrowing to a particular rate of growth. It is more a question of taking account of the rate of growth of ~~public~~ borrowing in so far as it affects the rate of growth of broader aggregates.

19. We are talking about private borrowing.

(Mr Peretz) Private borrowing affects the rate of growth of broad money because one of the counterparts ---

20. We understand that. What estimate have you made of elasticity? You were saying just now the rate of interest is supposed

to affect the level of private borrowing; you must have some idea what the relationship is.

(Mr Peretz) I think all I was saying was the rate of interest - the level of interest rates - is higher than it would otherwise be were the rate of private borrowing less.

Mr Townend

21. Is the Government worried at the present pressure put on private borrowers?

(Mr Peretz) The Government's judgment is that with the current level of interest rates, and the current level of growth of broader aggregates, the combination is roughly right.

Chairman

22. That is not the question. Would you answer the question?

(Mr Peretz) Your question is?

Mr Townend

23. Is the Government worried about present pressure on increased liquidity in the private sector and private borrowing?

(Mr Peretz) The answer is that is one of the things which goes into the setting of interest rates.

Chairman

24. We understand that. That is not the question.

(Mr Peretz) I am not ---

Mr Budgen

25. Is it the desire of the Government that this level of private borrowing should be reduced?

(Mr Peretz) I think one could say, if it were lower, then the level of interest rates might be lower and that would be consistent with the same downward pressure on inflation.

26. Is the answer to my question - listening to the various

ways in which people have formulated it - yes or not?

(Mr Peretz) Your question is? I mean, the Government -- - maybe this is a question you should ask the Chancellor rather than me.

27. We will.

(Mr Peretz) ~~Take~~ The ~~the~~ Government's position ~~to be that~~ on the level of private borrowing is that it is market processes which determine~~s~~ the level of private borrow~~ers~~ing ~~are free to borrow at~~, and that the instrument of Government policy is the level of interest rates.

28. You are saying then the Government does not have a view about the amount of private borrowing that is now taking place?

(Mr Odling-Smee) Perhaps I could say, following up what Mr Peretz has just said, the Government is concerned that the private financial markets should operate in a relatively unfettered way and that borrowing should be whatever is determined by the process as they go on within that. The Government's concern would be if that led to monetary conditions which were not consistent with objectives for money GDP over the medium range. Mr Peretz has been explaining that there is no reason to believe that monetary conditions at the moment are inconsistent with those objectives, despite what might appear to be rather alarming levels of borrowing to some people.

Despite what might appear to be rather alarming levels of borrowing to some people.

Mr Townend

29. What, if anything, can be done to correct the increase in private credit? Is it purely putting up interest rates, or do you have other ammunition in the locker?

(Mr Peretz) ~~Reall~~y, the instruments of government policy are interest rates and, over a slightly longer time horizon, fiscal policy. I am not sure what other instrument you are suggesting there might be.

30. I am asking you.

(Mr Peretz) It is certainly true that governments in the past have tried to control credit by volume controls of one kind or another and governments overseas have tried that too. I think as financial markets have become more sophisticated that has become extremely difficult and something which has proved not to work very well.

31. Not an option that is being considered by the present government?

(Mr Peretz) No.

Mr Beaumont-Dark: Well, I must tell you that I have never heard such twaddle!

Mr Sedgemore: He is in his academic mood today!

Mr Beaumont-Dark

32. One of my great joys is that I am not an academic. I have to live in the real world, and that is not the same thing, but one of the reasons why I thought the Budget was good - and it was good; I thought it was the best Budget since 1979 - was that I understood the strategy is that the reason why the Chancellor quite rightly resisted the normal temptation of any full-blooded politician to spend other people's money was that it would do one essential thing, which was that if you had three and a half billion that you kept in the bank

instead of enjoying it upon wine, women and song, it meant that you would be able to get interest rates down, and then we have these old women in Threadneedle Street, which you then tell me, and us, reflect the government's views. How can that be true? I agree we will ask the Chancellor on Monday, but surely the great success of the Chancellor's policy should be two things: to reduce the cost of money, which is at usurous levels in this country against all our competitors, and that the pound should not keep on going up, because would you not agree that one of the great tragedies we have had was that when the pound went to two dollars and more it acted like a scythe throughout manufacturing industry? Are you telling me that interest rates, with this little grovelling half per cent here and half per cent there, like some miser who does not want to give people their own money, is really what you are advising the Chancellor? I do not blame him. What advice is he getting? Are you really, along with those gnomes in the Bank of England, telling the Chancellor he should not reduce interest rates? Yes or no? What are you telling him, for God's sake?

(Mr Peretz) I am not sure I am allowed to tell you.

Mr Beaumont-Dark: I may not want to hear it!

Chairman: Order. It is, I think, a well-established convention that the advice of officials to the Chancellor is something they do not reveal.

Mr Beaumont-Dark: If it is bad, it ought to be private! What is your view on it? Are you actually telling us - because you have got to be here to do something - that you think interest rates at the moment are right or not? Do not tell us what advice you are giving him; what advice are you giving the British public, who pay us? Do you say that interest rates are too high, too low, or right? Which are they?

Chairman: I think that is really a question one ought to pursue with the Chancellor.

33. No, otherwise why are they here? What advice are you giving me, as a humble back-bencher, with a small "h"? I am fed up with this.

(Mr Peretz) I will make two comments. One is that, as I have already said, short-term interest rates have come down one per cent, or if you look at market rates, they have come down slightly more, ~~and~~ second long-term interest rates have come down from a 20-year yield ~~in~~ for gilts of around 10 per cent in January or February to rather under 9 per cent now. One should not forget about long-term rates as one of the costs to industry in borrowing.

(Mr Odling-Smee) Perhaps I could add a couple of comments as well, Chairman. I think that what one can say in reply to Mr Beaumont-Dark's question about the effects of the Budget on interest rates is that over a period of time, and not necessarily for the first ten days or whatever, the fact that the Chancellor has not spent all of the money, to use Mr Beaumont-Dark's language, will bring about somewhat lower interest rates than would otherwise have occurred, and so I think that he is right to welcome the Budget on that account. That is all I wanted to say.

34. Can I just say this? You said, and I agree, that we people who do not live in the clever world take things on rather a more simplistic basis, but you said the private financial market should operate freely. It obviously is not, and I will tell you why it is not: because it stands out, even for people like me to see, that here you have got the pound at $1.62, and we all know in a manufacturing sense - and I agree you may say I bleat about manufacturing industry, but when oil is gone you will depend upon my people and my kind to manufacture it, because it will not be coming out of the ground; it

will have to go over the ground. Why is it that you think that the pound should keep on going up? Why should thepound be $1.62 when in a manufacturing sense there is no justification for it? If we took one per cent or one and a half per cent off interest rates and the pound came down to $1.50, would there be blood flowing in the river? No; there would be prosperity flowing through industry. That is what matters. Why do you clever boys think it is much better to have a higher pound than higher industrial activity? Why? Tell me why. Tell my people, tell Birmingham people, manufacturing people, why.

(Mr Peretz) One point is that the Chancellor has said repeatedly recently that he is very happy with the level of the pound at its current level.

35. Is he?

(Mr Peretz) And that he would, by implication be unhappy were it to go up or down very significantly. Another comment is that it is a good deal lower now than it was a year and a half ago. In effective terms it has come down from somewhere in the 80s a year and a half ago to 72 today.

Chairman: I think this again is a matter which we would wish to pursue with the Chancellor or the Governor.

Mr Banks

36. I am sorry that I was late, Chairman. I came in at the point that Brian Sedgemore was asking whether the amount of private personal borrowing and plastic cards was actually important, and I thought it was being said that the government was not too worried about that; it did not make any difference. Subsequently, however, one heard that it was the level of private borrowing that was causing the upward pressure on interest rates, but then interest rates were

being kept at levels to protect against inflation. The question is this really, since it has been mentioned about overseas experiences: why then do we appear to have the worst of all possible worlds, which is in Europe it would appear to be amongst the highest short-term interest rates and the highest rate of inflation?

(Mr Peretz) There could be some relationship between interest rates and inflation.

Chairman: We understand that.

37. I entirely understand that point, but if the government is saying that it does not want interest rates to come down in order to protect against inflation, why have we still got the highest level of inflation and the highest level of short-term interest rates? Some must be doing it a bit better than us, must they not?

(Mr Odling-Smee) There has been a recent change in our position vis a vis Europe - perhaps one should put it the other way round: in some of the European countries vis a vis our past, in that the fall in the oil price helped to recuce inflation in most other European countries quite sharply last year, and that did not have the same effect on us because of our special position as a nett oil exporter.

So that in itself produced an inflation differential that was relatively adverse to us. In response to that - partly in response to that, but there are other things such as growth of private credit and further factors - it has been necessary to have somewhat higher interest rates here. So to some extent these two factors you observe - higher inflation at the moment and higher interest rates - are both the result of the developments over the last year or two in world economy, specially falling oil prices.

38. So if private borrowing is causing interest rates to stay high, if the Government were to do something about the level of private borrowing, one could assume then interest rates would go down.

(Mr Odling-Smee) I am not sure what it is the Government could do other than keep interest rates higher.

Mr Browne

Chairman, does the Treasury find it disturbing that there apepars to be a continuing upward trend in the private sector of liquidity and of borrowing, despite the fact that interest rates, as we have heard, remain at very high levels in real terms? Could you say what you feel should be done to curb this demand for credit in those circumstances?

(Mr Peretz) We keep being ~~asking~~ asked more or less the same question, Mr. Chairman. I find it very difficult to give a different answer than the one we have given so far.

39. I am not trying to ask you what advice you are giving the Chancellor, as has been asked before, because I quite understand this is not the forum for that advice to be aired in public, but I am trying to ask what your views are on the alternative options and therefore what you see - just as an individual member of the Treasury - can be done to curb the demand for credit in present circumstances.

(Mr Peretz) Interest rates are the most obvious and main instrument of the policy and that is, indeed, one of the reasons why interest rates are so high. Perhaps a slight diversion if I may, Mr Browne, you said real interest rates are high. It is never very easy to know what real interest rates actually are. You compare interest rates with current inflation but really you ought to be comparing nominal interest rates with people's expectations of future inflation ~~and~~. There was an article in the Bank of England Quarterly some time last year - I do not recollect the precise date - which ~~did~~ compared our real interest rates with other countries on various ~~those~~ different bases. On some bases our rates are not necessarily higher than other countries. It depends on the basis of comparison. One of the reasons why our real interest rates might be higher than other countries, is that clearly it takes a great many years for governments, for countries, to establish an international track record, if you like, of aiming for low inflation - countries like Germany, which has had twenty years or more, ever since the war, of track record of that kind. People in the market ---

Chairman

40. Mr Peretz, can I ask you please to listen to the questions and to seek to answer the questions rather than going off in a different direction. The question was, apart from interest rates, what are the alternative ways you might consider could be used to restrict the growth of private credit?

(Mr Peretz) Mr Chairman, I mentioned one before - direct controls of one kind or another. I said experience - not just in this country, in other countries - is that such controls were increasingly unworkable even if you thought they were desirable. I do not address the question whether they are desirable or not.

Apart from that, in the longer run fiscal policy has a role to play.

41. On consumer credit?

(Mr Peretz) On the level of interest rates.

42. Yes, but the question was on consumer credit.

(Mr Odling-Smee) Fiscal policy could restrict the demand for credit by slowing down the growth of money incomes.

Chairman: Thank you very much. Mr Browne?

Mr Browne

43. Thank you very much for that answer. By the way, I am very interested in what you said about real interest rates. It is just the normal terminology. What I am saying - and I think most people would agree - is that, despite your answer, that is the normal view. I would agree more with your definition myself, but does that mean that the outlook for inflation is going to be higher?

(Mr Peretz) I think what it means is ---

44. People expecting higher inflation?

(Mr Peretz) What one would hope it would mean is, as it becomes clear that inflation is on ~~the~~ a downward track, then interest rates will come down and the longer this track is - that, I think, is the Government strategy - the longer ~~this~~ the medium term strategy is held in place, the longer it is made clear that inflation is on ~~the~~ a downward track, then the more likely it is that nominal interest rates can be got down and kept down and held down in a sustainable way.

45. I was very interested in your answer to Mr Sedgemore's question about the relatively stable relationship between the growth of M0 and money GDP. Does this therefore mean broad money, however you define it, does or does not continue to have a role in the formulation and operation of monetary policy?

(Mr Peretz) No, I think it is fairly clearly set out in the documents. It does continue to have a role, it is just that the Chancellor decided its behaviour had been so - "erratic" is the wrong word - so difficult to interpret over the last few years that it would actually be less helpful rather than more to have a target range for it. So we will continue to take it into account, if you like, in the same sort of way the Government takes account of the exchange rate, but without any precise guideline for it.

46. Finally, the Chancellor said he would like sterling to remain roughly at its present level, say at 72, as you just told us. Does this indicate that he and the Government are changing their views and thinking of negotiating entry to the European Monetary System?

(Mr Peretz) The Chancelllor is on record very recently on the European Monetary System as saying there is a balance of advantages and disadvantages, which is kept under review, but the time is not ~~ripe~~ right to join yet. I think the one thing which has changed — maybe this might help you — ~~us~~ is the recent Paris Agreement between the major six countries which has created slightly different conditions for the operation of policy. First of all, ~~I mean~~, the fact the agreement took place reflected the fact that the patternof international exchange rates now is much closer to what one might think would be justified by fundamental economic circumstances ~~and this~~ than has been true for some time. Certainly that is what ~~the words of~~ the communique from the Paris Agreement concluded. So that the conditions that are there are much better than they have been for many years to achieve ~~the pattern~~ stability of exchange rates. The other element of the Agreement was the commitment of the six Finance Ministers present to operate policy in order to try and achieve a period of stability. I think that does put the operation of our own policy in a slightly different context than it has been up to now - if only that it means in our own policy decisions we are in a position to give slightly greater weight to achieving exchange ~~rates~~ rate stability because the chances of achieving ~~these~~ that are rather better than they have been. Every exchange rate has two parties to it. It is much harder to control your exchange rate if you are trying to do it by yourself, but with an international agreement like that it is slightly ~~better~~ easier.

Mr Watts

47. At the time of our inquiry into the Autumn Statement the Sterling Index was a little over 67 and the Chancellor told us he was happy with it, but at that level, and did not wish it to move significantly either up or down. In his interview with the Financial Times on 19th March he said again that he would like to see sterling remain at its present level. I think, Mr Peretz, you referred to that in reply to an earlier question about 72. Does the Chancellor's recent statement imply a target range, although not an acknowledged one, of 72 to 73, or what are we to understand by his recent comment?

(Mr Peretz) I am trying to remind myself of his words. I thought my recollection was he said he would not particularly like to see it go any lower than 67, or whatever the rate was at the time, rather than saying he thought that was about right. When ~~we~~ he came back from the Paris meeting he indicated he had already said he did not want to see it go any lower than it had been, and as a result of the Paris Agreement he would not want to see it go substantially higher than it was then, which was around 69 or thereabouts. More recently, after the Budget,

important

~~He~~ he indicated that he was very happy with it around its current level. I do not think it would be helpful for me to go beyond that. Suggestions of target ranges are really slightly wide of the mark - ~~certainly~~ narrow or wide. I must rest on what the Chancellor has said, which is that he is ~~quite~~ happy with it around its current level, as indeed ~~was~~ very much follows from the terms of the G6 Communique. All the finance ministers felt a period of stability of exchange rates (in current circumstances) around their current levels would be right and they would work to that end.

48. But does not the agreement at Paris to try to achieve a greater stability give rather more support to the notion of having a declared target range and are not the risks of doing that somewhat diminished when all of the major industrial countries have pledged themselves to try to achieve that stability?

(Mr Peretz) Mr Chairman, I am in some difficulty because almost anything any official says on this subject - or the Chancellor for that matter - is liable to misinterpretation in some form or other. I think the Chancellor has made it absolutely clear that he does not think it makes sense for this country to have an explicit exchange rate target outside the formal~~ly~~ ~~arranged~~ arrangement of the exchange rate mechanism of the EMS. We are not members of that at the moment. If we were to join, it would be a different matter. He has also made it clear that in line with the G6 agreement, he is content with the current level of sterling and is hoping for a period of exchange rate stability. I cannot go beyond that, because almost anything I said would be interpreted as meaning something slightly different.

49. It does seem to be a variable sort of stability, which has moved from an index of 67 in October/November to 72 or 73 now. That is quite a large percentage variation, but I acknowledge that

this is perhaps a matter to be pursued with the Chancellor rather than with you. There have been some rumours that foreign money is likely to flood into London because of our continuing relatively high interest rates, and indeed, the strength of sterling. If that were to occur, and sterling strengthened above whatever is the Chancellor's unacknowledged ceiling for sterling, what action would we expect to see? Would it be on interest rates?

(Mr Peretz) Well, I think it is really, in a sense, all set out in the medium-term financial strategy. The exchange rate is certainly one of the factors taken into account in interest rate decisions. If the exchange rate were to move and nothing else were to move, that would be a reason for judging that the monetary ~~position~~ condition ~~is a~~ had tightened ~~one~~, ~~and~~ One would need to look at all the circumstances, but it might be a reason for reducing interest rates. The other weapon on the exchange rate is intervention, which is available to central banks.

50. But if interest rates were reduced in order to assist the rise in the parity of sterling, is there not a risk that a fall in interest rates might loosen credit conditions? We have already spent a fair amount of time discussing the growth of private sector borrowing; is there not a dilemma there?

(Mr Peretz) Yes, there certainly is a potential dilemma there. All I would say is what I said before, that I think that the prospects of cutting through that dilemma are rather better than they have been for a long time, because the international environment is one where one has a much better environment for pursuing a period of exchange rate stability than there has been for some time. But governments in the past have been faced with ~~a~~ the dilemma in very acute form, and it could indeed happen again. It is not true at the moment, I should say. I think the exchange rate~~s~~ and certainly the MO monetary evidence is all pointing the same way, which is that current conditions are satisfactory.

51. One final point: within the forecast, wherever exchange rates have a significant impact on the forecast, what is the assumption of the index which has been used inpreparing the forecast?

(Mr Sedgwick) That is set out as clearly as we ever set it out in paragraph 306 of the Red Book. It says that the exchange rate will remain close to its current level, and "current" was in the week or so before the Budget.

52. And that was?

(Mr Sedgwick) It averaged somewhere in the region of 70-ish round about then.

53. So a little lower than it is now?

(Mr Peretz) I do not think you should read too much into the precision of the precise rate. ~~It may not~~ Small differences have that much effect on the forecast itself. It is a very small variation.

Mr Wainwright

54. I have some questions about the record of various forms of growth that were mentioned in the Chancellor's speech. For instance, in one passage he said that by contrast, during the 1980s Britain's growth rate has been the highest of all the major European economies, but is it not a fact that if one takes the 1980s, that is, starting the comparison at the beginning of the 1980s, it is simply not so; we are not at the top of the European economies.

(Mr Scholar) I think that it is indeed the case that we are at the top of the league table of major European countries, which is, I think, the qualification which the Chancellor made when this assertion was being made, but I think Mr Sedgwick may want to say a number of measures to complement in 1984 a form of Corporation Tax of which this was one. There are other measures including the change of Corporation Tax payment dates - the "pay and file" proposal and so on. This was, if you like, the second lap of the reform which he had begun in 1984.

77. The other very quick question I have is this: does the Treasury inflation forecast assume a mortgage rate cut?

(Mr Peretz) It is not the practice to reveal interest rate forecasts which form part of the forecast. This is a longstanding tradition, Mr Chairman, and I do not think we can break it.

(Mr Sedgwick) Which the Chancellor restated when he appeared here after the Autumn Station.

(Mr Peretz) There is an obvious market reason for it. ~~I could embellish that~~.

78. Could you tell me what the effect on the RPI would be of fully indexing alcohol and tobacco duties?

(Mr Scholar) 3% - that is a figure for the revaluation of all the duties - not just tobacco and alcohol.

Mr Budgen

79. Mr Odling-Smee, what you were saying was, was it not, that even if the PSBR flattens out the disciplines remain the same?

(Mr Odling-Smee) Yes.

80. And that does not involve you in any exposition of political policy, does it?

(Mr Odling-Smee) No.

81. Let us now turn to inflation: the rate of inflation was 4%, is that right?

(Mr Scholar) When?

going to be some further large appreciation which we assume is not the case, is a temporary effect. So if you want to think in terms of underlying inflation rates, I do not think you should take the negative rates of Germany as illustrative of price inflation being ---

(Mr Peretz) There is effectively a once-for-all (presumably) fall in oil price which for a country like the United Kingdom has been somewhat offset by the fall in exchange rate. For countries like Germany and Japan both the exchange rate and oil price have been pushing in the same direction, reducing inflation.

Mr Browne

97. Mr Chairman, may I quickly focus your attention on chart 2.5 on page 12 and just point out that this chart traces the path of public sector borrowing requirement in black, together with privatisation proceeds. I wonder if you could tell us whether this total is taken just as one total, in other words, two combined, or as PSBR? Is that a combined thing, that focus of attention, which I notice has been flat for the last three years?

(Mr Odling-Smee) I do not think it is really the case that either is, as it were, the focus of attention - the single focus of attention. I think we have always said to the Committee that there is no single indicator of fiscal policy. The Government presents policy in terms of thePSBR which is the black bit, and that is the way in which it is presented in table 2.5. For example, all the numbers in the tables are presented onthat basis. But we thought it would be helpful also to show in chart 2.5 the black bit plus the white bit, which is the PSBR adjusted for privatisation proceeds.

Mr Townend

98. We established in reply to Mr Budgen's questions that inflation is going to rise this year. Last year you were aiming

FROM: A C S ALLAN
DATE: 25 March 1987

MR PERETZ

cc:PS/EST
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Cassell
Mr Evans
Mr Scholar
Mr Sedgwick
Mr Odling Smee
Mr Turnbull
Mr Kelly
Mr Grice
Mr Culpin
Mr Ross Goobey

TCSC: QUESTIONS FOR OFFICIALS: MONETARY POLICY AND EXCHANGE RATE

The Chancellor was grateful for your note of 24 March. He was content with the line to take which you prepared, subject to changing (iii) to read

> "Other important indicators - M0 - also suggest that monetary conditions about right at present. Clearly precise level of short-term interest rates a matter of careful judgement [see Q/A3]"

CR

A C S ALLAN

pup ✓

TRANSCRIPT: For instructions on its use, see below. Ev 1

==

HOUSE OF COMMONS

MINUTES OF EVIDENCE

TAKEN BEFORE

THE TREASURY AND CIVIL SERVICE COMMITTEE

WEDNESDAY 25 MARCH 1987

MR M C SCHOLAR, MR D PERETZ, MR P SEDGWICK, MR J ODLING-SMEE and

MR A TURNBULL

Evidence heard in Public

Questions 1 - 116

USE OF THE TRANSCRIPT

1. Members and prospective witnesses to whom the transcript is sent in strict confidence, under the authority of Mr Speaker and the Committee, are asked to note that the text is unpublished and that its use should be governed by the guidelines in the following paragraphs.

2. Members receive copies for the purpose of correcting questions addressed by them to witnesses, and are asked to send any corrections to the Committee Clerk as soon as possible.

3. Prospective witnesses receive copies in preparation for any evidence they may subsequently give.

4. This is an uncorrected and unpublished transcript of evidence taken in public and reported to the House.

5. No public use should be made of the text.

WEDNESDAY 25 MARCH 1987

Members Present:

Mr Terence L Higgins, in the Chair
Mr Tony Banks
Mr Anthony Beaumont-Dark
Mr John Browne
Mr Nicholas Budgen
Mr Brian Sedgemore
Mr John Townend
Mr Richard Wainwright
Mr John Watts

EXAMINATION OF WITNESSES

MR M C SCHOLAR, Under Secretary, Fiscal Policy Group, HM Treasury, MR D PERETZ, Under Secretary, Monetary Group, HM TReasury, MR P SEDGWICK, Under Secretary, Forecast and Analysis, MR J ODLING-SMEE, Under Secretary, Medium Term and Policy Analysis, HM Treasury, and MR A TURNBULL, Under Secretary, General Expenditure Policy, HM Treasury, called in and examined.

Chairman

1. Mr Scholar, you and your colleagues are most welcome this afternoon to the beginning of our annual festivities, and we are grateful to you and your colleagues for coming along. I should perhaps mention, since this is a public session, that we shall be taking evidence from the Governor of the Bank of England in public tomorrow at 4.45 and from the Chancellor of the Exchequer on Monday at the unusual time of 2.15. You will appreciate that the pressure of time this year is very considerable because we always seek to produce a report for the benefit of the House ahead of the second reading of the Finance Bill and between now and then the recess intervenes. The result is we have very little time both to take evidence and to draft a report

ahead of the recess, and will need to have it available immediately afterwards. This does mean we are up against time, and that is the explanation for the somewhat unusual timing of the evidence which we shall be taking. Thank you all very much for coming. Perhaps I might invite you in the traditional way to introduce your colleagues, and then we might go straight to questioning. I presume there is no initial statement you wish to make, given that the House has been debating the matter for some days.

(Mr Scholar) Thank you, Mr Chairman. On my left is Mr Peretz of the Monetary Group of the Treasury. On his left is Mr Sedgwick of the Forecast and Analysis Group. On my immediate right is Mr Odling-Smee of the Medium Term and Policy Analysis Group, and on his right is Mr Turnbull of the General Expenditure Policy Group.

Chairman: Thank you very much. We would like to start clarifying some points as far as monetary policy and the exchange rate is concerned.

Mr Sedgemore

2. I wonder if you could help us with the rising fog of monetary indicators - M0, M1, PSO1, PSO2, DCE, and no doubt several others. Let us start with M0. This Committee has in the past argued that it is of little consequence in assessing the state of monetary conditions, that it is of limited importance as a measure of transactions demand because of the increasing growth of cheques and credit cards, and we have asserted, as I believe other people have, that it lags behind rather than anticipates growth in money GDP, so why do the Treasury continue to use it as a monetary indicator and should we not be looking at an alternative?

(Mr Peretz) I think a lot of the arguments are set out in the Budget documents, and have been set out at rather greater length in various statements, including the Chancellor's Lombard Association

Lecture last year, which was perhaps the longest and most extended explanation of monetary policy. Taking M0, I think we accept that in some ways it is not an ideal narrow aggregate, and some of the reasons are set out in the Red Book as to why other possible narrow aggregates are not very useful, such as non-interest-bearing money, which you might think would be useful, but what has been true in practice is that M0 has proved a fairly reliable indicator of monetary conditions and reliable guide to policy over quite some period of time.

Chairman

3. Before or after the event?

(Mr Peretz) Before the event, I think I would say, Mr Chairman. As to the question of whether it is lagging or not, I would prefer you to read the article we produced in May/June of last year, which presented a piece of work which looked at whether the relationship between M0 and money GDP was more stable if you looked at it lagged by a period, and on the whole it seemed that if you took the relationship between M0 one year and money GDP the next, that shows a slightly more stable relationship than M0 and money GDP in the same year, so I think if anything the evidence is that money GDP follows M0. I could add to that that M0 does have a useful practical advantage in that it is an indicator which is actually available very quickly after the event, whereas the figures we get or the indications we get of money GDP actually follows some months after it has actually happened. M0 we have a reading of sometimes almost every week. It is quite quickly available after the end of each month, so that even if you thought that it was a coincident indicator rather than one which was leading, it would still be a very useful one.

Mr Sedgemore

4. For what years? You say these figures - I have not read

this article, I must confess - show that money GDP follows M0. What period does that study cover?

(Mr Peretz) This was the EPR article published in May/June last year. It goes back to 1975, and also the period 1975-85.

5. And there is a constant relationship, is there?

(Mr Peretz) No, there is not a constant relationship. I do not think anybody would want to pretent that there are exact relationships which follow precisely, but it is true that M0 has shown a much more stable relationship than almost any of the other monetary aggregates, narrow ones or broad ones, and therefore I think as a practical matter it has a track record which we need to look at. We are not the only country to look at narrow aggregates; the Swiss targets their version of M0, and the principal German target, which is Central Bank money, in fact consists as to 50 per cent or so of notes and coin, so we are not all that extraordinary in international terms either.

6. If we could look at the cheques and credit card side of this, does their increasing use matter in terms of monetary conditions, either in terms of monetary conditions or in terms of wider economic policy? Would it matter if plastic cards became 110 per cent of income?

(Mr Peretz) It clearly is true that things like that, which you might call technical innovation, affect the velocity of M0, but our experience has been that they affect it in a fairly steady way rather than in jumps in particular years, so it has been a regular and fairly steady effect, which teams with the velocity trend. There is a chart, 2.2, in the Red Book, which shows the M0 velocity trend over a number of years, and shows just how stable it has been. It is not a straight line, but it is not a bad version of a straight line.

7. So you are happy that as far as monetary indications are concerned, the growth of plastic cards does not matter, because it is not big enough to change velocity of circulation?

(Mr Peretz) One of the reasons why we look at a range of indicators rather than just one is that it is clear that almost any single indicator can be subject to distortions from time to time. As I say, up to now that has not happened for M0, but I think one can be confident that as long as one was looking at a range of evidence, if it did happen, you would spot that it was doing something slightly peculiar from the other evidence.

8. Are there any sider economic implications about the growth of personal debt and plastic cards? I repeat what I said just now: does it matter if personal debt largely from the use of plastic cards became 110 per cent of income?

(Mr Peretz) Personal borrowing is one of the factors that goes to affect the growth of the broader aggregates of money, and the broader aggregates of liquidity, and certainly I think again all the Budget documents make it clear that we continue to pay attention to those, but they have proved very difficult to interpret in recent years because of rapid growth of personal borrowing combined with a build-up of personal financial assets of roughly the same rate and magnitude, and these things, to the extent they are liquid assets, appear to be liquid assets which are willingly held, and insofar as that is true, it is not because that particular concern .....

9. How do you pay attention to them - in relation to which broader money indicator?

(Mr Peretz) We look at a range of broader aggregates. Last year we had a target for sterling M3 and many years before that, but that is not the only one. I think there is a paragraph in the

Red Book which says that the broader aggregates, which include building society liabilities as well as bank liabilities, may prove slightly less erratic than those which are just bank liabilities. That is not particularly surprising since to some degree banks and building societies are now operating in very much the same market, competing with each other.

10. Are we still taking any notice of the MRI? I thought the Chancellor said we were.

(Mr Peretz) I think the Chancellor said very clearly he was still.

11. It says here in the Red Book at 2.14, "If the underlying growth of M0 threatens to move significantly outside its target range in 1987-88 there is a presumption that the Government will take action on interest rates unless other indicators clearly suggest that monetary conditions remain satisfactory." What are these "other indicators" and how would they have to behave to prevent an increase in interest rates?

(Mr Peretz) As a range of indicators we look at, apart from broad money and various measures of narrow money and the exchange rate, which are in a sense the three most important indicators, as highlighted in the Red Book, we look at quite a range of evidence - movements in asset prices, house prices, stock exchange can produce valuable evidence about monetary positions - most up-to-date information about inflation itself which includes producer prices as well as consumer prices, movements in the oil price which is clearly one of the important factors which affect the exchange rate, appropriate movements in the exchange rate and to some extent movements in the rates themselves, how our rates compare with rates abroad and differentials. I do not want to give the impression that that is a complete list, perhaps I have said enough to give some indication of the range of things that are taken into account. I think this paragraph really does mean precisely what it says, very much the answer I gave earlier on to Mr Sedgemore that M0 has proved quite a reliable indicator in a number of years, so we would need some persuading that it was telling us wrong things but, if the range of other evidence said it was giving us a misleading message, then we would do precisely what it says in that paragraph.

12. I am simply puzzled as to what you said because you have got to deal with cause and effect and you have got to deal with time lags. M0 goes outside its range and then you look at these other indicators which apepar to be stable. I take it you are saying something like that it is not changing very much so there is no need to start changing policy on interest rates, but if the purpsoe of M0 is actually to give you a trigger that something is going wrong, then what is the point of this statement? If it goes outside the range, do you then suddenly say "We are going to ignore the trigger"?

(Mr Peretz) I think what it would create is precisely what it says in the paragraph, a presumption that something is going wrong unless the other evidence were pointing clearly in the other direction.

13. The other evidence could only give a static analysis, it cannot give a dynamic analysis. You could not tell whether the evidence was going to point in no direction at all until it happened, until the time had passed.

(Mr Peretz) Well, these things do not happen instantaneously, I think that is an initial point. Indeed, it would be quite wrong to react to every single week's or month's reading of a particular aggregate because there are obviously random fluctuations and variations - some of these things.

14. Are you really telling us it is an intuitive process, you have lots of indicators, and somebody sits down and does not take any notice of M0 , M3 or broad money but "intuits" some kind of balance between them? Is it in fact some kind of curious art none of us understands?

(Mr Peretz) No, I am saying at the end of the day it is a matter of judgment;there are a number of - really three principal - things the Government says that the Government takes into account in making decisions in assessing monetary conditions, then taking decsiion on interest rates, the movement in M0 as judged against its target range, the behaviour of the exchange rate and the behaviour of broad money, which proved difficult to interpret in recent years but is still something very much which has to be taken into account. Then there is a range of other evidence I tried to give you an indication of we would also look at - very foolish to ignore that. I think it is information which is useful.

Mr Townend

15. Short term interest rates are still rather higher than most of our industrial competitors'. In view of the state of the market and the strength of sterling in recent weeks, why has the Government been so reluctant to allow a significant drop?

(Mr Peretz) There have been two half-percent cuts in the base rates in the last two weeks. I think the way the Government actually tried to explain the way the Government makes decisions about interest rates has been much more fully set out, for example, in the Lombard Association speech elsewhere and they aim to keep interest rates at a level on average that keeps monetary conditions tight enough to maintain downward pressure on inflation. There are sometimes also, I should say, tactical market issues ----

Chairman

16. The acoustics in this room are very bad. It is extremely difficult for the people behind you to hear. Could you please speak up?

(Mr Peretz) Sometimes also tactical decisions to be made about how best to achieve the level of interest rates - the level which the Government have judged right. But the rate of interest rates today - I do not think I can say more than this - reflects the Government's current judgment both of monetary conditions and market pressures. Beyond that I would say the Government's stated intention has been to operate the policy in a very cautious manner, not to take any risks with inflation.

Mr Townend

17. It is one of the reasons given in paragraph 2.15, which says, "Private sector borrowing has been rising and is now over 10 percent of GDP... It has clearly contributed more than public borrowing to upward pressure on real interest rates." Is it really the level of private sector borrowing which is keeping interest rates higher?

(Mr Peretz) That is certainly one of the factors that has affected the level at which it is.

Chairman

18. What estimates have you of relevant elasticity as far as that is concerned as to the relationship between short term interest rates and private borrowing?

(Mr Peretz) I do not think it is really a question of necessarily setting interest rates at a level that restrains borrowing to a particular rate of growth. It is more a question of taking account of the rate of growth of public borrowing in so far as it affects the rate of growth of broader aggregates.

19. We are talking about private borrowing.

(Mr Peretz) Private borrowing affects the rate of growth of broad money because one of the counterparts ---

20. We understand that. What estimate have you made of elasticity? You were saying just now the rate of interest is supposed

to affect the level of private borrowing; you must have some idea what the relationship is.

(Mr Peretz) I think all I was saying was the rate of interest - the level of interest rates - is higher than it would otherwise be were the rate of private borrowing less.

Mr Townend

21. Is the Government worried at the present pressure put on private borrowers?

(Mr Peretz) The Government's judgment is that the current level of interest rates, the current level of growth of broader aggregates, the combination is roughly right.

Chairman

22. That is not the question. Would you answer the question?

(Mr Peretz) Your question is?

Mr Townend

23. Is the Government worried about present pressure on increased liquidity in the private sector and private borrowing?

(Mr Peretz) The answer is that is one of the things which goes into the setting of interest rates.

Chairman

24. We understand that. That is not the question.

(Mr Peretz) I am not ---

Mr Budgen

25. Is it the desire of the Government that this level of private borrowing should be reduced?

(Mr Peretz) I think one could say, if it were lower, then the level of interest rates might be lower and that would be consistent with the same downward pressure on inflation.

26. Is the answer to my question - listening to the various

ways in which people have formulated it - yes or not?

(Mr Peretz) Your question is? I mean, the Government -- - maybe this is a question you should ask the Chancellor rather than me.

27. We will.

(Mr Peretz) Take the Government's position to be that the level of private borrowing is market processes which determines the level . private borrowers are free to borrow at, and that the instrument of Government policy is the level of interest rate.

28. You are saying then the Government does not have a view about the amount of private borrowing that is now taking place?

(Mr Odling-Smee) Perhaps I could say, following up what Mr Peretz has just said, the Government is concerned that the private financial markets should operate in a relatively unfettered way and that borrowing should be whatever is determined by the process as they go on within that. The Government's concern would be if that led to monetary conditions which were not consistent with objectives for money GDP over the medium range. Mr Peretz has been explaining that there is no reason to believe that monetary conditions at the moment are inconsistent with those objectives, despite what might appear to be rather alarming levels of borrowing to some people.

Despite what might appear to be rather alarming levels of borrowing to some people.

Mr Townend

29. What, if anything, can be done to correct the increase in private credit? Is it purely putting up interest rates, or do you have other ammunition in the locker?

(Mr Peretz) Really, the instruments of government policy are interest rates and, over a slightly longer time horizon, fiscal policy. I am not sure what other instrument you are suggesting there might be.

30. I am asking you.

(Mr Peretz) It is certainly true that governments in the past have tried to control credit by volume controls of one kind or another and governments overseas have tried that too. I think as financial markets have become more sophisticated that has become extremely difficult and something which has proved not to work very well.

31. Not an option that is being considered by the present government?

(Mr Peretz) No.

Mr Beaumont-Dark: Well, I must tell you that I have never heard such twaddle!

Mr Sedgemore: He is in his academic mood today!

Mr Beaumont Dark

32. One of my great joys is that I am not an academic. I have to live in the real world, and that is not the same thing, but one of the reasons why I thought the Budget was good - and it was good; I thought it was the best Budget since 1979 - was that I understood the strategy is that the reason why the Chancellor quite rightly resisted the normal temptation of any full-blooded politician to spend other people's money was that it would do one essential thing, which was that if you had three and a half billion that you kept in the bank

instead of enjoying it upon wine, women and song, it meant that you would be able to get interest rates down, and then we have these old women in Threadneedle Street, which you then tell me, and us, reflect the government's views. How can that be true? I agree we will ask the Chancellor on Monday, but surely the great success of the Chancellor's policy should be two things: to reduce the cost of money, which is at usurous levels in this country against all our competitors, and that the pound should not keep on going up, because would you not agree that one of the great tragedies we have had was that when the pound went to two dollars and more it acted like a scythe throughout manufacturing industry? Are you telling me that interest rates, with this little grovelling half per cent here and half per cent there, like some miser who does not want to give people their own money, is really what you are advising the Chancellor? I do not blame him. What advice is he getting? Are you really, along with those gnomes in the Bank of England, telling the Chancellor he should not reduce interest rates? Yes or no? What are you telling him, for God's sake?

(Mr Peretz) I am not sure I am allowed to tell you.

Mr Beaumont-Dark: I may not want to hear it!

Chairman: Order. It is, I think, a well-established convention that the advice of officials to the Chancellor is something they do not reveal.

Mr Beaumont-Dark: If it is bad, it ought to be private! What is your view on it? Are you actually telling us - because you have got to be here to do something - that you think interest rates at the moment are right or not? Do not tell us what advice you are giving him; what advice are you giving the British public, who pay us? Do you say that interest rates are too high, too low, or right? Which are they?

Chairman: I think that is really a question one ought to pursue with the Chancellor.

33. No, otherwise why are they here? What advice are you giving me, as a humble back-bencher, with a small "h"? I am fed up with this.

(Mr Peretz) I will make two comments. One is that, as I have already said, short-term interest rates have come down one per cent, or if you look at market rates, they have come down slightly more, and long-term interest rates have come down from a 20-year yield in gilts of around 10 per cent in January or February to rather under 9 per cent now. One should not forget about long-term rates as one of the costs to industry in borrowing.

(Mr Odling-Smee) Perhaps I could add a couple of comments as well, Chairman. I think that what one can say in reply to Mr Beaumont-Dark's question about the effects of the Budget on interest rates is that over a period of time, and not necessarily for the first ten days or whatever, the fact that the Chancellor has not spent all of the money, to use Mr Beaumont-Dark's language, will bring about somewhat lower interest rates than would otherwise have occurred, and so I think that he is right to welcome the Budget on that account. That is all I wanted to say.

34. Can I just say this? You said, and I agree, that we people who do not live in the clever world take things on rather a more simplistic basis, but you said the private financial market should operate freely. It obviously is not, and I will tell you why it is not: because it stands out, even for people like me to see, that here you have got the pound at $1.62, and we all know in a manufacturing sense - and I agree you may say I bleat about manufacturing industry, but when oil is gone you will depend upon my people and my kind to manufacture it, because it will not be coming out of the ground; it

will have to go over the ground. Why is it that you think that the pound should keep on going up? Why should thepound be $1.62 when in a manufacturing sense there is no justification for it? If we took one per cent or one and a half per cent off interest rates and the pound came down to $1.50, would there be blood flowing in the river? No; there would be prosperity flowing through industry. That is what matters. Why do you clever boys think it is much better to have a higher pound than higher industrial activity? Why? Tell me why. Tell my people, tell Birmingham people, manufacturing people, why.

(Mr Peretz) One point is that the Chancellor has said repeatedly recently that he is very happy with the level of the pound at its current level.

35. Is he?

(Mr Peretz) And that he would, by implication be unhappy were it to go up or down very significantly. Another comment is that it is a good deal lower now than it was a year ago. In effective terms it has come down from somewhere in the 80s a year ago to 72 today.

Chairman: I think this again is a matter which we would wish to pursue with the Chancellor or the Governor.

Mr Banks

36. I am sorry that I was late, Chairman. I came in at the point that Brian Sedgemore was asking whether the amount of private personal borrowing and plastic cards was actually important, and I thought it was being said that the government was not too worried about that; it did not make any difference. Subsequently, however, one heard that it was the level of private borrowing that was causing the upward pressure on interest rates, but then interest rates were

being kept at levels to protect against inflation. The question is this really, since it has been mentioned about overseas experiences: why then do we appear to have the worst of all possible worlds, which is in Europe it would appear to be amongst the highest short-term interest rates and the highest rate of inflation?

(Mr Peretz) There could be some relationship between interest rates and inflation.

Chairman: We understand that.

37. I entirely understand that point, but if the government is saying that it does not want interest rates to come down in order to protect against inflation, why have we still got the highest level of inflation and the highest level of short-term interest rates? Some must be doing it a bit better than us, must they not?

(Mr Odling-Smee) There has been a recent change in our position vis a vis Europe - perhaps one should put it the other way round: in some of the European countries vis a vis our past, in that the fall in the oil price helped to recuce inflation in most other European countries quite sharply last year, and that did not have the same effect on us because of our special position as a nett oil exporter.

So that in itself produced an inflation differential that was relatively adverse to us. In response to that - partly in response to that, but there are other things such as growth of private credit and further factors - it has been necessary to have somewhat higher interest rates here. So to some extent these two factors you observe - higher inflation at the moment and higher interest rates - are both the result of the developments over the last year or two in world economy, specially falling oil prices.

38. So if private borrowing is causing interest rates to stay high, if the Government were to do something about the level of private borrowing, one could assume then interest rates would go down.

(Mr Odling-Smee) I am not sure what it is the Government could do other than keep interest rates higher.

Mr Browne

Chairman, does the Treasury find it disturbing that there apepars to be a continuing upward trend in the private sector of liquidity and of borrowing, despite the fact that interest rates, as we have heard, remain at very high levels in real terms? Could you say what you feel should be done to curb this demand for credit in those circumstances?

(Mr Peretz) We keep asking more or less the same question, Chairman. I find it very difficult to give a different answer than the one we have given so far.

39. I am not trying to ask you what advice you are giving the Chancellor, as has been asked before, because I quite understand this is not the forum for that advice to be aired in public, but I am trying to ask what your views are on the alternative options and therefore what you see - just as an individual member of the Treasury - can be done to curb the demand for credit in present circumstances.

(Mr Peretz) Interest rates are the most obvious and main instrument of the policy and that is, indeed, one of the reasons why interest rates are so high. Perhaps a slight diversion if I may, Mr Browne, you said real interest rates are high. It is never very easy to know what real interest rates actually are. You compare interest rates with current inflation but really you ought to be comparing nominal interest rates with people's expectations of future inflation and there was an article in the Bank of England Quarterly some time last year - I do not recollect the precise date - which did compare our real interest rates with other countries on those different bases. On some bases our rates are not necessarily higher than other countries. It depends on the basis of comparison. One of the reasons why our real interest rates might be higher than other countries, is that clearly it takes a great many years for governments, for countries, to establish an international track record, if you like, of aiming for low inflation - countries like Germany, which has had twenty years or more, ever since the war, of track record of that kind, people in the market ---

Chairman

40. Mr Peretz, can I ask you please to listen to the questions and to seek to answer the questions rather than going off in a different direction. The question was, apart from interest rates, what are the alternative ways you might consider could be used to restrict the growth of private credit?

(Mr Peretz) Mr Chairman, I mentioned one before - direct controls of one kind or another. I said experience - not just in this country, in other countries - is that such controls were increasingly unworkable even if you thought they were desirable. I do not address the question whether they are desirable or not.

Apart from that, in the longer run fiscal policy has a role to play.

41. On consumer credit?

(Mr Peretz) On the level of interest rates.

42. Yes, but the question was on consumer credit.

(Mr Odling-Smee) Fiscal policy could restrict the demand for credit by slowing down the growth of money incomes.

Chairman: Thank you very much. Mr Browne?

Mr Browne

43. Thank you very much for that answer. By the way, I am very interested in what you said about interest rates. It is just the normal terminology. What I am saying - and I think most people would agree - is that, despite your answer, that is the normal view. I would agree more with your definition myself, but does that mean that the outlook for inflation is going to be higher?

(Mr Peretz) I think what it means is ---

44. People expecting higher inflation?

(Mr Peretz) What one would hope it would mean is, as it becomes clear that inflation is on the downward track, then interest rates will come down and the longer this track is - that, I think, is the Government strategy - the longer this medium term strategy is held in place, the longer it is made clear that inflation is on the downward track, then the more likely it is that nominal interest rates can be got down and kept down and held down in a sustainable way.

45. I was very interested in your answer to Mr Sedgemore's question about the relatively stable relationship between the growth of M0 and money GDP. Does this therefore mean broad money, however you define it, does or does not continue to have a role in the formulation and operation of monetary policy?

(Mr Peretz) No, I think it is fairly clearly set out in the documents. It does continue to have a role, it is just that the Chancellor decided its behaviour had been so - "erratic" is the wrong word - so difficult to interpret over the last years that it would actually be less helpful rather than more to have a target range for it, so we will continue to take it into account, if you like, in the same sort of way the Government takes account of the exchange rate but without any precise guideline for it.

46. Finally, the Chancellor said he would like sterling to remain roughly at its present level, say at 72, as you just told us. Does this indicate that he and the Government are changing their views and thinking of negotiating entry to the European Monetary System?

(Mr Peretz) The Chancelllor is on record very recently on the European Monetary System saying there is a balance of advantages and disadvantages under review, the time is not ripe to join yet. I think the one thing which has changed maybe - this might help us - is the recent Paris Agreement between the major six countries which has created slightly different conditions for the operation of policy. First of all, I mean, the fact the agreement took place reflected the fact that the patternof international exchange rates now is much closer to what one might think would be justified by fundamental economic circumstances and this has been true for some time. Certainly that is what the words of the communique from the Paris Agreement concluded. So that the conditions that are there are much better than they have been for many years to achieve the pattern of exchange rates. The other element of the Agreement was the commitment of the six Finance Ministers present to operate policy in order to try and achieve a period of stability. I think that does put the operation of our own policy in a slightly different context than it has been up to now - if only that it means in our own policy decisions we are in a position to give slightly greater weight to achieving exchange rates because the chances of achieving these are rather better than they have been. Every exchange rate has two parties to it. It is much harder to control your exchange rate if you are trying to do it by yourself, but an international agreement like that is slightly better.

Mr Watts

47. At the time of our inquiry into the Autumn Statement the Sterling Index was a little over 67 and the Chancellor told us he was happy with it, but at that level, and did not wish it to move significantly either up or down. In his interview with the Financial Times on 19th March he said again that he would like to see sterling remain at its present level. I think, Mr Peretz, you referred to that in reply to an earlier question about 72. Does the Chancellor's recent statement imply a target range, although not an acknowledged one, of 72 to 73, or what are we to understand by his recent comment?

(Mr Peretz) I am trying to remind myself of his words. I thought my recollection was he said he would not particularly like to see it go any lower than 67, or whatever the rate was at the time, rather than saying he thought that was about right. When we came back from the Paris meeting he indicated he had already said he did not want to see it go any lower than it had been and as a result of the Paris Agreement he would not want to see it go substantially higher than it was then, which was around 69 or thereabouts.

He indicated that he was very happy with it around its current level. I do not think it would be helpful for me to go beyond that. Suggestions of target ranges are really slightly wide of the mark - certainly narrow or wide. I must rest on what the Chancellor has said, which is that he is quite happy with it around its current level, as indeed was very much the terms of the G6 Communique. All the finance ministers felt a period of stability of exchange rates in current circumstances around their current levels would be right and they would work to that end.

48. But does not the agreement at Paris to try to achieve a greater stability give rather more support to the notion of having a declared target range and are not the risks of doing that somewhat diminished when all of the major industrial countries have pledged themselves to try to achieve that stability?

(Mr Peretz) Mr Chairman, I am in some difficulty because almost anything any official says on this subject - or the Chancellor for that matter - is liable to misinterpretation in some form or other. I think the Chancellor has made it absolutely clear that he does not think it makes sense for this country to have an explicit exchange rate target outside the formally arranged exchange rate mechanism of the EMS. We are not members of that at the moment. If we were to join, it would be a different matter. He has also made it clear that in line with the G6 agreement, he is content with the current level of sterling and is hoping for a period of exchange rate stability. I cannot go beyond that, because almost anything I said would be interpreted as meaning something slightly different.

49. It does seem to be a variable sort of stability, which has moved from an index of 67 in October/November to 72 or 73 now. That is quite a large percentage variation, but I acknowledge that

this is perhaps a matter to be pursued with the Chancellor rather than with you. There have been some rumours that foreign money is likely to flood into London because of our continuing relatively high interest rates, and indeed, the strength of sterling. If that were to occur, and sterling strengthened above whatever is the Chancellor's unacknowledged ceiling for sterling, what action would we expect to see? Would it be on interest rates?

(Mr Peretz) Well, I think it is really, in a sense, all set out in the medium-term financial strategy. The exchange rate is certainly one of the factors taken into account in interest rate decisions. If the exchange rate were to move and nothing else were to move, that would be a reason for judging that the monetary position is a tight one, and one would need to look at all the circumstances, but it might be a reason for reducing interest rates. The other weapon on the exchange rate is intervention, which is available to central banks.

50. But if interest rates were reduced in order to assist the rise in the parity of sterling, is there not a risk that a fall in interest rates might loosen credit conditions? We have already spent a fair amount of time discussing the growth of private sector borrowing; is there not a dilemma there?

(Mr Peretz) Yes, there certainly is a potential dilemma there. All I would say is what I said before, that I think that the prospects of cutting through that dilemma are rather better than they have been for a long time, because the international environment is one where one has a much better environment for pursuing a period of exchange rate stability than there has been for some time, but governments in the past have been faced with a dilemma in very acute form, and it could indeed happen again. It is not true at the moment, I should say. I think the exchange rates and certainly the MO monetary evidence is all pointing the same way, which is that current conditions are satisfactory.

51. One final point: within the forecast, wherever exchange rates have a significant impact on the forecast, what is the assumption of the index which has been used inpreparing the forecast?

(Mr Sedgwick) That is set out as clearly as we ever set it out in paragraph 306 of the Red Book. It says that the exchange rate will remain close to its current level, and "current" was in the week or so before the Budget.

52. And that was?

(Mr Sedgwick) It averaged somewhere in the region of 70-ish round about then.

53. So a little lower than it is now?

(Mr Peretz) I do not think you should read too much into the precision of the precise rate. It may not have that much effect on the forecast itself. It is a very small variation.

Mr Wainwright

54. I have some questions about the record of various forms of growth that were mentioned in the Chancellor's speech. For instance, in one passage he said that by contrast, during the 1980s Britain's growth rate has been the highest of all the major European economies, but is it not a fact that if one takes the 1980s, that is, starting the comparison at the beginning of the 1980s, it is simply not so; we are not at the top of the European economies.

(Mr Scholar) I think that it is indeed the case that we are at the top of the league table of major European countries, which is, I think, the qualification which the Chancellor made when this assertion was being made, but I think Mr Sedgwick may want to say something more about that.

55. I hope he will also pay attention to Italy, which is certainly recorded by the OECD as ahead of us.

(Mr Sedgwick) Let me just clarify the basis of the numbers or the rankings that the Chancellor was talking about. They were talking about growth in the 1980s compared with the 1960s and 1970s and growth in the 1960s was taken as growth between 1960 and 1970, and in the 1970s was 1970 to 1980, and in the 1980s was 1980 to 1986. On that basis it is clear for the major European economies that growth in the UK has been higher than for the others. It is, however, perfectly true that if you wish to define the 1980s as from 1979 until 1986, the ranking is somewhat different then. The UK has an average growth rate which is the same as that of Germany, rather above that of France and a little below that of Italy, but I think as long as one defines over what period these comparisons are made, it is clear what the position is, and I think the general point is that in recent years the growth in the UK economy has compared more favourably with the other major economies.

56. But the OECD tables which we have, the heading is precisely 1980 to 1986, not 1979 to 1986.

(Mr Sedgwick) I do not recognise that number. I think we have another set of comparisons around which have been used which are from 1979 to 1985, which show the average growth in the UK about the same as the other major European economies, rather above that of the Netherlands and a bit below that of Italy. I do not actually have in front of me the OECD figures you refer to.

57. We had better have a note about that. It will be important that we have it before we see the Chancellor, because we must get our tables right. I have them here.

(Mr Scholar) I think it would be helpful if perhaps after this hearing you could let us have a copy of the evidence which you are looking at.

Mr Watts: Yes, sure.

Chairman: We might reverse the usual procedure and we will let you have a note!

58. Growth measured as output per head, again another passage of the Budget speech: the Chancellor said that during the 1980s our annual rate of growth of output per head has been the highest of all theseven major industrial countries. Well, now, that again does not tally with our figures from the OECD and I just wonder----

(Mr Sedgwick) I think the Chancellor said that was true of the output per head of people in manufacturing industry , did he not?

59. What he said was during the 1980s the annual rate of growth of output per head "has been the highest of all the seven major industrial countries".

(Mr Sedgwick) I thought that was a remark about manufacturing industry.

(Mr Scholar) I thought it followed upon a sentence about manufacturing, but that is purely from memory.

60. You are saying this is intended to be manufacturing?

(Mr Scholar) I am looking at the text of the speech now. In the Budget Statement theChancellor said that "During the 1960s and again in the 1970s growth in manufacturing productivity in the United Kingdom was the lowest of all the seven major industrial countries in the world". He then went on to say,"During the 1980s our annual rate of growth of output per head in manufacturing has been the highest of all the seven". I think it is quite clear.

61. Did he say in his second sentence "output per head in manufacturing"?

(Mr Scholar) Yes, indeed.

Mr Wainwright: Thank you. That clarifies that.

Chairman

62. Might I pick up one or two random points? They are very random, really filling in gaps in some of our thinking. I would be right in thinking, would I not, that the medium term financial

strategy up to now has been for a steadily declining path for PSBR?

(Mr Odling-Smee) That is right.

63. The proposal now is that it should remain at a constant percentage of the GNP?

(Mr Scholar) That is right.

64. What is the reason for the change of policy?

(Mr Odling-Smee) The change is not a distinct change of policy, going from a declining path to a flat path, because clearly one could not every year into the future of the next fifty years always look for a declining path or else one would end up with a very large negative PSBR. At some stage this had to come to an end and the ---

Mr Budgen

65. It is not a change of policy then?

(Mr Odling-Smee) Not, quite so. There is no change of policy in the MTFS. Did I say there was a change of policy?

Chairman

66. I think you accepted what I said, which was a change of policy.

(Mr Odling-Smee) No, I am sorry, perhaps I could explain what I intended to say, that there has been a change in the direction of these trends. You were drawing attention to a purely arithmetic statement. I was going on to explain it was not a change of policy because at some stage the declining trend would have to end, and we have now reached that stage and have been able to reach that stage because of the unexpected buoyancy in revenues which has enabled the Chancellor to go down to a figure of 1 percent of GDP, which is lower than has ever been suggested at the end of any of the rows of MTFS figures in the past. That is the figure which he judges is the appropriate figure for the medium and long term.

67. But, in fact, that 1 percent figure, as you understand it, is not one which this Committee would accept since we have taken a different view from the Chancellor regarding the way in which assets sales proceeds should be treated. If you look at it as we are inclined to do, namely, as a means of funding PSBR, the figure would be approximately still 2 percent.

(Mr Odling-Smee) Yes.

68. Why should one not go on downward then to 1 percent in those terms?

(Mr Odling-Smee) I think the Chancellor would expect in the longterm to go down to 1 percent in those terms. He recognises that there are not enough assets to go on selling forever and at some stage that process has to come to an end - not in this Parliament or the next, perhaps two or three Parliaments beyond that - and, as we approach that stage, then through holding the PSBR itself to 1 percent of the GDP, the adjusted PSBR you favour would fall towards 1 percent of GDP and then to 1 percent in the longterm. Asset sales proceeds ---

69. I knew asset sales proceeds were going to appear at some stage of this discussion. Why should the PSBR remain positive?

(Mr Odling-Smee) There is clearly a demand for public sector debt and, as long as the economy is growing, there will be some interest in holding debt. That is one argument. Another is that it would be quite consistent with the growth of money GDP that the Government is seeking, and in the very longterm of course that is a growth which is equal to the rate of growth productive potential, and the Government sees no difficulty about selling an extra amount of debt which would match the accumulation of assets to some extent. I do not mean exactly match but taking place in a world where there is also some accumulation of assets this would be a stable and sustainable situation.

Chairman: I wonder if I might just continue on the ragbag of points I have before turning to Mr Budgen who may well wish to come back to this particular one.

Mr Budgen

70. Could I just clear this one up because I am a sincere admirer of Mr Odling-Smee's verbal dexterity but I do not understand how he is able to say there has been no change of policy. In the original medium term financial strategy the public sector borrowing requirement was seen to be continuously declining, was it not?

(Mr Odling-Smee) Yes.

71. It is true, is it not, that that originally took no account of sales of assets?

(Mr Odling-Smee) That is true.

72. Are you now saying that you concede that we are going to come from a downward path on to a flat path? You blandly say there is no change of policy. How on earth can you say that?

(Mr Odling-Smee) Well, I have just explained that, although there is a change of arithmetic, that is not a change of policy. The original MTFS to which you referred did not go so far as 1987-88 so we do not know what he would have said about it.

73. Come now, Mr Odling-Smee. We all enjoy this entertainment but the figures show the changes in policy. It is like saying, for the sake of argument, there has been a 4 pence cut in , shall we say, the standard rate of tax, but it does not convey any change of policy whatever. Just because you say it with such confidence and dexterity , it does not follow that it is true, does it?

(Mr Odling-Smee) No, I agree with that. The are other reasons why it is true. It is true that the numbers have changed and it is true that within the medium term financial strategy as a whole it is necessary from time to time to change the numbers, but we do that in a way which is consistent with the broad objectives of the medium term financial strategy. The objective of every fiscal policy since the first MTFS in 1980 has been to keep public sector borrowing at a level, and if necessary on a declining trend, which will support the monetary policy and the role of the monetary policy has been to create monetary confidence which will bring about the desired growth of money GDP and in early days put heavy downward pressure on inflation. We are now saying that the illustrative path of the PSBR over the medium term of 1 percent of GDP is fully consistent with those broad objectives. I agree the numbers are different, but the role of fiscal policy remains the same.

(Mr Scholar) Could I add one point? The Committee has in the past made the point that the PSBR was of less interest than the public sector financial deficit, or the PSBR with the proceeds of privatisation added ~~of a debt~~ back into that. If we imagine a profile in which the proceeds of privatisation stretch on some years at the sort of figures which are put into the Red Book - about £5 billion a year, ~~I think~~ - it is worth noting that on that measure the proportion of GDP taken by that aggregate will very gradually decline as the £5 billion reduces in real terms.

Chairman

74. I think all of this is helpful when we come to pursue matters with the Governor and the Chancellor. Can I come back to my diverse point which I will seek to deal with as quickly as possible: there is a proposal in the Budget that the rate of Capital Gains Tax charged on, for example, insurance companies shall be at the Corporation Tax rate thereby increasing the burden on such companies and raising quite a lot of revenue. Could you tell us the reason for that change?

(Mr Scholar) I think it was that the life assurance companies were treated in this proposal no differently from the rest of the corporate sector, and the aim was a simplifying and streamlining move to apply the ~~rates which are applicable at the~~ main Corporation Tax rate or the small companies rate as the rate at which gains were charged, and the proposal made no discrimination in that regard as between life assurance companies and any other company.

75. But given that the effect of this change will be to adversely affect those who hold insurance policies, was any consideration given to that - just as a "streamlining" exercise?

(Mr Scholar) I think it was recognised that this measure would have differential effects on different sectors and on different companies; some companies would be gainers and some would be losers - some sectors would be gainers and some would be losers. I would add to that that the effect on life assurance companies was considered.

76. But purely for a "streamlining" reason, you say? One's constituents may be rather worried about this kind of "streamlining".

(Mr Scholar) I think that the Chancellor, when he looked again at Corporation Tax in this Budget, saw himself bringing forward

545 2

a number of measures to complement ~~in~~ the 1984 ~~a~~ re form of Corporation Tax, of which this was one. The~~re~~ ~~are~~ other measures ~~including~~ are the change of Corporation Tax payment dates - the "pay and file" proposal and so on. This was, if you like, the second lap of the reform which he had begun in 1984.

77. The other very quick question I have is this: does the Treasury inflation forecast assume a mortgage rate cut?

(Mr Peretz) It is not the practice to reveal interest rate forecasts which form part of the forecast. This is a longstanding tradition, Mr Chairman, and I do not think we can break it.

(Mr Sedgwick) Which the Chancellor restated when he appeared here after the Autumn Station.

(Mr Peretz) There is an obvious market reason for it. I could embellish that.

78. Could you tell me what the effect on the RPI would be of fully indexing alcohol and tobacco duties?

(Mr Scholar) 0.3% - that is ~~a~~ the figure for the reval~~u~~orisation of all the duties - not just tobacco and alcohol.

Mr Budgen

79. Mr Odling-Smee, what you were saying was, was it not, that even if the PSBR flattens out the disciplines remain the same?

(Mr Odling-Smee) Yes.

80. And that does not involve you in any exposition of political policy, does it?

(Mr Odling-Smee) No.

81. Let us now turn to inflation: the rate of inflation was 4%, is that right?

(Mr Scholar) When?

545 3

82. Last year. It was anticipated to be 4% and has turned out to be a little lower.

(Mr Scholar) It averaged something below that in 1986.

83. About a quarter of a per cent. below that?

(Mr Scholar) That is right.

84. It was anticipated now to go up to 5%, is that right?

(Mr Scholar) In the Budget? No.

85. But with corrections? The consequence of the non-indexation of duties, and the anticipation of some fall in interest rates - you are, I think, entitled to say, are you not, that you had anticipated some fall in interest rates but you are not entitled to say how much, is that right?

(Mr Scholar) I think we would decline to make any comment about our expectations on interest rates. That I think is the normal practice which the Committee has in the past accepted.

86. You are not even allowed to say that, now that the market situation has gone, when the calculations were made at the time of the Budget, you anticipated some but an unspecified amount of interest rate fall?

(Mr Scholar) I think it would be a departure from our practice.

87. You are not allowed to say that?

(Mr Scholar) No.

88. I see. Well, are you able to say by how much the RPI is reduced for each 1% fall in the mortgage rate? You are allowed to say that, are you not?

(Mr Scholar) If we can remember the number! I think it is 0.3%.

(Mr Sedgwick) If you bear with me a second I will tell you the exact number. (After a pause) As you may know, there have been some provisions to the weighting system in the RPI which took effect from the announcement of the last monthly figures and the effect of a 1% reduction in the mortgage rate is now 0.36% rather than 0.44% which it was under the previous weights.

89. I see. So the consequence of not indexing the Excise Duties, and if the Committee were without any evidence from you to assume that the Chancellor had anticipated a 1% fall in the mortgage interest rate, would be, would it, (or would this be wrong) that there is an underlying rate of inflation of about 5% which has been reduced down to about 4% by the action of the Chancellor acting upon the RPI?

(Mr Sedgwick) Well, I am not going to get involved in saying what has been assumed on interest rates ----

90. No. We are making that assumption. We are not trapping you into anything.

(Mr Sedgwick) What I can say is what is in the forecast, and indeed what the Chancellor has said, which is that there is some expectation of some rise from the current level of RPI inflation to about 4.5% in the middle of this year, with it coming down to 4% which is the figure given in the Red Book by the fourth quarter of this year, and for the RPI inflation rate to be at that level in the second quarter of 1988. Those forecasts take account of the Budget measures.

91. That means that the underlying rate is about 5% and you are knocking off something in excess of half a per cent. for the reductions in mortgage interest rates and for non-indexation of duties, does it not?

(Mr Sedgwick) The point about indexation of duties is correct, but that is a temporary once-and-for-all effect on the RPI that would stay in for 12 months. I am not going to say anything

545 5

more about the mortgage rate.

(<u>Mr Scholar</u>) I think it would be fair, if one takes changes in the mortgage rate out of the future, also to take them ~~the mortgage rate~~ out of the base, ~~and I think~~ We would resist the suggestion that the underlying rate ofinflation is 5%. I would prefer to say, on the assumptions the Committee has made, that that is the peak rate rather than the underlying rate.

92. The underlying rate has gone up, has it not?

(Mr Scholar) I really cannot answer that question.

93. The unrigged rate has gone up, has it not?

(Mr Odling-Smee) The inflation rate has obviously gone up. The concept of underlying rate needs to be defined. It is not something which is a natural definition.

94. Of course, all right, and is it true that that is also at a time when commodity prices are continuing to be at a very low level?

(Mr Sedgwick) Certainly there have been very large falls in commodity prices, but in recent months there have been some signs that some have begun to rise again.

95. You mean there is no change of policy but they are flattening out?

(Mr Sedgwick) I think there is a policy on commodity prices as such. That is something, whether we like it or not, which is determined in world markets. If we measure them in SDRs there was quite a large fall over the last year or so and the assumption underlying the forecast here is that world commodity prices will rise a little from their historically low levels which in real terms they reached at the end of last year.

96. The rate of inflation in Germnay is now -1 percent. How has it been possible to achieve that in Germany and what are the different conditions that make it impossible here?

(Mr Sedgwick) In the very recent past one thing that has been happening in Germany which, apart from Japan, is not happening elsewhere is a very large real appreciation in the exchange rate and that must be exerting quite a powerful and profound effect on the consumer price inflation which, unless there is going to be some further large appreciation which we assume is not the case, is a temporary effect. So if you want to think in terms of underlying inflation rates, I do not think you should take the negative rates of Germany as illustrative of price inflation being ---

(Mr Peretz) There is effectively a once-for-all presumably fall in oil price which for a country like the United Kingdom has been somewhat offset by the fall in exchange rate. For countries like Germany and Japan both the exchange rate and oil price have been pushing in the same direction, reducing inflation.

Mr Browne

97. Mr Chairman, may I quickly focus your attention on chart 2.5 on page 12 and just point out that this chart traces the path of public sector borrowing requirement in black, together with privatisation proceeds. I wonder if you could tell us whether this total is taken just as one total, in other words, two combined, or as PSBR? Is that a combined thing, that focus of attention, which I notice has been flat for the last three years?

(Mr Odling-Smee) I do not think it is really the case that either is, as it were, the focus of attention - the single focus of attention. I think we have always said to the Committee that there is no single indicator of fiscal policy. The Government presents policy in terms of thePSBR which is the black bit, and that is the way in which it is presented in table 2.5. For example, all the numbers in the tables are presented onthat basis. But we thought it would be helpful also to show in chart 2.5 the black bit plus the white bit, which is the PSBR adjusted for privatisation proceeds.

Mr Townend

98. We established in reply to Mr Budgen's questions that inflation is going to rise this year. Last year you were aiming

for it going to tail off again towards the end of the year. If there is going to be a rise, in view of that rise in inflation how confident are you that the spending totals can be kept at the level under the Autumn Statement?

(Mr Turnbull) For 1987-88 Government plans which were set in cash terms have now been translated into the detailed control totals, that is, the cash limits in estimates,running cost limits of government departments, external financing limits for nationalised industries, and the presumption is that these will not be raised to accommodate higher inflation. If you take the experience of 1986-87 there was only one major adjustment of a cash limit to take account of higher pay, which was the case of the National Health Service, and the presumption is that will be repeated again in 1987-88.

99. That might be the presumption. My question was also, in view of the fact that the Contingency Reserve is low, how confident are you that those spending totals can be kept to, having regard to 1988?

(Mr Turnbull) The Contingency Reserve as a proportion of the planning for 1987-88 is higher than in any year except for the year that has finished, so it is a question of judgment as to whether it is a low Contingency Reserve. All I can say is the Government will be seeking to hold those totals. One other factor ---

100. You said that. My question was, are you confident they will be able to?

(Mr Turnbull) I do not know that it is my place to speculate on that or offer you my odds? One other factor to bear in mind is that when inflation is rising one major source of risk is the fact that social security benefits are linked to inflation. Now, what we have is that the timing of the upratings is such that if the inflation rate is taken in the year to September that applies from April, so for the coming year the social security benefits have an uprating that has been tackled and whatever is happening to inflation in the current months will not affect the rate of expenditure during 1987-88. That is a very large chunk which, in effect, is immune from current movement of inflation. That is quite an important factor to take into account.

101. There might still be considerable pressure on wages?

(Mr Turnbull) There will be pressure, there always is, but the Treasury will naturally resist that and only agree to changes in cash limits very much as an exception, as it did in 1986-87.

Mr Wainwright

102. My questions are about various forecasts. This time last year you were predicting that fixed capital formation would rise by 5%. In this year's Red Book it is acknowledged that there is an increase of 1.5%. What are the main factors that have led to that?

(Mr Sedgwick) I am not sure there is a ready explanation of the relatively low rate of growth of investments that at the moment appears to have taken place in 1986. That is the rise in total investment of half a percent. which is certainly lower than we had been expecting. It is not out of the question that in subsequent years (as has been the practice often in the past) the Central Statistical Office will advise that number upwards, but for the moment I think we have to take that as being the number. We do expect a rise in investment in 1987 on the total figure, as you see in the Red Book, of 4%. Perhaps I should mention the main items there which underpin that view which come from evidence given by surveys: both the CBI and the DTI have done surveys of private manufacturing and non-manufacturing areas (which is where distribution is widely defined) and these do seem to suggest that significant rises will take place during the current year.

103. But did you not use similar surveys this time last year in establishing your forecast of 5%?

(Mr Sedgwick) I think that is a fair point about those pieces of investment which are covered by service (which is manufacturing and private mainly) distribution. It does seem to me that at the moment the climate of opinion in industry is that generalisations are primarily about manufacturing. There is a good deal of optimism around (and one has to see the CBI surveys for that) regarding orders particularly for exports, and I would have thought in those circumstances and given there has been a perceptible upturn in activities since the middle of 1986 that some increase in investment in 1987 over the previous year is likely. But I take the point that there have been errors in the past, and it is not out of the question that we could be wrong about this year in either direction.

104. Well, then, the surplus on invisibles, as recently as the Autumn Statement, was being estimated for 1986 by you at 8.5 billion, which we did actually express some scepticism about at the time, but the outturn figure now is 1.5 billion less. Are there any factors that can account for that?

(Mr Sedgwick) I think you have to bear in mind that when we made the forecast that was in the Autumn Statement there was a recorded surplus by the CSO at that point of 4 billion for the first half of the year which has been subsequently revised down, and indeed their latest set of revisions (because they revised down 1985 to some extent and partly as a result of getting firmer information on 1985 they revised down those items of invisibles) are purely projections for 1986 as well, so we start off with the past having changed and I think the changes in the forecast are largely as a result of that.

105. Turning just to the tax yield forecasts, Corporation Tax which has shown an outturn rather more than 20% higher than was estimated in last year's Budget. What are the factors there?

(Mr Sedgwick) Two principally. One is that I think we underestimated the profits base in the previous year, particularly for financial companies. That was one reason. The other is that following a period when there have been substantial profit growths for a number of years, and large profit growths in every year, it is very difficult to estimate the extent to which previously tax

)5 3

exhausted companies key into tax pay, and I think that is probably one of the important reasons - or the main reason - why this time last year we underestimated onshore (which is what we are talking about here) Corporation Tax receipts in financial year 1986-87.

106. I can readily believe that and that leads me to ask why you do not request the Inland Revenue to give you some sort of estimate? To my great surprise at the moment they do not ask their districts to return the amounts of agreed losses for Corporation Tax. Nobody really knows. The answer from your Minister the other day was that the total of these losses has stood at some 25 billion-30 billion in recent years, and this amount is now reducing by some several billions of pounds a year. If you do not have any better information than that, why do you not ask the Inland Revenue?

(Mr Sedgwick) I think, Mr Wainwright, this is a question that the Inland Revenue itself will have to deal with. There were forecasts in the Red Book for receipts of taxes - ones where the principal work on them is done in the Revenue Department by Inland Revenue/Customs and Excise themselves, and I think if you have any detailed questions about how they assemble their information, say, on accumlated tax losses it is a question they would have to answer.

107. I cannot specify that you should not answer, but I am not asking for any detail of any sort. I am simply saying that these losses are agreed and are on file in the district offices, so why, as the Department responsible for the Inland Revenue, do you not require that these figures be coughed up? They are there and there is no doubt about them being there.

(Mr Sedgwick) I am not in a position to say whether the Inland Revenue are using all the information they have. I am sure that is the case, but I think it would be for them to reassure you on that point, rather than me.

108. But it does not sound as though they would be reassuring me, does it? They would be practically confessing that they have got all this information available, because agreed losses are on the files, but they are not brought out?

(Mr Sedgwick) I believe that a good deal of this information becomes available on an aggregate basis, which is what one needs here for doing forecasts of total Corporation Tax receipts somewhat in arrears, but I am not myself in a position to tell you exactly how much or what the precise arrangements within the Inland Revenue for collecting those figures are.

109. But the Treasury is responsible for the Inland Revenue.

(Mr Scholar) That is not quite accurate, Mr Wainwright. We are not responsible for the Inland Revenue, they are responsible for themselves - ~~and~~ although they are one of the Chancellor's departments, it is true. But ~~I think~~ what Mr Sedgwick said is quite right: a lot of this information ~~is~~ comes considerably in arrear and the question as to whether in administrative terms it is worthwhile or possible for them to collect this information in a timely way for the production of forecasts is one we should perhaps pursue.

Chairman

110. It is, of course, the case that the Chancellor is responsible for ~~revenue~~ the Revenue Departments, not you?

(Mr Scholar) Indeed,.

111. But, given the importance of the unexpected surge in revenue which obviously had an impact on the Budget, I think, using you as a kind of postman, if we could get a note from the Revenue on precisely how they do forecast that would be illuminating.

(Mr Scholar) I am sure we could arrange for that.

Mr Wainwright:

/ My last question is about forecasting in the Autumn Statement of the PSBR. We always approach this in a thoroughly charitable and generous and liberal spirit because we know how excruciatingly difficult it is, but in an interview - a very revealing interview - the Chancellor gave, which was published inthe Financial Times just after the Budget, he described the Autumn Statement official PSBR forecast as "totally ridiculous and up the pole". Has there been any change since he reached that verdict in the method of trying to forecast this very difficult number?

Chairman

112. That sounds more like Mr Beaumont-Dark!

(Mr Sedgwick) I think you should ask the Chancellor for his views. I was not at that interview. I do think it is worth just pausing a secondand seeing what the circumstances were at the time of the Autumn Statement when the forecast for the PSBR was made. We had figures for borrowing in the current financial year up to and including September, cumulative figures not terribly different from the year before. At the time of the Autumn Statement on November 6th the first of the two large corporation tax gathering months - which are October and January - had finished with the information on that subsequently published and it appears our figure was not available then. The other thing which I think is worth noting is that a good deal of the shortfall, if you compare the cumulative position in a particular month with the previous financial years, is that there has been rather low local authority and public corporation borrowing. That is something which has become more obvious, to put it mildly, in the latter months of the financial year than in the earlier months. Finally, it is worth bearing in mind that the financial year is not over yet and there is a fairly wide range of error margin in round forecasts made even at this time of year. The average for the past has been about a billion and obviously in individual years the error has been larger.

Mr Banks

113. Chairman, I just want to come back to a couple of points, one on the question of inflation. We were told earlier that the real interest rates somehow were influenced by inflation expectation and yet inflation rates have been mroe or less around about 5 percent for some years now. How long does it actually take for expectation to start influencing interest rates then?

(Mr Peretz) Experience is that it is rather a long process. As I said earlier, a country like Germany has a long track record; we now have a track record of declining inflation over seven or eight years.

114. You have no idea how much longer we have to wait then?

(Mr Peretz) I would not care to hazard a figure in numbers of years, no.

115. And the second point is this: on our side it is generally perceived that the manufacturing industry is in a God awful mess. We may be wrong perhaps - according to the Chancellor of the Exchequer we certainly are. It is just that this particular statement he made - and this was mentioned by Mr Wainwright in his earlier question - says "During the 1980s our annual rate of growth of output per head has been the highest of all the seven major industrial countries." As I understand it, manufacturing investment and manufacturing output is significantly down on 1979. I just wanted to know why we are wrong on this side, as it were, to believe that manufacturing industry is in a mess. I do not quite understand what factors have influenced us into having the highest rate of growth of output per head of all the seven major industrial countries? Is it just fewer workers and fewer factories, or is it something more substantial?

(Mr Sedgwick) I think it is helpful just to try and stick to numbers that can be measured, as far as I can help on this. It is certainly true what the Chancellor said about the rate of growth of output per head in manufacturing in the 1980s being higher than in the other major industrial economices, and in fact we published an economic progress report article on productivity quite recently which has a table which shows that. You are absolutely right: in order for the growth of output per head to have been relatively high, given that manufacturing output has not yet reattained the last peak which was in 1979, and that was lower than the previous peak in the early '70s, there has been a considerable shelling of labour in the manufacturing industry. That is absolutely truc.

615 2

116. So that would be the major factor then for the high growth rate? It is not people working with a greater level of per capita investment? It is just fewer people working?

(Mr Sedgwick) There has been over the last few years - in fact since about 1981 though I am not sure of the exact period - a situation where the manufacturing output has grown more or less in line with GDP, which itself has risen just under 3%, and that has not been the experience over the last 15 to 20 years, when manufacturing output in the UK has tended to grow rather more slowly than total GDP.

Chairman: Thank you very much. I am never quite sure whether I should be pleased or worried when, whenever the figures improve people say "This is the best result since 1973"! At all events we are very grateful to you for a most interesting session preparatory to our meeting the Governor tomorrow at 4.15 and the Chancellor on Monday at 2.15. We are very grateful to you for filling in some of the gaps before we meet them. Thank you for coming.

Talk strong market level of
real short-term IR

Terry   Sedg Paul

→ Chancellor saw lot to Wass
raised question

Thought Sedgwick had dealt with
this well. Overwhelming his remarks @
press conference were light hearted
etc (may not be clear from transcript).
bantering

Don't reflect his views. M

Interest rate & private borrowing $\boxed{\text{? US evidence}}$

My theory period boosts borrowing yrs i.e. surges (? unhelp to less int to.)
incomes ↑ etc. - Govt into debt is not