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PART C

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PART C

1986 AUTUMN STATEMENT
BUDGET DEBATE

DD's 25 years 27-01-95 N.Aziz

PO -CH /NL/0053
PART C

STARTS:- ~~12~~-12-86
9.1.87

pmp

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 5532

Miss Theresa Rolleston,
Chief Whip's Office,
House of Commons,
LONDON.
SW1A OAA

12 December 1986

Dear Theresa,

AUTUMN STATEMENT 1986-7: MOTION FOR DEBATE
ON WEDNESDAY 17 DECEMBER

Following is the text of the motion, approved by the Chancellor and No 10, on which the debate on Wednesday 17 December will be founded:

"That this House approves the Autumn Statement presented by Mr Chancellor of the Exchequer on 6th November; welcomes the prospect of continuing low inflation and steady growth as the basis for maintaining the trend of rising employment; and congratulates Her Majesty's Government on the continuing reduction in the share of national income pre-empted by public expenditure."

This is identical to last year's motion.

Yours ever
Richard Savage
RICHARD SAVAGE

cc PPS
PS/CST
PS/FST
PS/EST
PS/MST
Sir P Middleton
Sir T Burns
Mr Butler
Mr Cassell
Mr Anson
Mr Monck
Mr Turnbull
Mr Sedgwick
Mr Odling-Smee
Mr Gray
Miss C Evans

CONFIDENTIAL

Draft as at 10pm, 15.12.

RM14.4

PNP

AUTUMN STATEMENT DEBATE SPEECH: SECOND DRAFT

I beg to move ...

I begin by thanking the Treasury and the Civil Service Select Committee, under the chairmanship of my RHF the Member for Worthing, for their report on the Autumn Statement, which, as ever, they have produced with commendable promptness.

MCS is not sure this will come over well in the House. I have tried a more conventional opening at Flag A.

[In the course of my own evidence to the Committee, my RHF the Member for Worthing suggested that the office of Financial Secretary was older than that of Chancellor. That may depend on definitions. But certainly, recent holders of the post of Financial Secretary have achieved distinction in a number of ways. My RHF is Chairman of the Select Committee. The RHM for Ashton-under-Lyne is Chairman of the Public Accounts Committee, and the RHM for Dudley East was recently voted Inquisitor of the Year.

I have, of course, been privileged to hold both the offices of Financial Secretary and Chancellor, and only one other person has done this - John Herries, who became Chancellor in 1827. Not a household name, but his career is not without interest. In his maiden speech, he opposed the repeal of the window tax. He resigned as

Chancellor after only a few months - over the appointment of a Chairman of the Finance Committee. And later it was said of him - and I quote -

> "He made the public accounts intelligible, which they never were before."

This is an achievement I should like to emulate. This Government have been the first to publish the Medium Term Financial Strategy and the first to publish an Autumn Statement. As Chancellor, I have devoted, at a very rough estimate, [ ] words to explaining monetary policy alone. ~~Far from being economical with the truth~~, I have done my best to explain the truth about the economy. So I was gratified to see this comment in the latest Greenwell Montagu Monetary Bulletin:

MCS

[I don't think this will come off. AHll]

MCS

RPC suggests better to give this to a backbencher.

> "An historian dispassionately analysing the evidence to date is almost bound to reach the conclusion that Mr Lawson has gone out of his way to explain how monetary policy is being operated in practice, and how it has evolved, probably more so than any previous Chancellor. [He should be given credit for it.]

ACSA

Some [ ] per cent of the words on monetary policy have been uttered in this House. The Committee's Report criticises the fact that a speech on monetary policy in April of this year was made outside the House. But I have to say that when I concluded in the Budget, "I will say no more about monetary policy", the reaction was scarcely one of deep and widespread disappointment. [Indeed, the Official Report records Hon Members' saying "Hear, hear".]

Today, however, is an opportunity to discuss economic policy, and particularly monetary policy, in detail. The Treasury and Civil Service Committee has produced a serious Report which deserves a serious answer.

The Report suggests that in a number of areas "there has been a substantial change of policy". It starts by allowing that the stated objective of policy has been the same since 1979 - to reduce inflation and to create the conditions for sustainable growth. And it accepts that this policy has always had two key strands: firm control of monetary conditions; and reduction of public borrowing. [I might say that even this consistency of objectives has not always been a feature of British Governments.] But the Report goes straight on to search out changes, however microscopic, in the way we have pursued our objectives.

ACSA suggests omit.

Monetary Policy

See RPC redraft, at Flag B, to replace from here to 2nd line on p.5.

[The Report claims that "the operation of monetary policy has become increasingly obscure". Of course, it is an inevitably complicated subject, because it depends on judgements on a number of interrelated variables. But I suspect that the reason that the Committee finds it so hard to follow is that they are ~~making an elementary~~

MCS/ACSA

confus~~ion~~ed between the instrument of monetary policy, which is short-term interest rates, and the indicators of monetary conditions, which include the monetary aggregates and the exchange rate.

ACSA

It is ~~thus completely~~ misconceived to suggest, as the Committee does in paragraphs 8 and 11 of its Report, that we are now giving more emphasis to nominal interest rates and less to £M3. There cannot possibly be a trade-off between the two, because one is an indicator, and one is an instrument.

The Report seems to suggest that I was announcing a change of policy in my Lombard Association speech, when I said that "Short term interest rates are the essential instrument of monetary policy". But this was in fact set out as long ago as 1980, in the Green Paper on Monetary Control, which makes clear that, alongside fiscal policy, the main instrument for controlling monetary growth is interest rates.

Turning to the indicators, the Report suggests that the role of £M3 has become increasingly unclear, with the implication that this is a specially sinister development.

Again, a reading of the 1980 Green Paper demonstrates that we have never seen £M3 as the sole guide to monetary policy. As we said then, "No single statistical measure of the money supply can be expected fully to encapsulate monetary conditions". In 1980, it did make sense to have only one target aggregate, and one with which the markets were already familiar, because it was important to give a clear and simple indication of our commitment to financial discipline. But in the day-to-day operation of monetary policy, we recognised, to quote the Green Paper again, that "It is insufficient to rely on one measure alone".

We also recognised that the definition used and the choice of target aggregates might need to be adjusted, in the words of the Green Paper, "as circumstances changes" and "in the face of long term changes in the institutional structure". And, of course, that is what has happened. Circumstances have changed, and the institutional structure has altered, with the result that the behaviour of £M3 has become increasingly hard to interpret.

It is extraordinary that the Committee's Report makes hardly any mention of these developments. And it is even more extraordinary that there is no reference at all to experience overseas. For UK experience has been similar to that of the other major countries, most of which - including Germany - have found their monetary targets overshooting this year, while inflation has unambiguously come down.

We cannot and do not ignore the continued rapid growth of £M3 and other measures of broad money. But for a long period now this growth has proved consistent with downward pressure on inflation. So it must be looked at in conjunction with the evidence of other indicators. / Principal among these is MO - the broad monetary base - which has proved a reliable indicator, with a stable trend in velocity from year to year. This is why, having watched it for some years, we adopted it as a target aggregate in 1984.

APH: would shorten this para, & not ~~long~~ & refer so much to the TCSC.

MCS

The Select Committee say they are not convinced that MO is a useful indicator of monetary conditions. They do not say why. So I suggest they examine the evidence. It is ~~foolish~~ not right to imply that all narrow aggregates are misleading because the behaviour of M1 in the early 1970s did not foreshadow the subsequent inflation. Had they looked at the behaviour of MO in the early 1970s instead - and I tried to help by pointing them to it in my own evidence - they would have seen that it did, indeed, warn of coming inflation.

PEM would omit.

[This year MO has remained within its target range. But its acceleration in recent months was an important factor in the decision to raise interest rates in October by 1 per cent.]

The Select Committee go on to suggest that there has been a volte-face in policy in that we are paying more attention to the exchange rate. I acknowledge that we are. And indeed, the exchange rate is very important both as a transmission mechanism for monetary policy and an indicator of monetary conditions. In this country, as in the other major economies, it has come to play a more prominent policy role in recent years, as institutional developments have made the monetary aggregates more difficult to interpret. But as long ago as 1980 and early 1981, interest rates were reduced because the exchange rate was indicating that conditions were tight, despite a monetary overshoot. The 1982 MTFS explained that (and I quote);-

> "The behaviour of the exchange rate can help in the interpretation of monetary conditions, particularly when the different aggregates are known to be distorted ... the Government considers it appropriate to look at the exchange rate in monitoring domestic monetary conditions and in taking decisions about policy".

So why the surprise about an inevitable and, many would say, desirable development in the appraisal of monetary conditions?

The Committee also say - and this is my last point on monetary policy - that policy at present is uncertain. It is said that the Government wants both to prevent interest rates from rising and to prevent the exchange rate from falling.

Of course no one wants interest rates to be higher than they have to be. But the greatest disservice the Government could do to the economy would be to permit monetary conditions to develop that allowed inflation to take hold again.

PEM

It is true that the operation of policy ~~is complicated~~ can be complex. But - and this is a point I have already made elsewhere and will now make in the House - so is the real world. There are difficult judgements to be made. And the timing of decisions on interest rates is affected by considerations of market tactics. But there should be no uncertainty about our purpose. As I have said several times, here and in speeches outside, interest rates are and will be set at whatever level is needed to keep downward pressure on inflation.

RPC would omit this. So would I. In fact, I'd be ~~AH~~ tempted to drop the previous para too, & end the monetary section with the sentence on "the greatest disservice...". AH

[The dramatic fall in the price of oil earlier this year meant that some fall in the exchange rate was both necessary and desirable. It was the inevitable response to an unusual event. It did not reflect a loosening of monetary conditions.

But more often, a significant fall in the exchange rate is a clear signal of loose monetary conditions. In those circumstances there would be a presumption towards taking action unless there was reassuring evidence from other reliable indicators such as M0. I will certainly not hesitate to raise interest rates should that be necessary.]

Fiscal policy

Let me now turn to fiscal policy, where, I have to say, I find the Committee's observations scarcely more coherent. Their complaint here is not that the government's policy has changed, but rather that it is the same. Specifically, they are unhappy that the Autumn Statement reaffirmed the Government's commitment to the same fiscal stance as was set out in the 1986 MTFS.

The reasoning in this part of the Report is, Mr Speaker, frankly obscure. The Committee, spurred on no doubt by their advisers, have decided after all these years to abandon the PSBR as the measure of the fiscal stance. No reasons are given for this change of mind other than the assertion that the PSBR can be measured inclusive or exclusive of asset sales - though this is hardly a surprise since I myself drew attention to the size of the PSBR excluding privatisation proceeds in the Red Book this year. They then go on to argue that the public sector financial deficit is - I quote - a more "relevant and useful figure". It is a pity that when the Report goes on to give its own estimate of the PSFD for 1987-88 it gives a wholly irrelevant [and useless] figure - of £14.5 billion, which can in no way be reconciled with the £7 billion figure in the same table for the PSBR for that year.

See Colin Mowl's minute, esp para 9.

ACSA

But, important though these details are, they are really just technical errors in this Report. On the main issue, the Committee have, I fear, no advice to offer the House. They question whether the PSBR should be held to $1\frac{3}{4}$ per cent of GDP next year. But they express no view at all as to what would be the appropriate level at which to set it. On this they are silent.

This deficiency is perhaps understandable. But I find it very hard indeed to understand the justification for the

APH ?

doubt

slur which the Committee attempt to cast on the Government's commitment to hold the PSBR next year to $1\frac{3}{4}$ per cent of GDP. The reason given in the Report for this - that any forecast of the PSBR is uncertain and subject to a margin of error - is beside the point, and reveals a rather elementary misconception. When the Chancellor of the Exchequer on Budget day sets the borrowing requirement at a particular figure, he is not just making a forecast, and I am astonished that the Committee should misunderstand the Budgetary process in this way. ~~Rather~~, ~~He~~ he is above all making a judgement about the appropriate fiscal stance. And this judgement is an essential counterpart to monetary policy in the Government's overall economic strategy.

P. Sedgwick's suggestions. I think, take the second but not the first. The "forecast" element is explained in the next para. APH

The PSBR figure published on Budget day is, nevertheless, subsequently validated, or not, as the case may be, by events; and this government's record here is a good one. The November PSBR figures, published this week, show that public sector borrowing is firmly on course, or below, the level set in the Budget. Last year the PSBR undershot the Budget level by more than £1 billion. And in 1984-85, excluding coal strike effects, the outturn was about the same level as the Budget estimate.

As to the level of the PSBR, it is, at an estimated 1¾ per cent of GDP this year, low by any reckoning, below the general levels of recent years, and far, far below the excessive levels from 1974 to 1979, when it averaged nearly 7 per cent of GDP or over £20 billion a year at today's prices. This is the picture whether or not privatisation proceeds are taken into account and it is the picture laid down in successive versions of the MTFS right back to 1980.

I do, of course, take account of the forecast proceeds of privatisation in setting fiscal policy. But, as I have always made clear, privatisation is a policy that is fully justified on its merits.

Last month's flotation of the British Gas Corporation provides a further emphatic illustration of this. British Gas is now exposed to the disciplines of the private sector and the capital markets. And some five million people - including 95 per cent of the employees - bought shares in the company. Most were not seeking to make a quick buck - the offer was widely seen as tightly priced. Rather, they saw shareholding - and British Gas - as a sound and sensible investment.

c see Mr Robson's minute, flagged.

Tax cuts

Like other commentators, the Treasury Committee have speculated about ~~what all~~ the outlook for tax cuts. I decided last year no longer to publish a projection for the fiscal adjustment in the Autumn Statement, so as to discourage the pointless and misleading calculations which are always made at this time of year. Subsequent events last winter proved how right I was. But speculation persists.

Let there be no mistake about this. As I have said repeatedly, a pound used in additional expenditure is a pound which is not available for reductions in taxation, unless borrowing increases. And ~~But~~ I have ruled out higher borrowing. ~~The increase in public expenditure which I announced for 1987-88, of £4¾ billion, is a very substantial sum.~~

ACSA

The House should therefore be in no doubt that the substantial increase in public spending next year has much diminished any scope there might have been for reductions in taxation. Of course the uncertainties are enormous, as we always see in the period between the Autumn Statement and the Budget. But on one point there is no uncertainty, and no shadow of doubt - and that is the Government's resolve to keep borrowing under control, as we have done consistently since 1979; and to take no risks with inflation.

Public Expenditure

On public expenditure, the Committee have again engaged in a textual critique worthy of biblical or Shakespearean scholars to try to demonstrate a major change in direction. Which is odd since much of the material at the back of the report is developing the theme that public spending is returning to a trend.

The true position is very simple. We have long maintained that the state takes too much of the nation's income and its share should be reduced - this can be traced back not only to the 1979 manifesto, but even before that to our policy document "The Right Approach to the Economy". And we have pursued this objective consistently.

RPC:

And I have already explained to the House that we thought it right to increase the planning totals this year.

It is true that some of the targets we have set ourselves have in the event proved too ambitious. But it is better to attempt to meet demanding targets than to have the complete absence of financial discipline offered by the party opposite.

RPC is still concerned that the tone of this is too close to suggesting that nothing has changed. I suggested, & he agreed, that we might make this section crisper, and introduce it with something like 'Looks at "We have made considerable progress so far."' See redraft at C.
MWL

[If it were indeed the case, as the Committee contend, that policy on public spending had been changed this year, one would expect to be able to detect some break in trend.

But the figures show no such break. As I explained at the time of my Autumn Statement, the rate of increase of public spending in real terms, even excluding privatisation proceeds, has been coming down progressively. From 3 per cent in the decade to 1978-79, to 2¼ per cent in the last Parliament and to 1¾ per cent so far in the present one. Far from reversing that trend, our plans seek to extend it.

Here we are arguing about whether public expenditure will grow by 1 per cent a year, as our plans imply, or 1½ per cent a year as suggested by the Committee. Let me remind the House that the party opposite increased expenditure in real terms by 12 per cent in a single year.

There was a break in trend, certainly, but it came in 1982-83. Until then, public spending had continued to rise as a proportion of GDP, mainly as a result of the severe world recession. But in the 4 years since then, the proportion has fallen progressively. With spending planned to grow significantly more slowly than the economy as a whole, the downward trend will continue, so that by 1989-90, public spending as a proportion of national income will be back to levels last seen in the early 1970s.]

This analysis is based on General Government Expenditure. I had hoped the Committee would welcome this approach, because last year, they criticised me for focussing on the planning total and so ignoring debt interest. This year, I have followed their advice, but they now seem to want me to go back to the planning total. They should be more consistent in their policies!

Summing-up of riposte to the Committee

In summary, I have said before that there have been some changes of emphasis in the way different aspects of economic policy have been conducted, and changes of presentation. Indeed, it would be extraordinary if there had not been. Since 1979, there have been enormous changes in world economic conditions, in the position of the UK, in technology, and in the operation of the financial markets. The Select Committee, the House, and the country would be rightly concerned if Government policy had not evolved in the light of these developments. But to depict this evolution as "a substantial change of policy" is absurd. If the Committee needs to be reminded of what a real shift of policy is, they need look no further than the last Labour Government.

Of course, if ever there was a year in which I might have been expected to change policy, it has been 1986, with the halving of the oil price. And many people duly advised me to make changes. I rejected this advice, and maintained the same course. And there has been no crisis. Inflation has reached its lowest levels for nearly twenty years. Growth has continued steadily, after a short pause in the early part of the year. The number of people in work has continued to rise, and unemployment now looks to be on a downward trend.

The way that both the private sector and the public finances have withstood the fall in the oil price is a remarkable achievement. That is the best possible vindication of the economic policy we have pursued since 1979, a policy which has brought five years of steady growth, low inflation, and a million new jobs since 1983.

For 1987, I predicted a continuation of this pattern, with growth slightly faster than this year, and inflation staying low. The figures that have been released since the Autumn Statement tend to confirm that picture. Output has picked up, with industrial production in the three months to October 1½ per cent higher than in the previous three months. Exports are up by the same amount, resuming their upward trend. The current estimate that the surplus on invisibles was some £750 million a month in the third quarter contrasts with the view put to the Select Committee by Mr Bill Martin, who described the earlier projection of £600 million a month as "particularly optimistic". Seasonally adjusted unemployment fell by 25,000 in October, making a total fall of 56,000 over the last three months, the best performance for thirteen years. The inflation rate increased last month, mainly thanks to the rise in mortgage interest rates, but the underlying rate remains stable, and I see no reason to revise my forecast for next year.

The World Economy

The outlook for the British economy will, of course, depend on developments in the world economy.

One danger, which is more acute following the recent elections in the United States, is that world trade will become less free. A retreat into protectionism would be a disastrous step backwards. Following the agreement on a new GATT round, it would be tragic if unilateral action were to undermine this progress. The USA would do well to recognise that multilateral negotiation, and moderation where disputes arise, are in all our interests.

The past year or so has seen substantial changes and discontinuities - the halving of the oil price, falls in other commodity prices, and the realignment of exchange rates following the Plaza agreement. And the world economy is adjusting, with so far merely a pause in the growth of world trade. In part at least, this is because the major countries have cooperated in pursuing soundly based policies. The outlook for 1987 is for slightly faster growth, and it is crucial that we do not lose our way through failures of policy, such as a retreat into protectionism.

Attack on Labour

1986 has also been a notable year in the annals of the Labour Party. It is the year in which they have reassembled all the economic policies that have failed before, and been rejected by the electorate before. And the year in which they have broken with the traditions of previous Labour Governments by abandoning, in effect, the established defence policy of this nation.

If we have something like Flag A at the start, much of this would drop.

I had better be careful, because if I am too critical of the RHM for Sparkbrook, he may cancel his reply, just as he refused to speak to the CBI last week because they criticised his policies.

The RHM for Sparkbrook may not have had much time for economic policy recently - he has been busy standing in for his RHF the Leader of the Opposition, who has been absent from our affairs playing the world statesman to such disastrous effect for his party. Perhaps this is why, when my RHF the Chief Secretary wrote to the RHG, asking for clarification of his views on Labour's ~~proposed~~ proposal for a training levy on business, he got a very short reply, saying that the HM for Dagenham would be sending an answer in due course. The RHG is clearly too embarrassed to write himself.

But this sort of evasiveness has characterised the RHG's approach to economic policy over the years. We have sought in vain for clarity about how he would run monetary policy, or fiscal policy. Even on public spending, his views are not entirely clear. Ever since my RHF the Chief Secretary and I costed Labour's programme at some £28 billion, the RHG has tried to shout down our calculations, and dismiss them as fanciful. Indeed, in spite of this massive programme of spending, and in spite of their record of extravagance when in office and now in local government, the party opposite accused us of going on a spending spree in the Autumn Statement.

We on this side of the House know - and the country knows -that serious economic debate cannot be conducted in this way. The RHG has a clear choice. If he intends to fulfil the pledges costing £28 billion, let him say how he would finance them, whether by taxation or by borrowing, or both. If he intends to drop any of the pledges, he should say which ones. I have waited for months for a clear answer. So I ask him again - out of the massive programme of spending pledges, which would he propose to drop? Failing that, will he tell us how he proposes to raise the money to pay for them?

Conclusion

Mr Speaker, I have, of necessity ranged widely in my speech, and I hope this has helped the House in its consideration of the Autumn Statement.

In conclusion, let me come back to the Autumn Statement itself. The Forecast it contains offers the prospect of another year of low inflation and steady growth. It sets out public expenditure plans which make increases in spending in priority areas, within a framework in which public expenditure continues to fall as a proportion of national output. It is the latest step in a firm economic strategy which has been pursued consistently since 1979, and I commend it to the House.

A

"I am relieved to see the RHG the Member for Sparkbrook in his place today. Because he has ducked a few challenges recently.

- For months, he and his colleagues have refused to answer questions from News International newspapers.
- When my RHF the Chief Secretary asked his views about Labour's proposal for a training levy, his answer was that the HM for Dagenham would be replying in due course.
- Last Thursday, his party spun out the previous day's business so as to spare him the embarrassment of Treasury Oral questions.
- And on Friday, he broke off relations with the CBI, because they criticised his policies.

I have to admit that I, too, have also criticised the RHM's policies in the past. So I am relieved that he has not refused to take part in this debate."

Let me start with what has not changed, and come on to what has.

E

There has been no change whatever in this Government's view that monetary policy is the key to controlling inflation. There has been no change in our view that interest rates are - and must be - the essential instrument of that policy. And there has been no change in our view that a sound monetary policy needs to be accompanied by a prudent fiscal policy - by which I mean a low budget deficit.

The Committee suggests that what it calls "the enhanced role" for interest rates is new. But that is surely exaggerated, to say the least. Monetary policy, everywhere and always, <u>has to</u> operate through interest rates, for the simple reason that interest rates are the price of money.

APH: worth referring to GP on Monetary Control?

I acknowledge, though, that in the implementation of policy, a number of things have changed.

First, interest rates have come to bear more weight in restraining money and credit because we have - quite rightly - swept away a lot of other controls. When we took office, we inherited a corset for banks, foreign exchange controls for everyone, and mortgage rationing for those buying houses. All were unfair and inefficient. Now they are gone, and credit is rationed by price rather than bureaucratic controls.

Second, short term interest rates have come to bear more weight because - again, rightly - we have abandoned the practice of selling more gilts than are needed to finance the public sector deficit. This practice had the statistical effect of reducing £M3 - but only at the cost of raising long term interest rates relative to short term interest rates. We concluded that this could not be justified, and I explained that fully in last year's Mansion House speech.

Third, I accept that in setting interest rates it has become harder to use as a guide the particular measure known as £M3. But this is in no sense a bolt from the blue. The 1980 Green Paper said that "no single statistical measure of the money supply can be expected fully to encapsulate monetary conditions".

(C)

Public Expenditure

On public expenditure, the Committee have again engaged in a textual critique worthy of biblical or Shakespearean scholars to try to demonstrate a major change in direction. Which is odd since much of the material at the back of the report is developing the theme that public spending is returning to a trend.

The true position is very simple. We have long maintained that the state takes too much of the nation's income and its share should be reduced - this can be traced back not only to the 1979 manifesto, but even before that to our policy document "The Right Approach to the Economy". And we have pursued this objective consistently.

RPC:

And I have already explained to the House that we thought it right to increase the planning totals this year.

It is true that some of the targets we have set ourselves have in the event proved too ambitious. But it is better to attempt to meet demanding targets than to have the complete absence of financial discipline offered by the party opposite.

RPC is still concerned that the tone of this is too close to suggesting that nothing has changed. I suggested, & he agreed, that we might make this section crisper, and introduce it with something like 'Look at "We have made considerable progress so far."'

NWL

[~~If it were indeed the case~~, as the Committee contend, that policy on public spending had been changed this year, one would expect to be able to detect some break in ~~trend~~.

We have made considerable progress.

~~But the figures~~ show no such break. As I explained at the time of my Autumn Statement, the rate of increase of public spending in real terms, even excluding privatisation proceeds, has ~~been~~ coming down ~~progressively.~~ From 3 per cent in the decade to 1978-79, to 2¼ per cent in the last Parliament, and to 1¾ per cent so far in the present one. ~~Far from reversing that trend, our plans seek to extend it.~~ Our plans continue this process.

~~Here we are arguing about whether public expenditure will grow by 1 per cent a year, as our plans imply, or 1½ per cent a year as suggested by the Committee. Let me remind the House that the party opposite increased expenditure in real terms by 12 per cent in a single year.~~

~~There was a break in trend, certainly, but it came in 1982-83. Until then, public spending had continued to rise as a proportion of GDP,~~ We have also reversed the growth of public spending as a proportion of GDP. Until 1982-83, the long-term trend growth trend continued, mainly as a result of the severe world recession. But in the 4 years since then, the proportion has fallen progressively. ~~With spending planned to grow significantly more slowly than the economy as a whole,~~ Our plans mean that the downward trend will continue, so that by 1989-90, public spending as a proportion of national income will be back to levels last seen in the early 1970s.

This analysis is based on General Government Expenditure. I had hoped the Committee would welcome this approach, because last year, they criticised me for focussing on the planning total and so ignoring debt interest. This year, I have followed their advice, but they now seem to

pmp

FROM : S A ROBSON
DATE : 15 DECEMBER 1986

2nd

MR HUDSON

c.c. Ms Leahy

AUTUMN STATEMENT DEBATE SPEECH : FIRST DRAFT

Your minute of 15 December.

Copy Attached below.

2. You asked about new BGC points. I have sent a separate minute today to the Chancellor explaining Mr Walker's reference to 2 million first time shareholders. Its a pretty fragile statistic and, as Mr Walker has already laid claim to it, I see little advantage in using it.

3. The only new angle to the BGC sale is the international aspect. There was one genuinely novel feature. This was the first truely international share sale; previous "international" sales had in fact been a group of national sales which were more or less loosely tied together.

4. The difference on BGC was there was a single international underwriting agreement. This meant that, for example, the US investment banks which underwrote the issue would have had to take the shares if the SEC had not declared registration of BGC shares to be effective. In the past this risk would have been carried by the vendor.

5. This is pretty technical stuff. The line of argument you could make of it is :

> "The BGC offer was the first fully integrated international share offer. Previously the so-called international share offering - public sector or private sector - were in fact a series of loosely linked national offerings.

The BGC offer broke new ground. It did so because the UK's experience in privatisation enabled us to sieze an opportunity which had until then eluded all other vendors. The international dimension of the sale played an important part in enabling the Government to get a good price for the taxpayer. The techniques used on the BGC can help UK investment advisers win more overseas business."

SAR

S A ROBSON

CONFIDENTIAL

FROM : S A ROBSON
DATE : 15 DECEMBER 1986

CHANCELLOR OF EXCHEQUER

c.c. FST
Sir P Middleton
Mr Monck
Mr Moore
Mrs Lomax
Mr Neilson
Ms Leahy
Mr Tyrie

BGC PRIVATISATION : ALLOCATION

Mr Kuczy's minute of 11 December.

2. The figure of "some 2 million" shareholders in 1979 was based on NOP's 1979 financial research survey and, as such, is quite respectable.

3. On a rather separate point, you will have seen Mr Walker has claimed in public that, of the 5 million people who came into the BGC offer, some 2 million were first time share buyers. On the back of this, he is saying that the number of shareholders has risen from the figure of 7 million before BGC privatisation to 9 million after.

4. The basis of the figure of 2 million new shareholders is as follows. On the weekend of 29-30 November Dewe Rogerson conducted an opinion survey for the department (using a sample of 2000). This was the second weekend in the offer period and, based on the results, 6 million people appeared certain to buy. In the event 5 million did.

5. After the offer closed Dewe Rogerson subsequent re-interviewed a sample of those who had said, on November 29-30, that they were certain to buy. This sample numbered 36.

6. Of those 82% said they did buy. This gives the right "grossed up" results (i.e. 82% of 6 million is 4.9 million against the true figure of 5 million). Of those in this sample who did buy, 44%

CONFIDENTIAL

said they were first time shareholders. Applying this figure of 44% to the 5 million produces just over 2 million. This is the basis of Mr Walker's figure.

7. Dewe Rogerson urged caution in the use of the figure. This apparently cut no ice with Mr Walker.

SAR

S A ROBSON

3115/001

Rup

FROM: ANDREW TYRIE
DATE: 15 December 1986

CHIEF SECRETARY

cc PS/Chancellor
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Mr Cropper
Mr Ross Goobey
Craig Pickering

AUTUMN STATEMENT: KNOCKABOUT

Bryan Gould has been a good deal more careful than Roy Hattersley and has left fewer hostages to fortune. But I attach a few quotations which could be of use during the debate.

2. His description of Labours "laager mentality" and his discussion of Labour's credibility problem, both as recent as February of last year look like good Commons material. You asked for these tonight if possible.

Up to CST, but Feb of 1985 does not seem recent to me. Won't it come over better if Gould now said something contradictory?

AH
15.12.

AWT.

ANDREW TYRIE

TIMES 12 JAN 1985

Gould

THE TIMES SATURDAY JANUARY 12 1985

When will Labour face the truth?

by Bryan Gould

To say that the Labour Party's decline might be terminal has become a commonplace. In a sense it is now true in a way it was not before. It is not so much the by-election lost deposits and flagging opinion poll ratings. It is, rather, that despite a brave new leadership which has done much to restore Labour's image and morale, the party is being driven towards an intensification, rather than a resolution, of its problems.

To lay this bare is not to hasten the decline. A proper understanding of what is happening offers the only chance of doing something to halt a possibly fatal process.

The rational response to a loss of electoral support is to reach out to those whose support is being lost. But the fact of decline has left Labour dangerously vulnerable to those elements of self-delusion and introversion which militate against a rational response. Within our geographical and ideological laager a kind of siege mentality prevails; instead of trying to break out, we reinforce our defences against an outside world which appears shadowy and distorted.

The plaudits of those within appear more real and valuable than the votes of those outside; the rhetoric of class conflict and struggle seems more appropriate than the language of consensus; we comfort ourselves with a more and more arcane interpretation – intelligible only to a tiny minority of "activists" – of what is going on.

Thus, it is seriously asserted that the obstacle to majority support is that we are not "left-wing" enough. It is believed that one day the scales will drop from the eyes of "the masses" and that a demonstration on the floor of the Commons will bring the triumph of socialism closer.

This response may seem irrational and self-destructive, but it is implicit in the dynamic of decline. As a political party loses touch with the electorate, its activists, who are by definition unrepresentative, become disproportionately influential, thereby reinforcing the original failures of communication and persuasion.

As Labour has been increasingly driven back to its traditional heartland – the North, Scotland and Wales – its preoccupations have become almost exclusively regional and sectional. The voices within the party which used to speak up from the Midlands and the South and which underpinned Labour's claim to be a national party are now muted or silent.

Labour's reduced influence and popular support count against it in other ways. We have found ourselves powerless to defend the pensioners, the miners, the unemployed or the public sector against a ruthless and uncaring government. This has led the activists into making two further mistakes.

First, our case on behalf of those under attack is made in increasingly exaggerated terms. If every slight movement of government policy is attacked in apocalyptic terms, the effect raises the threshold of shock and outrage, so eventually anaesthetising the public against real injustice. At the same time, the strident defence of sectional interests encourages the sense of majority of those not directly affected.

Secondly, in despair at ever winning another election, the activists turn their energies away from the democratic route. It is easy to understand why, in anger and frustration, resort should be had to politics by emotional spasm; but to yield to this temptation is a confession of weakness, an apparent admission that Labour has lost the argument. Its credibility as an alternative government is reduced and doubt in the public mind, which is where our problems began, are reinforced.

More importantly, by appearing to abandon any real contention for parliamentary power, Labour not only concedes the next – and every successive – general election; we also give up the only weapon which could be used, in the lifetime of this Parliament, to defend our people.

The one constraint which would force Mrs Thatcher to moderate her policies would be the fear that Labour looked likely to win the next general election. Every time we resort to unreason, or claim to be above the law, or posture as a revolutionary movement, we deny ourselves that weapon. If our people conclude that we are no longer serious about defending them, or have lost faith in our ability to do so, they will turn elsewhere for protection.

A real effort of will and intellect is required for Labour to break free from the logic of decline. Unless we do, the voice of democratic socialism will be extinguished as an effective force in British politics.

The author is Labour MP for Dagenham and an Opposition spokesman on trade and industry.

Bryan Gould

TRIBUNE, FEBRUARY 1, 1985

The Left must take electoral policies seriously

by

BRYAN GOULD

AS IS so often in the case of politics, the debate about the direction the Labour Party should take is in danger of over-simplification. The debate is often presented as a straight Left/Right conflict.

The party activist is told he must choose between the Right's claim, on the one hand, that Labour is fatally handicapped by policies which alienate the electorate and which must therefore be abandoned, and, on the other hand, the Left's argument that a concern for "mere electoral success" should not be allowed to stand in the way of a renewed commitment to those policies.

Dichotomy

But what if neither of those propositions is correct? What if the dichotomy between Labour's policies and electoral success is a false one? What if the Right's analysis is mistaken and the Left is, as a consequence, led to draw the wrong conclusions itself?.

There is a good deal of evidence to show that it is not Labour's policies which prevent it from winning popular support. It is rather the credibility of the party as a whole, quite apart from its individual policies, which raises doubts in the minds of the electorate and which then spills over into a scepticism about the policies.

This process was seen quite clearly at the time of the 1983 general election. After years of conflict and squabbling, the party looked more like a rabble than a potential government; and, having made it painfully clear that our own internal preoccupations were infinitely more important than the views of the electorate, we had no right to be surprised when voters declined the sudden invitation to become involved again on election day.

The sheer ineptitude of our campaign, and our incompetence in some of the basic political skills, reinforced this impression. The consequence was that even on those issues where the electorate would normally have backed the Labour position, public support declined. It was not that Labour was handicapped by unpopular policies, but that Labour's general risk of credibility destroyed support for policies which would otherwise have been supported.

Let us take a concrete example.—The question of Cruise missiles was an issue which featured strongly in the run-up to and during the general election campaign. The table below shows the extent of opposition to Cruise missiles in the period before and after the 1983 elections campaign, and the level of support for Labour over the same period. (Source: MORI and NOP)

Clear majority

What this table shows very clearly is how closely opinion on the desirability of Cruise missiles was linked to the general level of support for the Labour Party as a whole. At the beginning of the year, when Labour support was running at 36 per cent, there was a clear majority against Cruise missiles.

As Labour support dropped to 28 per cent in the run-up to and during the election campaign, the anti-Cruise majority first dwindled and was then reversed altogether. With the election of a new party leadership and the revival of Labour's standing — to 37 per cent, the anti-Cruise majority re-asserted itself.

The conclusion is unmistakable. It was Labour's general unpopularity and lack of credibility which affected attitudes towards one of Labour's main policies. It was not the policy which handicapped Labour, but the party's loss of standing with the electorate which jeopardised the policy.

A similar point can be made in respect of other major planks in Labour's platform. Anti-EEC sentiment was running strongly before the election; the party's policy on the issue should have been a vote-winner. Yet, in line with Labour's loss of credibility, the public lost faith in our EEC policy, only for anti-EEC feeling to re-assert itself strongly once the nadir in Labour's fortunes had passed.

In the same way, it is now generally assumed that our economic policy was a vote-loser. Yet nothing should have been easier than to show people that we did not have to endure over 3 million unemployed. Again, it was the party which lacked credibility, rather than the policy. People could not see Labour as a potential Government; they were therefore disclined to believe the remedies we offered.

The lessons for the Left are clear. We do not have to abandon our policies in order to seek electoral support. On the contrary, the two objectives go hand in hand. Furthermore, if we fail to pay sufficient attention to the electorate, we forfeit their support for our policies.

In other words, the Left (and particularly the so-called hard Left) has allowed itself to swallow a false analysis. Commitment to policies does not require that the wider electorate (from which we shall need 3 million extra votes on 1987/88) should be ignored or treated with contempt. There is nothing unsocialist about wooing the wider electorate, since this is the pre-condition, not just for gaining power, but for retaining and building support for our policies.

Support for Cruise Missiles 1983	Yes	No	Support for Labour
January	36	54	36
May	42	44	33
June	48	38	28
September	45	44	27
October	43	51	37
November	38	50	37

Demo-politics

Each time we reduce our credibility with the electorate by resorting to demo-politics, or by speaking the language of violence or by pretending to be some sort of revolutionary movement, we betray the issues we claim to care about, and we abandon the people we claim to defend.

We must consiously eschew the introversion and self-delusion which have weakened our appeal to, and our understanding of, people whose support we have lost. It is time for the Left to take electoral politics seriously.

Bryan Gould is the Labour MP for Dagenham.

I have not checked yet of course but I am fairly sure it was Gould own pay (with 3% projection) less than 5% assumption was here

A heroic piece of opportunism

WHEN Margaret Thatcher came to power in 1979, public spending accounted for 40.5 per cent of national income. The Tories were outraged. They set about reducing it and they weren't too worried about how.

They attacked public spending for three main reasons. First, they have an ideological aversion to anything in the public sector.

Secondly, they swallowed whole the economic doctrine that, by cutting public spending, resources would be freed for use by the private sector.

And thirdly, they wanted to save money which could then be used to finance tax cuts for their wealthy supporters.

So they set about the task with a will. Local authority spending was squeezed to the point where local government has virtually no independence left.

Nationalised industries were forced to raise prices for revenue-raising purposes. Housing, education and health service programmes were laid waste.

Thousands of jobs were destroyed in the public sector and wage rates were forced down in real terms. Major promises on pensions and other benefits were broken.

And what was the result of this wide-ranging and determined effort to cut public spending down to size? A rise in the share of national income accounted for by public spending from 40.5 per cent in 1978-79 to 42 per cent today.

The price paid for this extraordinary failure has been high. The level of services on which so many of the most vulnerable people in society depend has plummeted. Those who have been forced out of employment in the public sector have been unable to find jobs in the private sector, which has suffered because its public sector customers have less to spend.

The level of capital spending on necessary economic infrastructure has fallen to a point where even the leaders of British industry are expressing alarm. Most ironically, the tax burden on all but the very rich has risen substantially.

What the Chancellor, Nigel Lawson, is saying in his recent White Paper on government spending plans is that all the harsh lessons of the last four years will be ignored, and that efforts to cut back on public spending will be redoubled.

The White Paper makes no pretence that unemployment will do anything other than stay firmly above 3 million for the next three years.

Instead, so that public spending can be held at present levels in real terms, local authorities will continue to be squeezed, capital spending in the public sector will actually fall – despite the pleas of the construction and engineering industries, asset

BRYAN GOULD on Lawson's White Paper

sales will continue at about £2,000 million a year until, presumably, there is nothing left to sell, and even defence will, in 1986-7, feel the full force of the axeman's blows.

The White Paper is based on some heroically optimistic assumptions. It is assumed that inflation will average under 5 per cent for the next three years and that public sector wages settlements will be even lower, at 3 per cent – representing a further decline in living standards.

The external financing requirements of nationalised industries are assumed to fall by no less than £2,500 million. This can happen only if gas and electricity prices rise even further and more steeply, and if the financial performance of the National Coal Board and British Rail miraculously improve.

Even on the most optimistic assumptions – (optimistic, that is, in the Government's terms) – public spending will still be where it was in 1978 as a proportion of total spending.

Much more likely is that we shall suffer again all the pain of further cuts, worse services and a poorer and weaker industrial infrastructure, but that public spending will remain high because of the need to finance continuing record unemployment.

Indeed, it could be worse than that. The huge Government revenues from North Sea oil are peaking right now. Nigel Lawson will then have to face the prospect of rapidly falling tax revenues.

What will he do then – more cuts? The White Paper is mercifully silent on that point.

Bryan Gould MP is the Labour MP for Dagenham.

GUARDIAN
16 SEP 1983

How the rightward swing of the SDP could do Labour a good turn

Bryan Gould

A CENTRE Party, as Shirley Williams proclaimed, may lack roots and principles; but the SDP at least has David Owen. The party's conference this week reveals how much the SDP has become a vehicle for the political philosophy and personal ambitions of its new leader.

This is no more than just reward for the man who, more than any other, was responsible for the SDP's formation. Roy Jenkins, who conceived the idea, was too remote from British politics to get it off the ground; Shirley Williams would have dithered forever; Bill Rodgers did not have the necessary weight; only David Owen was there to supply the drive needed to make the decisive break with Labour and form a new party.

The SDP's policies will increasingly bear the stamp of their leader's views. In Salford this week, Owen has mapped out a course for the SDP — the pursuit of a right-of-centre, free-market economic policy, coupled with and softened by a social conscience. The combination has a certain appeal; its weakness is that social consciences are too easily regarded as optional extras, to be jettisoned when the going gets tough.

The real heart of a political programme is to be found in its basic approach to running the economy. It is that which dictates everything else, and in the case of Owen's SDP, it is irremediably right wing.

This should come as no surprise. Since one of the main objects of setting up the SDP was to insulate men and women of moderation, who were used to running things, from the awkward pressures exerted on them from the left and the working class, the SDP — impervious to that spur of radicalism — will inevitably settle down in a right-of-centre position.

This, however, offers no comfort to the Labour Party. The position being taken up by the SDP is entirely consistent with a political scenario in which the electors are offered a choice between two parties of the right, while the left is represented by a plethora of splinter groups, preoccupied with internecine struggle and permanently remote from power.

It is a hard fact for the Labour Party to accept, but the SDP has changed the political scene, not so much by breaking the mould as by interrupting the swing of the pendulum.

There are many in the Labour Party whose unspoken assumption has been that it matters little how attractive Labour is to the electorate, since sooner or later the anti-Tory swing will produce a Labour government. That assumption always was dangerously ill-based; but now that the pendulum has somewhere else to swing, there can be no excuse for ignoring the danger.

Paradoxically, by forcing Labour to look again at the whole question of its electoral appeal, the SDP might in fact perform a service to the Party. It is at least arguable that, in doing so, it might also perform a service for the country, though not quite in the way they might have expected.

Social and political advance in Britain has owed much to those radicals and progressives — often, but not always, socialists — who have traditionally found their most natural political home in the Labour Party. It would be a tragedy of the first order if, by accident or design, a rearrangement of the groupings in British politics should leave those people without a significant voice in the affairs of government. The only non-conformist, radical and reforming force with a real chance of carrying their ideas into government would then have been shunted into a siding.

There is a danger that this could now happen. As the SDP moves rapidly away from the radical origins of its Labour founders towards the apolitical assumption that government is essentially administration, and the Labour Party becomes increasingly Marxist in its analysis and prescriptions, socialists in the British and therefore non-Marxist tradition could easily fall between the two as they pull apart from each other.

On the other hand, the very existence of the SDP and the threat it poses could provide the most effective safeguard against this happening. The Labour Party, without disowning its Marxist wing — a useful benchmark for any party with left-wing pretensions — could be spurred by both the danger and the opportunity presented by the SDP into re-asserting its traditional role as the vehicle for popular socialist reform.

In other words, the SDP, rather than posing a direct threat to the Labour Party, may actually beckon Labour in a direction in which it is very much in Labour's interest to go.

The danger for Labour is not so much that the SDP will compete for Labour territory as that the Labour Party will itself retreat further into a Marxist laager, leaving traditional Labour voters unrepresented and with nowhere to go. As the SDP disappears rightwards, however, Labour will have every incentive to move back into its own territory.

The increasingly clear elitism and pessimism of the SDP approach to politics can also be used to remind voters, and the Labour Party, of the uniquely valuable contribution which a radical, left-of-centre, and largely socialist party can make to British politics. In the end, there is no substitute for the passion and compassion which socialism at its best can bring; the SDP might just help Labour to bring out that best.

Bryan Gould is Labour MP for Dagenham

Gould
AG.

GUARDIAN 4 MAY 1984

It is not difficult to show that nothing has changed. H.

In search of the popular face of socialism

Bryan Gould

THE LATEST opinion polls show that, in spite of the favourable impact made by Labour's new leadership, the party still has a long way to go to resolve its basic strategic problems.

On the one hand, there are those, like Professor Miliband, who say that campaigning on radical socialist policies, if done with enough vigour and commitment, will eventually command popular support. In the meantime (in a phrase coined by Denis Healey to describe this position), there should be no compromise with the electorate. The meantime may of course last a very long time.

On the other hand, there are those, like Professor Hobsbawm, who argue that we cannot wait for the electorate to come to us. We must make whatever changes are necessary to command majority support. These concessions, it is said, need not entail any abandonment of socialist principles; but a better clue to such thinking is given by Professor Hobsbawm's warning that Labour might have to consider an electoral alliance or a coalition with the SDP.

Underlying both positions is the common assumption that there is an unbridgeable gulf between radical policies and popular support — a gulf that can only be eliminated if either radicalism is abandoned (the Hobsbawm view) or the electorate are finally convinced by the awfulness of the alternatives that an unpalatable radicalism is the only option left (the Miliband view).

The Labour Party should be chary of accepting this bleak assumption. The Labour Party came to power as an instrument of *popular* political action, and during its first 60 years it operated very satisfactorily on a quite different assumption — that radical socialism and popular support were perfectly consistent with each other. Indeed, I believe that a socialism which does not enjoy popular support can hardly be regarded — in the British context at anyrate — as socialism at all.

The apparent conflict between socialism and popular support arises because we accept far too easily the conventional definition of what is socialist and what is not. The Labour movement is currently lumbered with a whole corpus of ideas fixes which we are told are socialist, or radical, or left-wing. Virtually no one asks — who says so? Yet the truth is that many of these ideas are socialist only in the sense that they might claim a place in a museum of socialist intellectual history. They owe their origin to analyses made of societies which have long since evolved out of all recognition.

Nor can it be said that they are in any sense radical; they are essentially conservative, not to say reactionary — offering solutions to problems which have long since been solved and providing no answers to questions which should be in the forefront of political discussion.

Making a choice between popular support and radical socialism is not the Labour Party's problem. We do not have to abandon our radicalism; we have to re-discover it. As democratic socialists, our task is to find practical expressions of our socialism which, because they are socialist, will be popular.

It is not socialist, nor (as we have discovered to our cost) is it popular to create centralised institutions which are run as autocratically in the public sector as any in the private sector. It is not socialist or popular to allow great and virtually unchallengeable concentrations of power to arise, in bureaucracies or in trade unions or elsewhere.

It is not socialist or popular to categorise people and prevent them from leaving one category for another, as we have tried to do with public sector tenants; or implicitly to tell people that, while they may be required to vote Labour at infrequent intervals, at all other times the views of only a handful of unrepresentative activists will count.

There is much, in the form of co-operative action and community responsibility, to retain from our present thinking but there is also a whole radical and socialist programme waiting to be developed.

Faced with a Government which sees the promotion of inequality as a positive good, we should be much more aggressively egalitarian, arguing that greater equality is the best way of maximising individual freedom. We should make a much more determined attempt to produce an equal sharing of the benefits of social co-operation.

We should develop new and more flexible forms of social ownership, devising ways, for example, of using the immense savings of working people to obtain control of wealth creation. We should be planning an attack on limited liability and the joint stock company, and a radical limitation of the rights of inheritance. We should break down concentrations of power wherever they arise, tolerate institutions only where they operate on a human scale, and make authority less remote and more manageable. Popular support and a new radical socialism are not incompatible; they need each other.

Bryan Gould is Labour MP for Dagenham.

Gould

Where are principles to woo Labour loyalists?

Bryan Gould

THE Parliamentary Labour Party is rather like the remnants of a scattered army returning after decisive defeat on the battlefield. There is much talk of fallen comrades, overwhelming odds, mistakes by the leadership and the need to regroup and rethink before the next engagement.

Even in the PLP, however, it is doubtful if there is any real appreciation of the true dimensions of Labour's defeat. In nearly half the country, Labour is no longer even in contention. The old argument about wasted votes can now be turned back on us. To rebuild Labour as a national party is at least as formidable a task as that facing the Alliance parties, with the added disadvantage that the momentum of change is against us.

It's not just the arithmetic which makes the task daunting. Even more worrying is the doubt as to whether Labour has the heart, will and intelligence to get to grips with it. The disaster of June 9 was not a one-off, to be explained away on the basis of avoidable mistakes which can be corrected next time. Our problems go much deeper.

Labour has been losing votes and support for a long time. Its class base is contracting: the old working class is getting smaller and older. The most commonly advanced reason for voting Labour was "We've always been Labour"; but loyalty without constant reinforcement, is a diminishing asset. There is remarkably little enthusiasm for Labour's policies among our traditional supporters, and this is hardly the base from which to convert the new generation of support that Labour needs.

The young marrieds on the new estates have no loyalty to Labour. They are a class and a generation whose aspirations Labour has ignored. For them, Labour is seen too often as frustrating their legitimate ambitions e.g. to own their own homes. They see Labour institutions like trade unions as undemocratic and restrictive, providing no benefit to them and with no significance other than as power bases for union officials.

For these people, moving into the new middle class is an escape from, and is achieved in spite of, what the Labour Party appears to stand for. To accuse them of being class traitors is merely to emphasise the finality of their breach with Labour.

What Labour needs is a new crusade to reach out to millions of people who do not now naturally think of voting Labour. But we cannot crusade without agreement on and confidence in what we believe. One of the most disappointing features of the recent campaign was our failure to offer a different vision of society, a different set of moral values. It was this failure, more than anything else, which revealed the fatal loss of confidence at the heart of Labour's position.

For a party which claims to want a radical reconstruction of society, we have shown an astonishing lack of interest in ideas. We are now paying the price. Having abandoned, and rightly, the muddled form of social democracy which was the only ideological underpinning Labour bothered about in the post-war years (it is now the preserve of the SDP), the Labour movement has been caught short, forced to rummage around in a sort of historical junkshop where the only ready-made ideas are a clapped out, reactionary dogma which was barely relevant to the 1930s, let alone the 1980s.

The result is an ideology which is so out of line with what its supporters find acceptable that the Party dare not reveal it fully to the electorate. Voters are allowed only a brief and partial glimpse, not because Labour's leaders are engaged in a deliberate conspiracy, but because they have no confidence themselves in the sort of centrally planned, party-dominated society which is all they they can dredge up.

It may seem fanciful to suggest that the Labour canvasser on the doorstep is aware of this intellectual vacuum. But he certainly is aware that the old confidence, the old moral authority has gone.

He knows that there has been a fundamental shift in the balance of the intellectual argument and that it is the new Right which is brimful of cofidence and making the running.

There are many things Labour can do before the next election — elect a new leadership, rethink its policies, use its House of Commons representation to mount an effective Parliamentary opposition. But most importantly, we must do some new thinking — about principles as well as policies — so that we have confidence in a democratic and socialist Britain which reflects the interests and hopes of that majority we must win to Labour. That is a task for every member of the party.

Bryan Gould is Labour MP for Dagenham.

Gould
Election PM

GUARDIAN
24 JUN 1983

ps4/9H

UNCLASSIFIED

PLP

FROM: A P HUDSON

DATE: 15 December 1986

PS/CHIEF SECRETARY

cc Sir P Middleton
Sir T Burns
Mr Scholar
Mr Turnbull
Mr Culpin
Miss O'Mara
Mr Allan
Mr Dyer
Mr Tyrie
Mr Ross Goobey

MOTION FOR AUTUMN STATEMENT DEBATE

The Chancellor has decided that the Government motion for the Autumn Statement debate is to be exactly the same as last year's. That is,

> "That this House approves the Autumn Statement presented by Mr Chancellor of the Exchequer on 6 November; welcomes the prospect of continuing low inflation and steady growth as the basis for maintaining the trend of rising employment; and congratulates Her Majesty's Government on the continuing reduction in the share of national income pre-empted by public expenditure."

APH

A P HUDSON

~~PS~~ cc. Chancellor
Andrew FST
MST PWP
EST
Mr Cropper
Mr Ross-Goobey
Mr Tyrie
Miss O'Mara
Mr Culpin

HOUSE OF COMMONS

LONDON SW1A 0AA

15 December 1986.

Rt Hon John MacGregor MP,
Chief Secretary to the Treasury,
Treasury Chambers,
Parliament Street,
London SW1P.

Dear John,

Your letter of 10 December to Roy Hattersley has been passed to me for reply.

As I believe you know, the matter was fully dealt with by Roy in the debate on the Queens Speech on 19 November. In case you found it difficult to take in fully what he said on that occasion, may I suggest that you refer to Column 569 of Hansard for that day?

Yours sincerely,

Bryan

Bryan Gould MP

[Mr. Roy Hattersley]

The Chancellor did not answer or attempt to answer those questions in our last debate and he will not attempt to answer them today. His failure to answer any of those questions is a brilliant demonstration of the one area of the economy in which he has been an undoubted success— the economy of truth. That, of course, is a wholly parliamentary expression because the Cabinet Secretary explained to us that it is not quite the same as telling a lie.

Mr. Richard Hickmet (Glanford and Scunthorpe): While dealing with the economy of truth, will the right hon. Gentleman say if he is in favour of a 1 per cent. levy on the turnover of companies, and will he say what effect that would have on employment?

Mr. Hattersley: I miscalculated. I thought I would be asked first about bailing out the councils and that this would come second. I shall tell the hon. Gentleman exactly the position *[Interruption.]*—if I am given a chance to do so. There is unanimous agreement in the Opposition that we need a major training initiative. There is unanimous agreement that without more training there will never be the expansion in the economy which is desperately needed. We also agree unanimously that because the Government have no training policy there is virtually no training. The new training policy that we will bring in will certainly be financed by the only possible means—a levy and grant system. Again, we are unanimous about that.

Yesterday, my hon. Friend the Member for Kingston upon Hull, East (Mr. Prescott) could not have been more frank in saying that in his judgment that levy should be 1 per cent. No doubt that is what he will put to the policy committee discussing these matters and we shall see what comes out.

Mr. John Prescott (Kingston upon Hull, East): That is exactly what I said at Knowsley.

Mr. Hattersley: I do not know whether I should take next the planted bailing-out questions about councils or whether I should continue on this topic. I shall turn instead to the real issues of today, the collapse of manufacturing industry and the recurring balance of payments crisis— which, like the huge growth in unemployment and the massive increase in poverty, are the direct responsibility of the Government. Indeed, they are part of the Government's economic strategy.

The Government's response to poverty and unemployment is to obscure the extent of their failure by the constant manipulation of the figures. They cannot do that with sterling. A month of bad figures on money supply, borrowing and balance of payments and we would be back into another bout of speculation and depreciation. Of course, the Chancellor's response to that would be another interest rate increase, even though our real interest rate is the highest in the industrialised world and even though the present rate of interest is doing desperate, indeed in some ways mortal, damage to the prospects of British manufacturing industry, as well as imperilling the secure future of home owners by pushing up the price of mortgages.

Bad monthly figures, as least for the balance of payments, are now inevitable. Following the autumn statement forecast, Lloyds bank suggested that the balance of payments deficit under present policies would be £2·6 billion by 1987-88. I chose that figure from the middle of the range. The National Institute of Economic and Social Research predicts a deficit of almost £6 billion. The gradual accumulation of that deficit is bound to be reflected in the published figures month by month from now on. Those figures will provide a regular demonstration of the Chancellor's failure to revive and support the real economy—the economy of investment, output and exports.

The figures will provide continual proof of the Chancellor's willingness to sacrifice the real economy in the hope of short-term party advantage. The balance of payments crisis will be the direct result of three related causes. The first of these is the consumer and credit boom which the Government have encouraged in the hope of political gain. Secondly, manufacturing industry has been so damaged during the last seven years that its share of world trade has fallen by 16 per cent. since 1979. Thirdly, and perhaps most desperate of all, is the waste of oil revenues, oil earnings, which should have been used to revive manufacturing industry but which have been squandered on the cost of escalating unemployment and which are now beginning to run out.

Already the deterioration in our manufacturing industries is imperilling our economic prospects. In 1978 there was a surplus of £5 billion in our trade in manufactured goods. In 1985 that turned into a deficit of £3 billion. On the Chancellor's own forecast—for what that is worth—the deficit will grow to £7·5 billion by 1987. By then the Chancellor will be working in the City, where I have no doubt at all that he will feel completely at home. His willingness to ignore the needs of the real economy and to allow — indeed, to encourage — an escalating balance of payments deficit proves that his horizons stretched no further and that today they stretch no further than the next general election.

Mr. John Maples (Lewisham, West): The right hon. Gentleman has said repeatedly that one of his policies for helping to reduce interest rates is the compulsory repatriation of foreign assets. Would that not drive up the exchange rate and thereby penalise the export of manufactured goods?

Mr. Hattersley: It would stabilise the exchange rate, which is desperately needed. Under this Government there have been the biggest fluctuations in the exchange rate of any industrialised country in Europe. If the hon. Gentleman were to talk to those who are particularly concerned with the export of manufactured goods, they would tell him——

Mrs. Elaine Kellett-Bowman (Lancaster): Will the right hon. Gentleman give way?

Mr. Hattersley: I should like to finish answering one question before I am asked the next.

Mrs. Kellett-Bowman *rose*——

Mr. Hattersley: Those who are involved in manufacturing industries would tell the hon. Gentleman that the problem that is second only to intolerably high interest rates is the fluctuation in sterling. By having a mechanism under which sterling would be subject to upward pressure, we should be able to provide a degree of stability. However, I am unique in my willingness to plead guilty. I think that I am the first Labour Shadow Chancellor to plead guilty to the accusation that I should be acting in a

RH12.3

CONFIDENTIAL

PWP

FROM: A P HUDSON

DATE: 15 December 1986

SIR P MIDDLETON

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir T Burns
Mr Cassell
Mr Scholar
Mr Turnbull
Mr Peretz
Mr H P Evans
Mrs Lomax
Mr Sedgwick
Mr Culpin
Miss O'Mara
Mr Allan
Mr Robson
Mr Mowl
Mr Riley
Miss C Evans
Mr Tyrie
Mr Ross Goobey
Mr P Lilley MP

AUTUMN STATEMENT DEBATE SPEECH: FIRST DRAFT

I attach the first draft of the Chancellor's speech for the Autumn Statement Debate on Wednesday.

2. The Chancellor saw the draft over the weekend. He thinks it is well along the right lines, and is grateful to all those who contributed.

3. He will be doing further work on the draft tonight. He has asked me to shorten it as follows:

(a) Confining the world economy section to (essentially) the first sentence plus a slightly shorter, but still forceful, warning on protectionism;

(b) taking out the privatisation section, and instead referring to the BGC success at the end of the fiscal policy section on page 11 - that is, immediately before the tax cuts section - and prefacing the reference by reminding the House that privatisation stands on its own merits;

(c) taking out the Big Bang section all together.

4. The Chancellor would be grateful for comments on the rest of the draft as soon as possible. It would be helpful if these could reach me by 5.00 pm this evening.

5. The Chancellor has also asked for the following information, by the same deadline, please.

(a) Some <u>news</u> about the BGC flotation. Please could <u>Mr Robson</u> see again if anything is available? I realise that there did not look to be anything, but the Chancellor notes that Mr Walker has already been talking about 2 million first-time shareholders.

(b) The Chancellor recalls that sometime this year, Christopher Johnson, writing in the Lloyds Bank bulletin, was advocating a PSBR of, he thinks, £14 billion, on the grounds of maintaining a consent debt/GDP ratio. Please could <u>Mr Mowl</u> get hold of this?

(c) The Chancellor would be grateful if all the figures in table 1 in paragraph 26 of the TCSC Report up to and including 1985-86 could be checked. In particular, he wonders why the PSFD was so freakishly low in 1981-82. (Mr Mowl).

(d) He wonders what he can say about the PSFD in 1987-88 that is compatible with a PSBR of 1½ per cent of GDP, privatisation proceeds of £5 billion, and other published information. (Mr Mowl.)

APH

A P HUDSON

AUTUMN STATEMENT DEBATE SPEECH: FIRST DRAFT

I beg to move ...

I begin by thanking the Treasury and the Civil Service Select Committee, under the chairmanship of my RHF the Member for Worthing, for their report on the Autumn Statement, which, as ever, they have produced with commendable promptness.

In the course of my own evidence to the Committee, my RHF the Member for Worthing suggested that the office of Financial Secretary was older than that of Chancellor. That may depend on definitions. But certainly, recent holders of the post of Financial Secretary have achieved distinction in a number of ways. My RHF is Chairman of the Select Committee. The RHM for Ashton-under-Lyne is Chairman of the Public Accounts Committee, and the RHM for Dudley East was recently voted Parliamentarian of the Year.

I have, of course, been privileged to hold both the offices of Financial Secretary and Chancellor, and only one other person has done this - John Herries, who became Chancellor in 1827. Not a household name, but his career is not without interest. In his maiden speech, he opposed the repeal of the window tax. He resigned as

Chancellor after only a few months - over the appointment of a Chairman of the Finance Committee. And later it was said of him - and I quote -

> "He made the public accounts intelligible, which they never were before."

This is something that I have consistently tried to do, and it is really not fair of the Treasury and Civil Service Committee to suggest otherwise. This Government have been the first to publish the Medium Term Financial Strategy and the first to publish an Autumn Statement. As Chancellor, I have devoted, at a very rough estimate, [ ] words to explaining monetary policy alone. Far from being economical with the truth, I have done my best to explain the truth about the economy. So I was gratified to see this comment in the latest Greenwell Montagu Monetary Bulletin:

> "An historian dispassionately analysing the evidence to date is almost bound to reach the conclusion that Mr Lawson has gone out of his way to explain how monetary policy is being operated in practice, and how it has evolved, probably more so than any previous Chancellor. [He should be given credit for it.]

Some [ ] per cent of the words on monetary policy have been uttered in this House. The Committee's Report criticises the fact that my monetary speech in April of this year was made outside the House. But I have to say that when I concluded in the Budget, "I will say no more about monetary policy", the reaction was scarcely one of deep and widespread disappointment. [Indeed, the Official Report records Hon Members' saying "Hear, hear".]

Today, however, is an opportunity to discuss economic policy, and particularly monetary policy, in detail. The Treasury and Civil Service Committee has produced a serious Report which deserves a serious answer.

The Report suggests that in a number of areas "there has been a substantial change of policy". It starts by allowing that the stated objective of policy has been the same since 1979 - to reduce inflation and to create the conditions for sustainable growth. And it allows that this policy has always had two key strands: firm control of monetary conditions; and reduction of public borrowing. I might say that even this consistency of objectives has not always been a feature of British Governments. But the Report goes straight on to search out changes in the way we have pursued our objectives.

The Report claims that "the operation of monetary policy has become increasingly obscure". Of course, it is an inevitably complicated subject, because it depends on judgements on a number of interrelated variables. But I suspect that the reason that the Committee finds it so hard to follow is that they are making an elementary confusion between the instrument of monetary policy, which is short-term interest rates, and the indicators of monetary conditions, which include the monetary aggregates and the exchange rate.

It is thus completely misconceived to suggest, as the Committee does in paragraphs 8 and 11 of its Report, that we are now giving more emphasis to nominal interest rates and less to £M3. There cannot possibly be a trade-off between the two, because one is an indicator, and one is an instrument.

The Report seems to suggest that I was announcing a change of policy in my Lombard Association speech, when I said that "Short term interest rates are the essential instrument of monetary policy". But this was in fact set out as long ago as 1980, in the Green Paper on Monetary Control, which makes clear that, alongside fiscal policy, the main instrument for controlling monetary growth is interest rates.

Turning to the indicators, the Report suggests that the role of £M3 has become increasingly unclear.

Again, a reading of the 1980 Green Paper demonstrates that we have never seen £M3 as the sole guide to monetary policy. As we said then, "No single statistical measure of the money supply can be expected fully to encapsulate monetary conditions". In 1980, it did make sense to have only one target aggregate, and one with which the markets were already familiar, because it was important to give a clear and simple indication of our commitment to financial discipline. But in the day-to-day operation of monetary policy, we recognised, to quote the Green Paper again, that "It is insufficient to rely on one measure alone".

We also recognised that the definition used and the choice of target aggregates might need to be adjusted, in the words of the Green Paper, "as circumstances changes" and "in the face of long term changes in the institutional structure". And, of course, that is what has happened. Circumstances have changed, and the institutional structure has altered, with the result that the behaviour of £M3 has become increasingly hard to interpret.

It is extraordinary that the Committee's Report makes hardly any mention of these developments. And it is even more extraordinary that there is no reference at all to experience overseas. For UK experience has been similar to that of the other major countries, most of which - including Germany - have found their monetary targets overshooting this year.

We cannot and do not ignore the continued rapid growth of £M3 and other measures of broad money. But for a long period now this growth has proved consistent with continued firm downward pressure on inflation. So it must be tested continuously against the evidence of other indicators. Principal among these is MO - the broad monetary base - which has proved a reliable indicator, with a stable trend in velocity from year to year. This is why, having watched it for some years, we adopted it as a target aggregate in 1984.

The Select Committee say they are not convinced that MO is a useful indicator of monetary conditions. They do not say why, and I suggest they examine the evidence. It is foolish to imply that all narrow aggregates are misleading because the behaviour of M1 in the early 1970s did not foreshadow the subsequent inflation. Had they looked at the behaviour of M0 in the early 1970s instead - and I tried to help by pointing them to it in my own evidence - they would have seen that it did, indeed, warn of coming inflation.

[This year M0 has remained within its target range. But its acceleration in recent months was an important factor in the decision to raise interest rates in October by 1 per cent.]

The Select Committee go on to suggest that there has been a volte-face in policy in that we are paying more attention to the exchange rate. Certainly the exchange rate is very important both as a transmission mechanism for monetary policy and an indicator of monetary conditions. In this country, as in the other major economies, it has come to play a more prominent policy role in recent years, as institutional developments have made the monetary aggregates more difficult to interpret. But as long ago as 1980 and early 1981, interest rates were reduced because the exchange rate was indicating that conditions were tight, despite a monetary overshoot. The 1982 MTFS explained that (and I quote);-

> "The behaviour of the exchange rate can help in the interpretation of monetary conditions, particularly when the different aggregates are known to be distorted ... the Government considers it appropriate to look at the exchange rate in monitoring domestic monetary conditions and in taking decisions about policy".

The Committee also say - and this is my last point on monetary policy - that policy at present is uncertain. It is said that the Government wants both to prevent interest rates from rising and to prevent the exchange rate from falling.

Of course no one <u>wants</u> interest rates to be higher than they have to be or the exchange rate to spiral ever downwards. But the greatest disservice the Government could do to the economy would be to permit monetary conditions to develop that allowed inflation to take hold again.

It is true that the operation of policy is complicated. But - and this is a point I have already made elsewhere and will now make in the House - so is the real world. There are difficult judgements to be made. And the timing of decisions on interest rates is affected by considerations of market tactics. But there should be no uncertainty about our purpose. As I have said several times, here and in speeches outside, interest rates are and will be set at whatever level, on average, is needed to keep downward pressure on inflation.

The dramatic fall in the price of oil earlier this year meant that some fall in the exchange rate was both necessary and desirable. It was the inevitable response to an unusual event. It did not reflect a loosening of monetary conditions.

But more often, a significant fall in the exchange rate is a clear signal of inflationary pressures. In those circumstances there would be a presumption towards taking action unless there was reassuring evidence from other reliable indicators such as M0. I will certainly not hesitate to raise interest rates should that be necessary.

Fiscal policy

Let me now turn to fiscal policy, where, I have to say, I find the Committee's observations scarcely more coherent. Their complaint here is not that the government's policy has changed, but rather that it is the same. Specifically, they are unhappy that the Autumn Statement reaffirmed the Government's commitment to the same fiscal stance as was set out in the 1986 MTFS.

The reasoning in this part of the Report is, Mr Speaker, frankly obscure. The Committee, spurred on no doubt by their advisers, have decided after all these years to abandon the PSBR as the measure of the fiscal stance. No reasons are given for this change of mind other than the assertion that the PSBR can be measured inclusive or exclusive of asset sales - though this is hardly a surprise since I myself drew attention to the size of the PSBR excluding privatisation proceeds in the Red Book this year. They then go on to argue that the public sector financial deficit is - I quote - a more "relevant and useful figure". It is a pity that when the Report goes on to give its own estimate of the PSFD for 1987-88 it gives a wholly irrelevant and useless figure - of £14.5 billion, which can in no way be reconciled with the £7 billion figure in the same table for the PSBR for that year.

But, important though these details are, they are really just technical errors in this Report. On the main issue, the Committee have, I fear, no advice to offer the House. They question whether the PSBR should be held to 1¼ per cent of GDP next year. But they express no view at all as to what would be the appropriate level at which to set it. On this they are silent.

This deficiency is perhaps understandable. But I find it very hard indeed to understand the justification for the slur which the Committee attempt to cast on the Government's commitment to hold the PSBR next year to 1¾ per cent of GDP. The reason given in the Report for this - that any forecast of the PSBR is uncertain and subject to a margin of error - is beside the point, and reveals a rather elementary misconception. When the Chancellor of the Exchequer on Budget day sets the borrowing requirement at a particular figure, he is not making a forecast, and I am astonished that the Committee should misunderstand the Budgetary process in this way. Rather, he is making a judgement about the appropriate fiscal stance. And this judgement is an essential counterpart to monetary policy in the Government's overall economic strategy.

The PSBR figure published on Budget day is, nevertheless, subsequently validated, or not, as the case may be, by events; and this government's record here is a very good one. The November PSBR figures, published this week, show that public sector borrowing is firmly on course, or below, the level set in the Budget. Last year the PSBR undershot the Budget level by more than £1 billion. And in 1984-85, excluding coal strike effects, the outturn was about the same level as the Budget estimate.

As to the level of the PSBR, it is, at an estimated 1¾ per cent of GDP this year, low by any reckoning, below the general levels of recent years, and far, far below the excessive levels from 1974 to 1979, when it averaged nearly 7 per cent of GDP or over £20 billion a year at today's prices. This is the picture whether or not privatisation proceeds are taken into account and it is the picture laid down in successive versions of the MTFS right back to 1980.

Tax cuts

Like other commentators, the Treasury Committee have speculated about what all this means for tax cuts. I decided last year no longer to publish a fiscal adjustment in the Autumn Statement, so as to discourage the pointless and misleading calculations which are always made at this time of year. Subsequent events last winter proved how right I was. But speculation persists.

Let there be no mistake about this. As I have said repeatedly, a pound used in additional expenditure is a pound which is not available for reductions in taxation, unless borrowing increases. But I have ruled out higher borrowing. The increase in public expenditure which I announced for 1987-88, of £4¾ billion, is a very substantial sum.

The House should be in no doubt that the substantial increase in public spending next year has much diminished any scope there might have been for reductions in taxation. Of course the uncertainties are enormous, as we always see in the period between the Autumn Statement and the Budget. But on one point there is no uncertainty, and no shadow of doubt - and that is the Government's resolve to keep borrowing under control, as we have done consistently since 1979; and to take no risks with inflation.

Public Expenditure

On public expenditure, the Committee have again engaged in a textual critique worthy of biblical or Shakespearean scholars to try to demonstrate a major change in direction. Which is odd since much of the material at the back of the report is developing the theme that public spending is returning to a trend.

The true position is very simple. We have long maintained that the state takes too much of the nation's income and its share should be reduced - this can be traced back not only to the 1979 manifesto, but even before that to our policy document "The Right Approach to the Economy". And we have pursued this objective consistently.

It is true that some of the targets we have set ourselves have in the event proved too ambitious. But it is better to attempt to meet demanding targets than to have the complete absence of financial discipline offered by the party opposite.

If it were indeed the case, as the Committee contend, that policy on public spending had been changed this year, one would expect to be able to detect some break in trend.

But the figures show no such break. As I explained at the time of my Autumn Statement, the rate of increase of public spending in real terms, even excluding privatisation proceeds, has been coming down progressively. From 3 per cent in the decade to 1978-79, to 2¼ per cent in the last Parliament and to 1¾ per cent so far in the present one. Far from reversing that trend, our plans seek to extend it.

Here we are arguing about whether public expenditure will grow by 1 per cent a year, as our plans imply, or 1½ per cent a year as suggested by the Committee. Let me remind the House that the party opposite increased expenditure in real terms by 12 per cent in a single year.

If one looks for a break in trend you will find one certainly, but it was in 1982-83, when the rise in public spending as a proportion of GDP came to an end. In the 4 years since then, the proportion has fallen progressively, and with spending planned to grow significantly more slowly that the economy as a whole, the downward trend will continue, so that by 1989-90, public spending as a proportion of national income will be back to levels last seen in the early 1970s.

I might say, incidentally, that I have been speaking here about General Government Expenditure, because last year, the Committee criticised me for focussing on the planning total and so ignoring debt interest. This year, I have followed their advice, but they now seem to want me to focus on the planning total.

Summing-up of riposte to the Committee

In summary, I have said before that there have been some changes of emphasis in the way different aspects of economic policy have been conducted, and changes of presentation. Indeed, it would be extraordinary if there had not been. Since 1979, there have been enormous changes in world economic conditions, in the position of the UK, and in the operation of the financial markets. The Select Committee, the House, and the country would be rightly concerned if Government policy had not evolved in the light of these developments. But to depict this evolution as "a substantial change of policy" is absurd. If the Committee needs to be reminded of what a real shift of policy is, they need look no further than the last Labour Government.

Of course, if ever there was a year in which I might have been expected to change policy, it has been 1986, with the halving of the oil price. And many people duly advised me to make changes. I rejected this advice, and maintained the same course. And there has been no crisis. Inflation has reached its lowest levels for nearly twenty years. Growth has continued, albeit at a slightly slower rate than in previous years. The number of people in work has continued to rise, and unemployment now looks to be on a downward trend.

The way that both the private sector and the public finances have withstood the fall in the oil price is a remarkable achievement. That is the best possible vindication of the economic policy we have pursued since 1979, a policy which has brought five years of steady growth, low inflation, and a million new jobs since 1983.

For 1987, I predicted a continuation of this pattern, with growth slightly faster than this year, and inflation staying low. The figures that have been released since the Autumn Statement tend to confirm that picture. Output has picked up, with industrial production in the three months to October 1½ per cent higher than in the previous quarter. Exports are up by the same amount, resuming their upward trend. The current projection that the surplus on invisibles will be some £750 million contrasts with the view put to the Select Committee by Mr Bill Martin, who described the earlier projection of £600 million as "particularly optimistic". Seasonally adjusted unemployment fell by 25000 in October. [Inflation.]

The World Economy

The outlook for the British economy will, of course, depend on developments in the world economy.

In the Autumn Statement, I forecast that growth in the major seven industrial countries would average 3 per cent in 1987, slightly faster than this year. The latest industrial production figures released by these countries bear out this assessment. Output in the third quarter in France, the United States and of course, the United Kingdom, was up markedly compared with the second quarter. I expect this upward trend to be maintained into 1987, as the benefits of lower oil prices feed through. Meanwhile, the annual rate of inflation in the seven Summit countries is set to stay low.

And world trade in manufacturing is expected to grow much faster than it did in 1986.

One of the main changes in the world economy over the past 15 months has been the relative fall in the value of the dollar following the Plaza Agreement in September of last year. Plaza itself has been a notable success, both in terms of the cooperation between countries to achieve a given goal, and in terms of the orderly way in which exchange rates have adjusted. So far, we have seen some of the familiar initial effects of currency realignments - the first part of the so-called "J-Curve" effect. In particular, the value of US imports has gone up, and with it the US current account deficit. Similarly, in dollar terms, Japanese exports reached record levels in September of this year. But there are now signs that the tide is turning, which tends to confirm my forecast that Japanese growth might be relatively modest next year. The overall outcome will depend on how far the Japanese implement some of the measures under discussion to boost domestic demand.

Most forecasters expect GNP in the USA and Germany to grow by about 3 per cent next year, though domestic demand should grow much faster in Germany than in the US. This pattern of growth should contribute to reducing the current account imbalance of the two countries.

One threat to the progress of the world economy in 1987 is protectionism, a threat which is greater following the recent elections in the United States. This would be a disastrous step backwards. A major step towards freer trade was taken in Uruguay in September, with the agreement on a new GATT round, to include services and agriculture for the first time. I took the initiative in putting the thorny issue of agricultural subsidies on the agenda for the next round of international meetings. And as far as the United States is concerned, the exchange rate fall which they sought at Plaza, to make their industry more competitive, has now taken place.

My hope is therefore that countries will continue to co-operate to make world trade more, rather than less, free.

The past year or so has seen substantial changes and discontinuities - the halving of the oil price, falls in other commodity prices, and the realignment of exchange rates. And the world economy has adjusted, with merely a pause in the growth of world trade. In part at least, this is because the major countries have cooperated in pursuing soundly based policies. The outlook for 1987 is for faster growth, and it is crucial that we do not lose our way through failures of policy, such as a retreat into protectionism.

<u>**Privatisation**</u>

More and more countries are now pursuing similar policies, not just in terms of broad economic strategy, but of micro economic policies too. A key example is privatisation - a policy which we pioneered, and is now being emulated around the world. This year saw both the French and the Japanese embark on a privatisation programme.

Our own privatisation programme has taken a major step forward with the sale of British Gas. This has been a triumphant success. Some 5 million people decided to buy shares. Most of them were not seeking to make a quick buck - the offer was widely seen as tightly priced.

Rather, they saw shareholding - and British Gas - as a sound and sensible way to invest their savings. This bodes well for future privatisations, and indeed for the health of industry and the economy in general.

There will be enormous benefits from exposing British Gas to the attitudes and pressures of the private sector, and to the disciplines of the capital markets.

- Customers will gain from improved efficiency, with the regulatory regime guarding against excessive price increases.
- Management will be free to manage.
- And no less than 95 per cent of employees took the chance to buy shares, which sharpens their incentive to succeed.

A further recent illustration of the benefits of privatisation has been the further expansion of Jaguar, where the start of a new night-shift means that 2000 new jobs have been created since privatisation.

Beyond that, there is the benefit of wider share ownership. Even before British Gas, the number of shareholders had doubled since 1979. And the flotation of the Trustee Savings Bank Group and sale of British Gas have revealed the massive widespread interest that now exists in investment in equities.

As on so many issues, the people who are out of step are the Opposition in this House. So I would like to ask the RHM for Sparkbrook a question which is of interest not only to us in the House, but to the 5 million people who have bought shares in British Gas. In the unlikely event of a Labour Government, what would happen to their shares?

I shall gladly give way.

The Big Bang

One other thing for which 1986 will be remembered is the Big Bang.

It is still early days, but the new market structure is working well, with some inevitable teething troubles on the technical side. Market turnover is up by around thirty per cent. Commission costs are markedly lower. If the good progress continues, there will be benefits not just for the City but for the whole economy.

All this could, of course, be put at risk if London lost its reputation as a clean place to do business, and some people have seized on the recent cases of misconduct as evidence that this will indeed happen. However, the fact that these cases have come to light shows that firms are well aware of the importance of maintaining the integrity of the London Market. And the Government's decision to bring the draconian new insider dealing powers in the

Financial Services Act into effect two months early shows that we will take whatever action is necessary to uphold standards.

Taken together, the Financial Services Act, the Building Societies Act, and the Banking Bill, currently before the House, provide a comprehensive framework for the regulation of the whole financial market. And we are also keen to improve cooperation with regulators in other countries to ensure uniformity of standards and exchange of information. Bad regulation must not be allowed to drive out good.

Attack on Labour

1986 has also been a notable year in the annals of the Labour Party. It is the year in which they have reassembled all the economic policies that have failed before, and been rejected by the electorate before. And the year in which they have broken with the traditions of previous Labour Governments by abandoning, in effect, the established defence policy of this nation.

I had better be careful, because if I am too critical of the RHM for Sparkbrook, he may cancel his reply, just as he refused to speak to the CBI last week because they criticised his policies.

The RHM for Sparkbrook may not have had much time for economic policy recently - he has been busy standing in for his RHF the Leader of the Opposition, who has been absent from our affairs playing the world statesman to such disastrous effect for his party. Perhaps this is why, when my RHF the Chief Secretary wrote to the RHG, asking for clarification of his views on Labour's proposed for a training levy on business, he got a very short reply, saying that the HM for Dagenham would be sending an answer in due course. The RHG is clearly too embarrassed to write himself.

But this sort of evasiveness has characterised the RHG's approach to public spending, ever since my RHF the Chief Secretary and I costed Labour's programme at some £28 billion. The RHG has tried to shout down our calculations, and dismiss them as fanciful. Indeed, in spite of this massive programme of spending, and in spite of their record of extravagance when in office and now in local government, the party opposite accused us of going on a spending spree in the Autumn Statement.

We on this side of the House know - and the country knows -that serious economic debate cannot be conducted in this way. The RHG has given no indication of how he would finance his programme, whether by taxation or by borrowing, or both. So I ask him again - out of the massive programme of spending pledges, which would he propose to drop?

Conclusion

Mr Speaker, I have, of necessity ranged widely in my speech, because I thought it would help the House in considering the Autumn Statement.

In conclusion, let me come back to the Autumn Statement itself. The Forecast it contains offers the prospect of another year of low inflation and steady growth. It sets out public expenditure plans which make increases in spending in priority areas within a framework in which public expenditure continues to fall as a proportion of national output. It is the latest step in a firm economic strategy which has been pursued consistently since 1979. I commend it to the House.

3693/19

PWP

CONFIDENTIAL

FROM: COLIN MOWL
DATE: 15 December 1986

CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr Turnbull
Mr Peretz
Mr Sedgwick
Mr Odling-Smee
Mr Culpin
Miss O'Mara
Mr Riley
Miss C Evans
Mr Hudson 15/12
Mr Tyrie
Mr Ross Goobey

AUTUMN STATEMENT DEBATE SPEECH

Mr Hudson's minute of today's date to Sir Peter Middleton asked me to follow up three points:

(i) Christopher Johnson's estimate that a £14 billion PSBR is consistent with a constant debt/GDP ratio;

(ii) the accuracy of the figures in table 1 of paragraph 26 and an explanation of the low PSFD in 1981-82.

(iii) what can be said in public about the PSFD in 1987-88 assuming a 1¾ per cent PSBR and privatisation proceeds of £5 billion.

(i) Christopher Johnson

2. I attach a copy of the Johnson article.

(ii) Table 1 Paragraph 26

3. There are a number of errors in the numbers for the past and a very misleading figure for the PSFD in 1987-88. I attach an annotated copy of the table with the correct figures in

manuscript. The most important error is for 1985-86 where the PSFD should be £7.8 billion, not £10.25 billion. This does of course accentuate the increase between 1985-86 and 1986-87. The Committee's forecast, or rather Gavyn Davies', for 1986-87 is £12 billion, a figure which we would not quarrel with, as it is close to both the FSBR and (unpublished) Autumn Statement forecasts.

4. The Committee's forecast of the PSFD in 1987-88 is again Gavyn Davies' but it is very misleading because it is based on a PSBR of £9¾ billion, rather than the PSBR of £7 billion shown in the same table. Davies assumes that public expenditure will overspend plans in 1987-88 by £2 billion and that taxes will be cut by £¾ billion more than the £1 billion which he estimates is consistent with a PSBR of £7 billion and privatisation proceeds of £5 billion.

5. If we adjust Davies' figures back to a £7 billion PSBR we get a PSFD of £11¾ billion, a number reasonably close to internal Treasury projections made at the time of the Autumn Statement. Davies' memorandum to the Committee also correctly estimated that the 1987-88 PSFD implied by the 1986 MTFS was £12 billion.

6. Page 9 of the draft speech already points out that a £14½ billion PSFD cannot be reconciled with a £7 billion PSBR, but without explaining why. You might wish to say explicitly that this PSFD figure is based on a PSBR much higher than the figure you are committed to.

7. We are not yet in a position to answer properly your question about the relatively low PSFD in 1981-82. It appears to be due to the difference between tax accruals and receipts (the accruals adjustment). The PSFD is measured on an accruals basis and the PSBR on a receipts/cash basis.

(iii) PSFD in 1987-88

8. As you are aware we have not given in public a PSFD figure for 1987-88. Once an assumption is made about privatisation proceeds however it is not too difficult to work out roughly

what is implied by a £7 billion PSBR. As the previous paragraph noted Gavyn Davies did this accurately for the MTFS projections. Apart from privatisation proceeds the other four items which lie between the PSFD and PSBR are:

(i) net government lending which is erratic but fairly close to zero on average in recent years;

(ii) transactions with certain public sector pension schemes which have benefitted the PSBR by a steady £¾ billion in recent years;

(iii) the accruals adjustment which reduces the PSFD relative to the PSBR when taxes are buoyant;

(iv) a balancing or unidentified item which can be large in individual years but which has averaged close to zero over the past four years.

9. To sum up, it is not difficult to make sensible assumptions about these items. There would therefore be no problem about saying something along the following lines in the debate:

"I do not dispute the evidence to the Committee that a PSBR in 1987-88 of £7 billion is consistent with a PSFD of the order of £12 billion."

You might then want to go on to criticise the Committee for including in paragraph 26 a PSFD of £14½ billion alongside a PSBR of £7 billion.

PSFD in 1986-87

10. Finally you might like to note that the PSFD for the first half of 1986-87 will be published in Financial Statistics at the end of this month. Unless there are revisions between now and then it will show a deficit of £7¾ billion compared with a deficit £5¾ billion in the same period last year.

Colin Mowl

COLIN MOWL

CORRECTIONS TO TABLE

average error at ¾ per cent of GDP (equivalent to £2½ billion). The margin of error is only slightly less for any figure announced at Budget time. This means that any PSBR target does not have precise implications for taxation, nor is any figure precisely verifiable. The constraint on fiscal policy entailed by the Chancellor's firm commitment to a PSBR figure for next year is therefore not as binding as it might appear to be at first sight. Moreover present accounting conventions (as regards the treatment of asset sales in particular) provide additional scope for adjusting policy, should the need arise, without infringing the PSBR target.

24. As the Chancellor said:

> "I cannot guarantee that at the end of the year the PSBR will in fact turn out to be what I have said at the time of the Budget,"[1] but

> "the important thing which I think the Committee should focus on is that they have been told the PSBR will be set at 1¾ per cent of GDP; that is a genuine figure, which within a margin of error, will be the outcome".[2]

The Chancellor also said that in setting the PSBR one of the guidelines was that it:

> "can be comfortably financed in a non-inflationary way"[3]

even if it does not turn out as expected. However, the Chancellor would not be drawn on the steps the Government would take if it appeared that the PSBR was off-track next year.

25. What *has* changed since the Budget Statement is the Treasury's assessment of the UK's balance of payments position, which is now substantially worse than previously expected. It is questionable in the light of such changed circumstances whether it is appropriate to maintain unchanged the Government's original borrowing target. But as we noted in our review of the 1986 Budget, the Government's rationale for particular targets for the PSBR is obscure. The target appears now to be chosen more by presentational need than by a considered appraisal of economic realities. In short, what the MTFS now lacks is a coherent framework for the setting of fiscal policy.

26. The original intention of focussing attention on the public sector borrowing requirement was to create a climate of rational expectations by making Government intentions absolutely clear. Since the PSBR is, for various reasons, an ambiguous measure, and since the figures are further confused by the then unanticipated scale of asset scales, currently running at a very high level and forecast to go even higher, we consider that public debate and the government's own strategies should now concentrate on the far more relevant and useful figure of the Public Sector Financial Deficit. For the year ahead our estimates are that this will run at £14½ billion and the following table shows its increase compared to the PSBR for each year since 1979.

Table 1
PSBR and Public Sector Financial Deficit since 1979

£ billion

	1979–80	1980–81	1981–82	1982–83	1983–84	1984–85	1985–86	1986–87	1987–88
PSBR	10.0	12.7	8.6	8.9	9.8	10.2	5.8	7.7	7*
PSFD	~~7.9~~ 8.2	~~11.5~~ 11.9	~~6.2~~ 5.7	8.4	12.1	13.8	~~10.25~~ 7.8	12**	14.5**

*From MTFS, 1986–87, Table 2.5
**See Table 3 Appendix 1.

27. The Government has been fortunate this year that spending overruns have not led to a higher PSBR than forecast. At paragraph 1.64, the Autumn Statement describes the upward revision of nearly £2 billion to the forecast of non-oil receipts in 1986–87, as "largely the result of buoyant VAT and corporation tax receipts." Unexpectedly high increases in earning growth have also led to proportionately higher increases in tax revenues due to the progressivity of the tax system. A similar process could occur in 1987. Sufficient buoyancy of tax revenue, fuelled by economic growth, could provide the Government with an opportunity to finance both the extra public expenditure announced in the Autumn Statement and cuts in the rate of income tax. If this occurs, fiscal policy will then have become pro-cyclical in nature, boosting through tax cuts an economy already in recovery.

[1] Q. 111.
[2] Q. 112.
[3] Q. 111.

LLOYDS BANK ECONOMIC BULLETIN

A MONTHLY ANALYSIS FROM LLOYDS BANK

NUMBER 80 AUGUST 1985

I wish to discuss with Mr Davies. Meanwhile, worth noting that the new fashionable focus on the debt/income ratio lends support to the conventional definition of the PSBR, ie after asset sales.

ct.

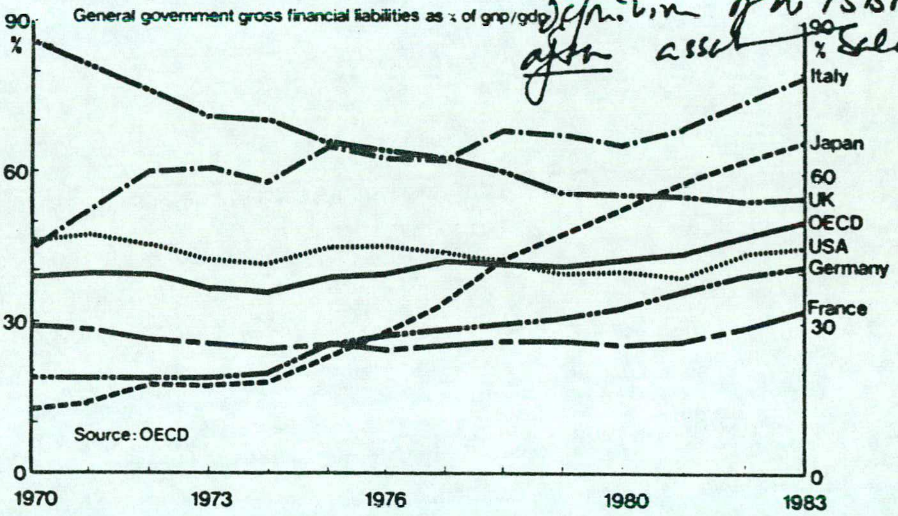
Rules for fiscal expansion

'A national debt, if it is not excessive, will be to us a national blessing'. So said Alexander Hamilton, the US Secretary of the Treasury, in 1781. Even though the present incumbent, Mr James Baker, may be thinking that the excessive Federal debt of today is a national curse, Hamilton had a point which is sometimes forgotten.

As chart A shows, the public debt has risen from 39 per cent of gdp in 1970 to 50 per cent in 1983 in the industrial countries. In the USA, it has risen from 39 to 46 per cent of gdp in the two years to 1983 and in France from 26 to 33 per cent with the same suddenness. Over the whole period it has gone up more steadily from 12 to 66 per cent in Japan, from 18 to 41 per cent in Germany, and from 44 to 80 per cent in Italy. Remarkably in the UK it fell from 86 per cent in 1970 to 56 per cent in 1979, and has remained stable since then.

In most countries, the public debt has risen because governments have borrowed more to finance rising public expenditure in preference to raising taxes to the full extent required. Higher borrowing since the 1970s, combined with higher interest rates in the 1980s, has meant that debt interest as well as debt has increased as a proportion of gdp, and governments have borrowed even more to meet the interest payments. High inflation has reduced the debt in real terms in some countries, particularly the UK in the mid-1970s, but low inflation, together with high public deficits, has increased it in the USA, Germany and Japan. Less frequently, high real national income growth reduces debt in relation to income. Wars cause sharp increases in public debt, and countries usually have a gradual reduction in the debt-income ratio in post-war periods.

Chart A
DEBT/ INCOME RATIOS



The public debt-national income ratio has recently been discussed as a possible target of financial policy. Both the IMF and the OECD have exhorted member countries to reduce it. The reasons given are that a high debt-income ratio raises interest rates and debt interest, crowds out private investment, reduces public expenditure on social programmes, causes inflation, and lays a burden on future generations. Reasons can also be given for at least maintaining, if not increasing, debt-income ratios. Public debt creates risk-free financial assets, with a sure, sometimes tax-free, flow of income, especially for savers and pensioners; it can finance profitable public investment, and expand idle economies so as to reduce unemployment. The higher a sustainable debt-income ratio is, the more the government can borrow each year while keeping it stable.

Mr Roy Hattersley, the Shadow Chancellor of the Exchequer, recently said that he would announce an objective for the debt-gdp ratio, without specifying what this would be. One possible objective would be to keep it stable at times of high unemployment, and allow it to fall at times of full employment. This would be in contrast to the present Government's Medium-Term Financial Strategy, where a public sector borrowing requirement falling as a proportion of gdp 'represents a further decline in the ratio of public sector debt to money gdp and contrasts with a rising trend in debt/ income ratios in most other major countries'.

The present UK debt-gdp ratio of 55.5 per cent is close to the OECD average, and might well be sustainable as a medium-term objective. The debt-income ratio, like the psbr itself, should not be fine-tuned from year to year. The debt is better measured at book values, to avoid annual fluctuations in market value. The ratio falls in years of high real gdp growth or high inflation,

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Chart B
DEBT-INCOME RATIO – RISING OR FALLING?

The boxes show the effect on the debt-income ratio of positive, zero and negative values of the the two variables.

Growth – interest differential* \ Primary fiscal balance†	+	0	–
+	–	–	?
0	–	0	+
–	?	+	+

†Difference between public receipts and public expenditure minus debt interest, as percent of gdp

* Difference between rate of growth of nominal gdp and nominal rate of interest, in percentage points

and in neither case would it be the right short-term policy to increase public borrowing above its existing target. The broad stability of the ratio depends on public borrowing increasing the stock of debt held outside the public sector at the same rate as the rise in nominal gdp. In long-run equilibrium, the debt-income ratio is equal to the psbr as a percentage of gdp divided by the growth rate of nominal gdp. Thus debt can be kept at 50 per cent of gdp if the psbr is 5 per cent of gdp, and nominal gdp is growing at 10 per cent.

The conditions for stability can also be expressed in terms of two key statistics. First, the psbr less debt interest, or the primary fiscal balance, as a percentage of gdp. Second, the difference between the growth rate of nominal gdp and the nominal interest rate, or the growth-interest differential. Chart B gives the effect of various combinations of values of these two statistics on the debt-income ratio. If the primary balance is zero (the psbr being accounted for exactly by debt interest), and the rate of nominal income growth and the interest rate are the same, then the debt-income ratio remains stable. A primary deficit (psbr exceeding debt interest) and an interest rate higher than the growth rate cause the debt-income ratio to rise (the case of the USA just at present), while a primary surplus and a growth rate higher than the interest rate make it fall. There are two more finely balanced situations that can go either way: a primary surplus but an adverse growth-interest differential (the UK now), or a primary deficit and a favourable growth-interest differential (the UK in the mid-1970s). If the debt-income ratio is to be stable, the ratio between the primary balance and the growth-interest differential must equal it.

Table 1
A. MEDIUM-TERM FISCAL EXPANSION PLAN – £bn

Financial years	1984	1985	1986	1987	1988	1989	Long run % of gdp
1. Average debt increasing 8%	180	194.4	210.0	226.7	244.9	264.4	55.5
2. Nominal gdp increasing 8%	324	349.9	377.9	408.1	440.8	476.1	8.0 (increase)
3. Psbr (debt increase) at 4.3% of gdp	14.0*	15.0	16.4	17.4	18.9	20.4	4.4
4. Debt interest: 10%, or 5.5% gdp†	17.0	19.4	21.0	22.7	24.5	26.4	5.5
5. Primary surplus: (4-3), 1.2% gdp	4.0	4.4	4.6	5.3	5.6	6.0	1.11

B. PRESENT MEDIUM-TERM FINANCIAL STRATEGY – £bn

Financial years	1984	1985	1986	1987	1988	1989	Long run % of gdp 1993-94
1. Average debt	180	190.8	198.0	205.4	212.8	220	
% increase	9.2	6.0	3.8	3.7	3.6	3.4	2.0 (increase)
2. Nominal gdp	324	354	377	399	419	438(e)	
% increase	5.9	9.3	6.5	5.8	5.0	4.5	2.0 (increase)
3. Psbr (debt increase)	14*	7.1	7.5	7.2	7.5	7.0	
% of gdp	4.3	2.0	2.0	1.8	1.8	1.6	1.0
4. Debt interest:	17.0	19.0	19.0	19.5	20.0	20.0	
: % of gdp	5.2	5.4	5.0	4.9	4.8	4.6	1.75
: % interest rate	9.4	10.0	9.6	9.5	9.4	9.1	3.5
5. Primary surplus:	3.0	11.9	11.5	12.3	12.5	13.0	
(4-3) : % of gdp	0.9	3.4	3.4	3.1	3.1	3.0	0.75
6. Debt : gdp %	55.0	53.9	52.5	51.5	50.8	50.2	50.0
7. £M3 average	110.1	117.8	124.9	131.1	136.4	140.5	
% increase	10.3	7	6	5	4	3	2.0 (increase)
8. £M3 : debt ratio	61.2	61.7	63.1	63.8	64.1	63.9	63.4 (ratio)

Source: Financial Statistics and Budget Report 1985-86. †5.2 per cent in 1984-85.

* Calculated as difference in public debt outstanding at beginning and end of year. This may differ from PSBR for statistical reasons in 1984-85, but it is assumed to be the same from 1985-86 onwards.

Two fiscal policies for the UK

If the UK chose to maintain its present debt-income ratio, this would be a major change from the present fiscal strategy. The two alternatives for the next five years are set out in table 1, comparing 1984-85 with 1989-90. A is our own fiscal expansion strategy, B is the Treasury's Medium-Term Financial Strategy. The debt-income ratio stays at 55.5 per cent in A, and falls to 50 per cent in B. Nominal gdp is assumed to rise by 8 per cent a year in A, about 4 per cent growth and 4 per cent inflation, while it falls to 4½ per cent by 1989 in B, 2 per cent growth and 2½ per cent inflation. The psbr, financed by debt issues and not by money creation, is 4.3 per cent of gdp in A, rising to £15bn in the current year, and £20bn by 1989, while it falls to 1.6 per cent of a lower gdp in B, falling to £7bn.

In A, debt interest is assumed to remain at 10 per cent of debt (at book value – less at market value if capital values rise), because of the upwards pressure of a more steeply rising debt, but is stable at 5.5 per cent of gdp. In B, the Treasury is implicitly assuming a fall in interest rates on the book value of debt to 9 per cent by 1989, and debt interest comes down to 4.6 per cent of gdp. The primary surplus is a constant 1.2 per cent of gdp in A, enough to offset the 2 per cent adverse growth-interest differential while it stays up at 3 per cent in B, showing considerable fiscal stringency, and more than balancing the even larger adverse growth-interest differential of 4.5 per cent. The important difference is that A could mean higher growth and lower unemployment, combined with a responsible fiscal stance, while B is almost certain to bring higher unemployment with predicted lower growth.

The two policies are summed up in table 2, showing the changes in various figures, including public expenditure and taxes, as a percentage of gdp. A increases the psbr by 1.1 per cent of gdp and debt interest by 0.3 per cent, leaving debt unchanged as a proportion of gdp. B cuts the psbr by 1.4 per cent, debt interest by 0.4 per cent, and debt by 5.3 per cent. There are two variants; E involves

Table 2
ALTERNATIVE POLICIES
Changes between 1984-85 and 1988-89 in % of gdp

	Fiscal expansion	Govt. MTFS
Psbr	+1.1	−1.4
Debt interest	+0.3	−0.4
Primary surplus	−0.8	+1.0
Public debt	0.0	−5.3
Public spending (ex interest)	E: +0.8 T: −0.3	E: −1.6 T: −4.0
Public receipts (mainly taxation)	E: 0.0 T: −1.1	E: −0.6 T: −3.0
Gdp growth	+1.8	−0.3
Gdp deflator	−0.5	−1.5

Note. E = policy favouring public expenditure.
T = policy favouring tax cuts.

Table 3
EQUILIBRIUM RATIOS COMPARED

	Fiscal expansion	Green paper
1. Debt/gdp	0.555	0.50
2. Psbr/gdp	0.044	0.01
3. Nominal gdp growth	0.08	0.02
4. Primary surplus/gdp	0.011	0.0075
5. Growth – interest differential	−0.02	−0.015
6. Interest rate	0.10	0.035
7. Real growth rate	0.04	0.02
8. Inflation rate	0.04	0.0
9. Interest/gdp	0.055	0.0175

Relationship between items:
1 = 2/3 = 4/5   9 = 1 x 6

Source: The Next Ten Years: Public Expenditure and Taxation into the 1990s, Cmnd 9189

increasing public expenditure, T cutting taxes. Both have been shown for both strategies, but in A an expenditure increase is more likely, because of its greater job-creation effects, while in B tax-cutting is probably preferred. Thus A would increase expenditure by 0.8 per cent of gdp, while holding taxes at the same proportion, while B would cut taxes by 3 per cent of gdp, but only by slashing expenditure by 4 per cent of gdp. A increases the economic growth rate by 1.8 per cent, while B cuts it by 0.3 per cent. A cuts the inflation rate by only ½ per cent, compared with 1½ per cent in B.

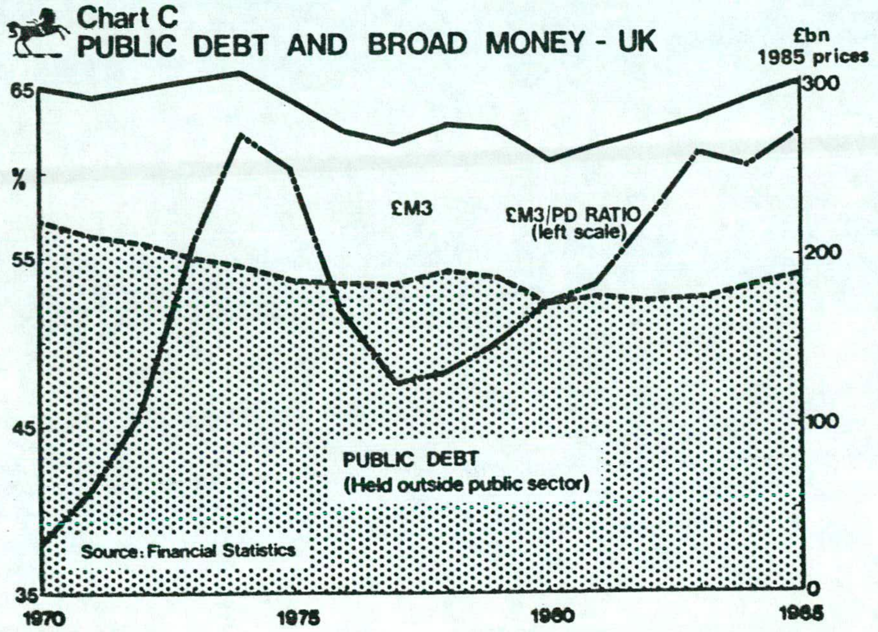
The long-run equilibrium positions are compared in table 3, which takes the Treasury's 1993-94 projections from the green paper 'The Next Ten Years'. For A they are those shown in table 1, because the debt-income ratio is held stable from now on. For B they set out the somewhat improbable world of zero inflation and 2 per cent growth (taking the higher end of the 1½ – 2 per cent range). This means that the psbr must be held to only 1 per cent of gdp to stabilize the debt-income ratio at 50 per cent, not much below its present 55.5 per cent. Zero inflation and low growth make the debt burden flatten out at a surprisingly high level. The implication of the Treasury's figures is that the real — and nominal — rate of interest will be 3.5 per cent, giving an adverse growth-interest differential of 1.5 per cent. This, like the Treasury's figure of only 1.75 of gdp for debt interest is implausible, since it implies a halving in nominal terms of current annual debt interest.

The link with money

An important indicator which measures the mix of monetary and fiscal policy is the ratio of £M3 to public sector debt, or the money-bonds ratio. This rose, see chart C, from 38 per cent in 1970 to 62 per cent in 1974. It then fell to 47 per cent in 1977, and rose again to 62 per cent in 1985. The Government's squeeze on borrowing has slowed down the growth of public debt, but there has been a corresponding rise in interest-bearing money, particularly when short-term interest rates have been high, with a downward-sloping yield curve. Fiscal prudence has thus made monetary control more difficult, and even the overfunding of the psbr by additional public debt sales has neither brought £M3 within its targets, nor prevented it rising faster than public debt. Table 1 shows the Treasury's B strategy raising the money-bonds ratio to 64 per cent, with public debt continuing to increase more slowly than £M3. Strategy A for fiscal expansion would maintain the money-bonds ratio at no higher than the current 62 per cent, allowing £M3 to rise at about 8 per cent a year, the same rate as public debt and nominal gdp.

The total stock of £M3 plus debt is a proxy for total credit in the economy, and has shown a remarkable long-run stability with regard to the price level. Between 1979 and 1985 this total and the retail price index each rose by 11.5 per cent a year, but with considerable annual deviations of up to 10 per cent a year from the average ratio. At times of high inflation the stock of £M3 plus public debt rises less than prices, at times of low inflation, more. Regression analysis indicates that in 1970-85 it has increased at a constant 7.5 per cent a year, plus 0.31 times the inflation rate. This would be 8.75 per cent at an inflation rate of 4 per cent, close enough to our assumption of an 8 per cent increase for £M3 plus public debt.

Chart C
PUBLIC DEBT AND BROAD MONEY - UK



Conclusions

1. The UK is unusual in that its public debt has fallen relative to gdp in the 1970s, and been stable in the 1980s, while it has risen sharply elsewhere.
2. The public-debt to gdp ratio is an important financial indicator. At a time of high unemployment it should not be reduced, as the Government intends, but stabilized at its present level.
3. A stable debt-gdp ratio would make it possible to increase the psbr to £15bn in 1985-86, and then to keep it at 4.3 per cent of gdp, assuming that nominal gdp grows at 8 per cent.
4. Interest on the public debt may remain at 9-10 per cent for the next few years, higher than the rate of growth of nominal gdp. The debt-gdp ratio can still remain stable or fall if there is an offsetting surplus of taxation over public expenditure minus debt interest.
5. Sterling M3 has been rising faster than public debt in the 1980s. The two should increase at the same rate to prevent them getting out of balance, with sterling M3 rising more slowly and public debt faster than in recent years.
6. A strategy of fiscal expansion can be made as acceptable to financial markets as the present Medium-Term Financial Strategy, while offering better hopes of reducing unemployment.

CHRISTOPHER JOHNSON
Economic Adviser, Lloyds Bank

ps4/9H

UNCLASSIFIED

pmo

FROM: A P HUDSON
DATE: 15 December 1986

PS/CHIEF SECRETARY

cc Sir P Middleton
Sir T Burns
Mr Scholar
Mr Turnbull
Mr Culpin
Miss O'Mara
Mr Allan
Mr Dyer
Mr Tyrie
Mr Ross Goobey

MOTION FOR AUTUMN STATEMENT DEBATE

The Chancellor has decided that the Government motion for the Autumn Statement debate is to be exactly the same as last year's. That is,

> "That this House approves the Autumn Statement presented by Mr Chancellor of the Exchequer on 6 November; welcomes the prospect of continuing low inflation and steady growth as the basis for maintaining the trend of rising employment; and congratulates Her Majesty's Government on the continuing reduction in the share of national income pre-empted by public expenditure."

APH

A P HUDSON

RH12.4

pup

FROM: A P HUDSON
DATE: 15 December 1986

MR TYRIE

cc Mr Culpin
Miss O'Mara
Mr Allan
Mr Pickering
Mr Ross Goobey

AUTUMN STATEMENT DEBATE: POSSIBLE INTRODUCTION

As an alternative to the piece about John Herries, how about the following, at the start of the Chancellor's speech in the Autumn Statement Debate?

"I am relieved to see the RHG the Member for Sparkbrook in his place today. Because he has ducked a few challenges recently.

- For months, he and his colleagues have refused to answer questions from News International newspapers.
- When my RHF the Chief Secretary asked his views about Labour's proposal for a training levy, his answer was that the HM for Dagenham would be replying in due course.
- Last Thursday, his party spun out the previous day's business so as to spare him the embarrassment of Treasury Oral questions.
- And on Friday, he broke off relations with the CBI, because they criticised his policies.

I have to admit that I, too, have also criticised the RHM's policies in the past. So I am relieved that he has not refused to take part in this debate."

APH

A P HUDSON

RWP

FROM: ROBERT CULPIN
DATE: 15 DECEMBER 1986

MR HUDSON

cc Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr Peretz
Miss O'Mara
Mr Pickford

AUTUMN STATEMENT DEBATE SPEECH

I am afraid I have not had as much time as I wanted to work on your draft; but I have scribbled a few comments below; and I attach a rough alternative to the bottom of page 3 and most of page 4.

RC

ROBERT CULPIN

Let me start with what has not changed, and come on to what has.

There has been no change whatever in this Government's view that monetary policy is the key to controlling inflation. There has been no change in our view that interest rates are - and must be - the essential instrument of that policy. And there has been no change in our view that a sound monetary policy needs to be accompanied by a prudent fiscal policy - by which I mean a low budget deficit.

The Committee suggests that what it calls "the enhanced role" for interest rates is new. But that is surely exaggerated, to say the least. Monetary policy, everywhere and always, has to operate through interest rates, for the simple reason that interest rates are the price of money.

I acknowledge, though, that in the implementation of policy, a number of things have changed.

First, interest rates have come to bear more weight in restraining money and credit because we have - quite rightly - swept away a lot of other controls. When we took office, we inherited a corset for banks, foreign exchange controls for everyone, and mortgage rationing for those buying houses. All were unfair and inefficient. Now they are gone, and credit is rationed by price rather than bureaucratic controls.

Second, short term interest rates have come to bear more weight because - again, rightly - we have abandoned the practice of selling more gilts than are needed to finance the public sector deficit. This practice had the statistical effect of reducing £M3 - but only at the cost of raising long term interest rates relative to short term interest rates. We concluded that this could not be justified, and I explained that fully in last year's Mansion House speech.

Third, I accept that in setting interest rates it has become harder to use as a guide the particular measure known as £M3. But this is in no sense a bolt from the blue. The 1980 Green Paper said that "no single statistical measure of the money supply can be expected fully to encapsulate monetary conditions".

CONFIDENTIAL

PWP

FROM: **P N SEDGWICK**
DATE: 15 DECEMBER 1986

MR HUDSON AH 15.12.

cc Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr Mowl

AUTUMN STATEMENT DEBATE : FIRST DRAFT

I do not think that the current draft gives quite the right impression (on page 10) on the role of the PSBR for the year ahead on budget day. I suggest redrafting it as follows.

> When the Chancellor of the Exchequer on budget day sets the borrowing requirement at a particular figure, he is not just making a forecast, and I am astonished that the Committee should misunderstand the budgeting process in this way. He is above all making a judgement about the appropriate fiscal stance. And this judgement...."

P.N.S

P N SEDGWICK

dk 18 DEC 1986 -6

RWP.

The Hon. Peter Brooke MP
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REC. 16 DEC 1986
Mr PRH Allen
PS/CHIEX
PS/CST, PS/EST
Mr Scholar
Miss Sinclair

16 December 1986

Parliamentary Clerk
Mr Martin IR
PS/IR
PS/C+E
MST

Dear Mr Brooke

Confidentiality of Information in Revenue Departments

Thank you for your letter of 25 November 1986.

I am reassured by your reply but not totally convinced by it. The fact that a Minister is answerable to Parliament for the actions of a Government Department is indeed a powerful weapon of democracy; so is a House of Lords ruling; but the strongest weapon of all, and indeed the raison d'etre of Parliament itself, is statute law.

By the very nature of things uncertaintity in the law plays into the hands of a taxing authority: taxing statutes can be interpreted in a way that suits the taxing authority best and the taxpayer, without a bottomless purse, is forced to accept the authority's contentions. I should, perhaps, therefore not have been surprised that you have avoided the important issue that I have raised in both my earlier letters. This is as follows:

If the House of Lords rulings regarding the disclosure of confidential information are considered sufficient protection for the taxpayer, why has not such legislation as Taxes Management Act, section 6 and 1 Schedule not been repealed? Conversely, if the aforesaid legislation is considered a necessary strenthening of the legal rulings for one revenue department, why is it not deemed to be so for another?

Would you now please address yourself to answering these questions? Whilst my previous letters have mentioned the Customs and Excise Department as not being bound by statute, it has also been pointed out to me that the Health and Social Security Department is also a revenue department as regards national insurance contributions and that it too is not covered by statute as regards confidentiality of information supplied to it.

In the past few years, when we have had to suffer taxing statutes of unparallelled length and complexity and House of Lords rulings which seem to rewrite revenue law without the authority of

Parliament, taxpayers and their professional advisers have striven for one thing above all others: namely <u>certainty</u> in revenue law. Without doubt, what is required here is unequivocal statute which ensures that, in all cases, the staff of revenue departments are under a statutory oath of secrecy which is enforceable by penalties. I trust that, after due consideration, you will be able to agree with my contentions.

Yours sincerely

P. C. Noakes.

Patrick Noakes

CONFIDENTIAL

Source: P. Allum
EA1
x 4696

Figures consistent with the 1986 Autumn Statement printout.

Financial year:	Short term interest rates 1	RPI inflation (% change) year on year 2	RPI inflation (% change) through the year 3	Real short term interest rates 4
1970-71	7.7	7.3	8.6	1.1
71-72	5.5	9.3	8.0	-2.8
72-73	7.8	7.1	7.9	1.2
73-74	12.8	10.5	12.8	3.0
74-75	12.3	17.9	20.3	-7.0
75-76	10.2	24.6	22.5	-12.9
76-77	12.1	15.3	16.5	-2.5
77-78	6.8	14.0	9.5	-6.6
78-79	10.8	8.3	9.6	1.5
79-80	14.9	15.8	19.1	-0.6
80-81	15.5	16.3	12.7	0.7
81-82	14.2	11.5	11.1	3.1
82-83	11.5	7.1	4.9	4.0
83-84	9.7	4.7	5.2	5.0
84-85	10.9	5.1	5.5	6.0
85-86	12.1	5.9	4.9	7.0
86-87	10.5	3.1	3.6	7.0
87-88	10.3 *	4.0	3.1	7.3
88-89	10.0 *	3.9	4.7	5.9
89-90	10.0 *	5.4	5.6	4.8

1 3 month sterling LIBOR rate.
2 current financial year over year earlier
3 end quarter (Q1) of current financial year over previous end quarter (Q1
4 3 month LIBOR rate less year on year percentage change in consumers' expenditure deflator. (Different measures of real interest rates could be obtained using other price deflators, for example the wholesale price index, or by using an alternative measure of inflation, for example 'through the year' rather than 'year on year.')

* Autumn statement printout shows interest rates ~~below~~ for 1987-88 and later years below those in the internal October forecast. This reflects the decision to make the AS printout consistent with PEWP assumptions on interest rates issued to Departments.

ps4/11L UNCLASSIFIED

Nigel
Worth keeping an archive of this sort of info, I think!
AH

FROM: A P HUDSON
DATE: 16 December 1986

FINANCIAL SECRETARY

AUTUMN STATEMENT DEBATE SPEECH

Many thanks for putting us straight about the people who have been both Financial Secretary and Chancellor (Mr Heywood's minute of today).

2. You - and Mr Higgins - will also no doubt be aware that four out of the last five Conservative Financial Secretaries (not including yourself) have become Cabinet Ministers.

AH

A P HUDSON

FINANCIAL SECRETARY TO THE TREASURY

FROM: J J HEYWOOD
DATE: 16 December 1986

MR HUDSON

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr Turnbull
Mr Peretz
Mr H P Evans
Mrs Lomax
Mr Robson
Mr Sedgwick
Mr Culpin
Mr Mowl
Miss O'Mara
Mr Riley
Miss C Evans
Mr Tyrie
Mr Ross Goobey
Mr P Lilley MP

AUTUMN STATEMENT DEBATE SPEECH: FIRST DRAFT

The Financial Secretary had a look at the Chancellor's draft speech overnight. His attention was particularly caught by paragraph 3.

2. Whilst he is sure that in the foreseeable future there will be no additions to the elite group who have been both Financial Secretary and Chancellor, he would diffidently point out that more than two Financial Secretaries have become Chancellor. He just happens to know that there were at least four in the 19th century and in the present century, Austen Chamberlain, McKenna, Baldwin and Anthony Barber all were members of this exclusive club! He thinks Mr Higgins is quite likely to know this piece of useless information.

3. On the question of British Gas, one point which has not received much attention is that 60% of the 5 million who came into the offer opted for bonus shares. This implies that they expect to retain their shares for at least 3 years, even though, of course, some of those "opting" for bonus shares will, in practice, have stagged the issue.

4. The clear point is that millions of people applied for shares at a time when press reports were suggesting the issue was tightly priced. These people came in not because they were expecting windfall capital gains, but because they wanted to share in the long-term future of British Gas.

5. The Financial Secretary is not convinced that the Government's achievement here has been fully recognised. To encourage 5 million people to invest, long-term, in a "dull utility" and to encourage these investors to pay a price which was widely regarded as tight, at a time when the market was retreating is an achievement which is worth boasting about!

6. You should already have a copy of the Financial Secretary's Press Release on BGC which received little coverage.

JEREMY HEYWOOD
Private Secretary

ps5/57L

UNCLASSIFIED

Andrew

FROM: MRS D C LESTER
DATE: 16 December 1986

cc Mrs Ryding

PS/CHIEF SECRETARY

cc PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Mr Dyer
Mr Cropper
Mr Tyrie
Mr Ross Goobey
Mr P Lilley MP

AUTUMN STATEMENT DEBATE: WEDNESDAY, 17 DECEMBER

I have set out below the Ministerial Bench Duty Rota which I think has been agreed for the Debate on Wednesday.

2. The Chancellor will speak first and will be followed by Mr Hattersley. All Ministers should be present for both speeches.

3.30 to 4.30 approx.	:	All Ministers
4.30 to 5.50	:	FST
5.50 to 7.10	:	EST
7.10 to 8.30	:	MST
8.30 to 10.00	:	CST

Debbie Lester

MRS D C LESTER
Diary Secretary

psl/32A

> Ch
> Ian Byatt's note below contains more background, but it totally unsuitable for PM. This is re-draft of my earlier version — content?
> AA

SUPPLY SIDE EFFECTS OF TAX CHANGES

Background

The Guardian reported yesterday that research commissioned by the Treasury at a cost of £500,000 had demonstrated no incentive effects from tax cuts. The story is picked up in the FT and other papers today.

2. This is a substantial econometric study, commissioned before the 1979 Election. The work was carried out by Professor Brown at Stirling University.

3. The study was confined to short run supply effects; eg the effects of tax changes on hours people would wish to work in their existing jobs. It is not surprising that the study found little effect: it showed that for most workers - 80 per cent in 1980 - there was little opportunity for overtime.

4. The study was not designed to investigate wider effects of taxes on economic performance (enterprise and risk-taking, willingness to train and acquire skills etc.) on which the Supply Side case for lower taxes is based.

5. The Treasury had always envisaged that the researchers would publish their results. They have already produced 22 technical working papers and plan a book. The Treasury has received its final report, but the research team is doing further work at its own expense. No final decision on publication has yet been made.

Line to take

6. This study was commissioned under the previous Government. It is confined to short run supply effects. It does not examine the wider effects on enterprise and risk-taking, which is where we believe the major benefits come.

Why waste so much money?

7. The research was commissioned before the Election, and the bulk of the expenditure was incurred in 1980 in carrying out the OPCS survey.

Publish the results?

8. That is a matter for my RHF the Chancellor of the Exchequer.

8/3068

PKP

FROM: DAVID PERETZ
16 December 1986

MR CULPIN

cc Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Miss O'Mara
Mr Pickford
Mr Hudson
Mr Kelly

AUTUMN STATEMENT DEBATE SPEECH

Could I offer a few comments on the redraft attached to your minute of 15 December.

2. These are:-

(i) It seems a pity to lose the reference from the 1980 Green Paper about interest rates being the "main instrument" for controlling monetary growth.

(ii) If we are going to refer to non-price controls, I suggest we make the additional point that we could not operate them nowadays even if we wanted to. That deals with those who say that it would be better, say, to have mortgage rationing and lower interest rates.

(iii) If we are to refer to overfunding, I am sure we should make the point that it was never, originally, envisaged that we would get into overfunding as a way of life.

3. I attach a possible redraft of your third, fourth, fifth and sixth paragraphs.

DLCP

D L C PERETZ

The Committee suggests that what it calls the "enhanced role" for interest rates is new. But that is surely exaggerated, to say the least. Monetary policy, everywhere and always, has to operate through interest rates, for the simple reason that interest rates are the price of money. We set this out in 1980, in the Green Paper on monetary control, which makes it clear that, alongside fiscal policy, the main instrument for controlling monetary growth is interest rates.

I acknowledge though, that the way we implement policy has developed over the period since 1980.

First, we no longer have non-price controls on money and credit. When we came to office we - quite rightly - swept away a range of bureaucratic controls that were unfair and inefficient. As other countries have also found, such controls have increasingly become unworkable as the financial system becomes more sophisticated. This inevitably puts more immediate weight on interest rates as the instrument of policy. Second, we did for a while come to use systematic overfunding - the practice of selling more gilts than needed to fund the PSBR - as a way of reducing the recorded growth of £M3. This led to undesirable distortions in financial markets, which also made policy harder to operate. I announced rather over a year ago that we would return to the original aim of neither over or underfunding the borrowing requirement.

8/3068

FROM: DAVID PERETZ
16 December 1986

PLAP

MR CULPIN

cc Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Miss O'Mara
Mr Pickford
Mr Hudson
Mr Kelly

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pmp

FROM: C R PICKERING
DATE: 16 December 1986

CHIEF SECRETARY

cc Chancellor
Miss O'Mara
Mr McIntyre
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Ross Goobey
B/10

AUTUMN STATEMENT DEBATE: MR GOULD

I have seen Mr Tyrie's minute of 15 December. You may also be interested in the attached article by Mr Gould, from 'The Times' of 11 April 1985.

2. Mr Gould's suggested use, or mis-use, of 'golden shares' is of particular interest.

C R Pickering

C R PICKERING

"THE TIMES"

11 APRIL 1985.

A gold leaf from the Tory book

Privatization is the nearest thing to a success this government can claim; it is ideologically satisfying to its backbenchers, it brings in useful amounts of cash which help the Chancellor to balance the books, and, by invading Labour territory, it places the Opposition firmly on the defensive.

Despite some difficulties in fixing the prices at which privatized shares should be sold, the Government has emerged pretty well unscathed from Labour counter-attacks. A blanket defence of the status quo has reinforced Labour's image as the defender of vested (and largely unpopular) interests. The attempt to deter private buyers through the threat of renationalization has also been counter-productive: to the extent that it means buying the shares back, the sheer cost of doing so reduces the credibility of both threat and the party, and a policy of renationalization without compensation would do such damage to Labour electorally that it has been quietly dropped.

Little wonder, therefore, that neither the City nor the Government loses sleep over Labour's protests. A great deal has been done to make the privatized enterprises attractive to investors – by writing off debts, rejigging expensive pension arrangements and preserving monopoly and dominant market positions; and the Government has also ensured that many of the shares have gone on favourable terms to employees and customers who would not look kindly on any threat to nationalize their newly acquired holdings.

What then is Labour to do, either to stem the privatization tide in the short term or (which is very much the same thing) to offer a credible means of reversing it in the long? The answer may lie, partly at least, in studying very carefully the lessons to be learnt from the way the Tories have handled the issue.

First, they have shown how the value of assets can be juggled to suit political purposes. Just as enterprises have been made more attractive to private buyers through the ruthless use of write-offs to reduce liabilities, so an equally ruthless Labour government should not hesitate to use similar devices to increase the liabilities and reduce the market value of such enterprises as a prelude to buying them back.

More importantly, the Tories have quite cynically (and in clear defiance of their own propaganda about competition and liberalization) made sure that the market value of privatized enterprises has been enhanced by protecting their monopoly positions. Labour can equally well depress their market value by doing, with the most justifiable of motives, what the Tories should have done – by introducing a proper regulation of how these enterprises conduct themselves in the market (particularly in matters of price), and, for so long as it is the market which is supposed to regulate their activities, by subjecting them to a proper element of competition.

A company which was compelled by government regulation to pay much greater attention to the public interest might find it less possible to make easy profits from a captive market; and if a Labour government were to introduce a policy of real competition, which concentrated less on the structural questions arising from mergers and more on actual anti-competitive practices (as in America), then again the guaranteed profitability of many of these companies could be significantly reduced.

Most interesting, however, is the potential weapon offered to a future Labour government through the Tory use of the so-called special or "golden" share. The Government has hit upon this device to deflect criticism that it is handing over what are sometimes vital national interests to the vagaries of the market. Not so, it claims: through the special share, which may have little commercial value but which carries substantial voting rights, the public interest can be defended. The Government retains a "golden" share in many privatized concerns, including Cable and Wireless, Britoil, Amersham International, Jaguar, Enterprise Oil, British Telecom and British Aerospace.

The "golden" share, sanctified by Tory practice and therefore, one assumes, immune from attack in principle, offers Labour a means of exercising real control over these companies without having to pay anything to buy them back, whereas a Tory government might be expected to pay only lip service to the concept of using the special share to exercise public control, a Labour government could make it a reality.

The beauty of the device is that its use need not stop there. What is to stop a Labour government from acquiring shareholdings in other companies and, following Tory precedent, declaring them to be "golden" shares?

The device would not achieve everything Labour hopes for from public ownership. There would still be room for – indeed a need for – other forms of social or public ownership, ranging from the state corporation which has so far been the norm to the municipal and co-operative enterprises which look to be the most promising form in the future.

The "golden share" would, however, provide Labour with an instrument of intervention and public control which is effective and, because it is inexpensive and in no sense confiscatory, credible. It would enable Labour not only to inhibit further privatization and to reverse that which has already occurred, but also to carry the battle into enemy territory.

This makes v. clear what ~~public~~ ~~control~~ Labour are really interested in.

The agenda for public control would no longer be determined by Labour's opponents; Labour would be able to think afresh about the criteria for public control and ownership, secure in the knowledge that it had a flexible and effective instrument for bringing it about.

The author is Labour MP for Dagenham

Rup

FROM: ROBERT CULPIN
DATE: 16 DECEMBER 1986

CHANCELLOR

cc Chief Secretary
Sir P Middleton
Sir G Littler
Mr M L Williams
Mr Hudson
Mr Pickford

AUTUMN STATEMENT DEBATE

As I mentioned, you might have a bit of fun with Dr McDonald's hiking off to Geneva to treat with OPEC. Here are a couple of cuttings.

RC

ROBERT CULPIN

SATURDAY DECEMBER 13. 1986

Daily Telegraph

Opec close to pact on production cuts

17 3.

By Roland Gribben

AN AGREEMENT by member states of the Organisation of Petroleum Exporting Countries to cut production to push up prices was in sight last night.

Ministers at the Geneva meeting of the 13-nation cartel said agreement had been reached in principle to cut production by 5 p.c. to 10 p.c. in the first quarter next year.

But details have still to be worked out. Some countries, Iran, the United Arab Emirates and Libya, were pressing for a 20 p.c. cut while small producers, notably Ecuador and Gabon, were seeking exemption. Bigger producers, Saudi Arabia and Venezuela, were consulting their governments before making commitments.

Libya said there was no opposition to the formula, but oil analysts said that Opec would have to make a longer commitment to production curbs to achieve its price objective of $18 a barrel.

The breakthrough on an output deal came after oil prices and the pound jumped on hopes that Opec would hammer out a swift agreement on production curbs.

North Sea prices jumped by up to 75 cents a barrel at one stage yesterday before easing in European markets on suggestions that Saudi Arabia had not made commitments to cutting production while early gains in West Texas Intermediate were pared by 40 cents in the United States. Brent oil was being quoted at $15.75 a barrel for February delivery in Europe before the mark down.

Sterling was helped by the oil market and Bank of England predictions about $18 a barrel next year and $20 by 1988. The pound gained half a cent against the dollar to finish at $1.4285 in London with its average international value up by 0.4 to 68.7 after gains against continental currencies.

Suggestions from Oslo that Norway is considering an 8 p.c.-9 p.c. production cut next month to reinforce its support for Opec helped the market and sentiment.

The impetus for a new price and production pact has been provided by Saudi Arabia after the dismissal of Sheikh Yamani as oil minister. It has won support for an $18 a barrel target but has been opposing production cuts.

Peter Holmes, chairman of Shell Transport and Trading, was cautioning against premature expectations about a sustained Opec pact before last night's developments. He said oil markets would remain volatile and over the next year prices could range from under $10 to $20 a barrel.

Mr Holmes estimated the oil surplus was still running at between two and two and a half million barrels a day. Shell puts demand for Opec oil in the first-half next year at only 16 million to 16.3 million daily barrels, well below current levels.

THE INDEPENDENT

Opec poised to cut output

III 13

From Frances Williams in Geneva

OPEC ministers yesterday said they had agreed in principle to cut output to push the oil price up to their target of $18 a barrel. Delegates were last night consulting their governments on proposed cuts of 5 or 10 per cent in Opec's collective output ceiling, now just over 17 million barrels a day.

Saudi Arabia, which had before this week's meeting indicated reluctance to contemplate tougher production curbs, has apparently acquiesced on condition that other countries bear their share of the reduction. The acting Saudi oil minister, Hisham Nazer, was last night seeking approval from King Fahd for the proposed cuts.

On the European spot market, prices soared above $15 a barrel as delegates expressed optimism that the meeting would reach a speedy conclusion. In New York West Texas Intermediate crude for January delivery rose early in the evening by 75 cents to $16.35 a barrel.

But there may still be problems over reaching accord on individual production limits. Iran's insistence that Iraq, excluded from the current temporary production-sharing accord, be included in any new quota allocations could prove a critical stumbling block. So far seven Opec members, including Kuwait, have said they favour production cuts.

Dr Oonagh McDonald, Labour spokeswoman on Treasury affairs, said earlier after meeting key ministers here yesterday that she detected a "great political will" to reach agreement.

She added that a future Labour government would wish to talk to Opec and other producers on possible co-operation.

Ministers yesterday morning discussed the mechanics of returning to a fixed price system and in particular the thorny issue of differentials for different grades of crude. The recommendation of Opec's three man ministerial pricing committee that the "marker" price be based on a basket of seven types of crude was strongly contested by Iran which wants Saudi Light alone as the reference. The basket system would permit the Saudis to sell their oil at less than $18 a barrel.

7/2

Opec ministers seek output cut

From John Hooper 18
in Geneva

Opec Ministers were last night consulting their governments about a 5-10 per cent cut in output to raise prices to the organisation's new target level of around $18. But they were still keen to see how much progress could be made towards reinstating a system of fixed, official prices.

Crude oil prices on both sides of the Atlantic had earlier fallen sharply when the conference president, Mr Rilwanu Lukman of Nigeria, was reported as saying that Saudi Arabia, the cartel's most influential member, had not offered to cut its output — a scarcely surprising state of affairs at that stage. In private, the Saudi minister, Mr Hisham Nazer, has assured his counterparts that the kingdom will do whatever is necessary to secure a rise in prices.

Nevertheless, with Saudi production independently reported to be well in excess of its official quota, there is serious concern among other delegations about the extent to which the kingdom is willing — or able — to comply with the terms of a new deal. Numerous barter deals have been concluded by Saudi Arabia in the last year which need to be serviced by a hefty output.

According to informed sources, Mr Lukman arrived here under instructions from his government not to enter substantive negotiations on a new deal until this point had been cleared up. But an attempt to raise the issue during yesterday morning's session was rapidly stifled by Gulf ministers. Delegates said Nigeria is in favour of a formal system of penalties for quota violations.

At the end of yesterday morning's session, ministers commissioned a panel of experts to study the implications of a return to fixed pricing. A similar body, which met at the Opec secretariat in Vienna for 10 days at the end of last month, was unable to agree on the relative value of the numerous crudes produced by Opec's member states — an issue which is crucial to the competitiveness of each country's output.

The sensitivity of the issue was driven home during yesterday's talks by what the visiting Labour Party spokeswoman, Dr Oonagh McDonald, called " some unexpected fireworks from Algeria " whose representative, Mr Belkacem Nabi, was seeking a formula which would effectively favour " light " crudes such as those produced in North Africa.

Among the ideas being canvassed was for the organisation to announce a band within which the prices of different blends of Opec crude would be allowed to fluctuate. This would enable the meeting to finish swiftly without a solution to the historically problematic issue of price differentials, but was being seen last night as a fall-back position.

THE GUARDIAN

Labour MP briefed by Opec men

2

From John Hooper
in Geneva

Labour's front bench Treasury spokeswoman, Dr Oonagh McDonald, held talks in Geneva yesterday with key ministers and officials of the Organisation of Petroleum Exporting Countries, including its president, Mr Rilwanu Lukman of Nigeria, and Sheikh Yamani's successor as Saudi Arabian Oil Minister, Mr Hisham Nazer.

Dr McDonald, who described herself as an observer, stressed that she was acting "in a personal capacity and not as a representative of the party."

But her initiative is likely to create resentment among Labour's energy spokesmen, who have avoided criticism of the Government's "hands off" oil policy in spite of this year's price collapse and the serious damage it has done to the prospects for further development of the North Sea.

Her arrival was greeted with delight within Opec, which for more than two years has been calling for Britain to trim its output to prop up prices.

The Indonesian and Kuwaiti oil ministers and Opec's acting secretary-general, Mr Fadhil al-Chalibi, also briefed her on the progress of the organisation's Geneva talks.

It was striving yesterday to put together a package of measures to raise the oil price to $18 a barrel from about $15.

TODAY

The three paths open to Opec

28

OIL PRICES seem certain to come under renewed pressure next spring. Opec is producing 17m. barrels a day, but stocks are high and demand for its members' oil is likely to be no more than 16m-16.3m barrels in the first quarter of next year.

Peter Holmes, a managing director of Royal Dutch Shell, believes there are equal chances of OPEC succeeding and pushing prices over $20 a barrel; failing and sending them below $10; or muddling through and leaving them around $15. OPEC has raised its market share by 1.5m barrels a day at the cost of halving revenues to $70bn this year.

7/3

SIR P MIDDLETON

c Sir T Burns
Mr Cassell
Mr Monck
Mr Scholar
Mr Spackman
Mr Odling-Smee
Miss Kelley
Mr Culpin
Miss O'Mara
Mr G P Smith
Mr A C S Allan

BROWN STUDY

I enclose a line to take and background.

IB

I C R BYATT
16 December 1986

SUPPLY SIDE EFFECTS OF TAX CHANGES: PROFESSOR BROWN'S STUDY

Line to take

The Guardian yesterday, and the F.T., Independent and Today today report that Treasury research at a cost of £500,000 has demonstrated no incentive effects from tax cuts.

2. This is a substantial study commissioned before the 1979 election. Officials are considering it. Contains much detailed information about hours of work, payment systems, availability of overtime etc for a sample of families. Data were collected in Autumn 1980. Contains elaborate econometric approach to estimates of response of labour supply to tax changes.

3. On incentives, the study focusses on short run supply effects; eg the effect of tax changes on hours people would wish to work in their existing jobs. Like other studies here and in the US the study finds little effect.* (But the data on which the UK studies were based were far from ideal.)

4. The study was not designed to investigate wider effects of taxes on economic performance (enterprise and risk taking, willingness to train and acquire skills etc) on which supply side case for low taxes is based.

5. General conclusions about macro economic policy, eg that nominal demand is inadequate, cannot be drawn from a study of this kind. The study showed that for most workers - 80 per cent in 1980 - there was little opportunity for overtime.

---

* Work by Professor Laffer in the early 1980's suggested that tax cuts could have large supply side effects. But these claims remain controversial. Recent work by Professor Lindsey suggests that lower tax rates lead to greater compliance with the tax system (and so a greater tax yield) among higher rate taxpayers. We are looking at the implications for the UK.

6. Cost has been high, but investigating individual behaviour in detail often requires collection of detailed information which is inevitably expensive.

7. We had always envisaged that the researchers would publish their results. They have already produced 22 technical working papers* and plan a book. C.U.P. have made an offer (subject of course to our assent). We have received our final report, but the research team is doing further work on its own resources.

8. If pressed on publication we could place the report in House of Commons Library. It would be better to do this without comment. Publication in that way would show the academic scale of the research.

---

* List attached

15 copies of the final report plus one copy of the documents listed in this annex to the final report.

DOCUMENTS

One copy of each of the following documents is being sent to H M Treasury with this report. A second set is being sent to the ESRC DATA Bank (except for the simulations manual). The list does not include documents for the pilot, or the programs or related documents.

Fieldwork documents

Some of the following fieldwork documents were produced entirely by OPCS - most involved collaboration:

- Interviewers instructions
- Sift schedule
- Household schedule
- Workers' schedule
- Sift exercise
- Calendars for 1979 and 1980
- Concealed multihousehold selection sheet
- Despatch note
- Details of calls made
- 3 prompt cards
- Statement of purpose
- Note of thanks to respondents

Working papers

C V Brown, K W Glaister, R J Ruffell, D J Sanderson and D T Ulph 'Sample selection for studying the effects of direct taxation on short run labour supply', <u>H M Treasury Project Direct Taxation and Short Run Labour Supply Working Paper</u> No. 1, May 1982.

C V Brown, K W Glaister, R J Ruffell, D J Sanderson and D T Ulph 'The choice of the dependent variable', <u>H M Treasury Project Direct Taxation and Short Run Labour Supply Working Paper</u> No 2, July 1982.

C V Brown, K W Glaister, R J Ruffell, D J Sanderson, D T Ulph 'Problems in Questionnaire Design', <u>H M Treasury Project, Direct Taxation and Short Run Labour Supply Working Paper</u> No. 3, August 1982.

C V Brown, K W Glaister, E J Levin, P J Rosa, R J Ruffell, D J Sanderson, D T Ulph, 'Response rate and non response bias', <u>H M Treasury Project, Direct Taxation and Short Run Labour Supply Working Paper</u> No. 4, August 1982.

C V Brown, K W Glaister, E J Levin, P J Rosa, R J Ruffell, D J Sanderson, D T Ulph 'Construction of Net-of-Tax Budget Constraints for Labour Supply Estimates', <u>H M Treasury Project, Direct Taxation and Short Run Labour Supply Working Paper</u> No. 5, August 1982.

C V Brown, K W Glaister, E J Levin, P J Rosa, R J Ruffell, D J Sanderson, D T Ulph 'Is the Poverty Trap Important? (A provisional assessment)' <u>H M Treasury Project, Direct Taxation and Short Run Labour Supply Working Paper</u> No. 6, September 1982.

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Documentation of the Data

Sift Schedule: Final Version with Full Coding Instructions
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WHAT DOES THE REPORT CONTAIN?

The research arose out of the concern of the late 1970s that a rising tax burden might be an increasing disincentive to labour supply in the short as well as the longer term.

2. Research results in this area were sparse. The few studies in existence tended to show that the effects of higher taxation were either negligible or small, except in the case of married women. Income effects tended to cancel out substitution effects. Earlier work by Professor Brown showed that people were often unaware of their marginal tax rate.

3. Existing survey data (FES/GHS) had deficiencies for investigating this area of behaviour. They did not document the full complexity of payments systems, nor adequately cover relevant issues such as travel to work. The samples were also relatively small.

4. Professor Brown was commissioned to undertake a study where results would be based on new survey data and OPCS agreed to carry out a survey as part of their programme.

5. The survey produced much useful information on payments methods, travel to work, the work attitudes, etc. of those who were not working, family responsibilities, etc. An important feature of the survey was that it cast light on family as opposed to individual labour supply.

6. In addition to producing these descriptive statistics, Professor Brown's research strategy was directed to establishing econometric relationships between wage rates and labour supply so that the effects of tax changes could be simulated econometrically.

7. This strategy proved to be both time-consuming and restrictive. It was restrictive because the labour supply response was limited to change in hours worked by particular individuals in particular situations in a particular week. The complexity of payments systems led to great difficulty in mapping budget constraints and the techniques used involved considerable use of computer time. Constraints on the funding of the project eventually led the researchers to adopt a number of short cuts.

8. Unlike much cross sectional work which attempts to infer behaviour from observation of individuals in different positions, this work attempts to estimate the results of tax changes by modelling the behaviour of those who are in a position to adjust their hours of work in a particular short period. This greatly reduced the usable section of the sample and led to high standard errors in making estimates.

9. The results of the econometric analysis suggest:-

(i) that labour supply functions for most workers are vertical, indicating that reduced tax rates are unlikely to lead to an increase in the number of hours worked. The labour supply functions for married women are positively sloped but the elasticity is low;

(ii) simulations of reductions in tax rates show no change in the number of hours worked - income effects cancel out substitution effects;

(iii) simulations showing increases in allowances indicate a small reduction in the number of hours of labour supplied;

(iv) a combined, revenue neutral, simulation showing a cut in tax rates associated with a reduction in tax allowances indicates a small positive increase in labour supply.

WHAT DO WE THINK OF THE REPORT'S CONTENTS?

(i) the report does contain some useful descriptive statistics.

(ii) Its conclusions on the short run supply of hours is broadly consistent with US studies and other British work, some of which started after the Brown project. The contribution which the Brown study makes to this consensus results from the better data base used.

(iii) although it does produce some results, it is, taken all in all, a disappointing report. With the wisdom of hindsight, the concentration on such an ambitious econometric approach was somewhat misconceived - although this does at least indicate where the frontiers are in this area;

(iv) given the paucity of work in this area, it seemed useful to begin by looking at the simpler aspects of the labour supply function - i.e. those that could be studied quantitatively. The results have done little more than confirm what was suspected from poorer evidence. But they also indicate the limits of work on short run labour supply.

(v) This suggests that further efforts should be focussed on medium and longer term effects. This will of course be extremely difficult to do. First the appropriate research methodologies must be devised. Then there will be a massive job to do collecting the data.

352/4

APS/C/EX

PWP

Treasury Chambers, Parliament Street, SW1P 3AG

01-270-5183

Miss N Roche
10 Downing Street
LONDON
SW1

17 December 1986

Dear Nicky

BOX LIST: AUTUMN STATEMENT DEBATE

I should be grateful if you would arrange for the following thirteen names to be placed on the Speaker's Box list for the Debate on the Autumn Statement today:-

R Culpin
Mrs R Dunn
P Gray
G Hacche
A Hudson
R Kerley
Miss O'Mara
C Pickering
A Pirie
A Ross Goobey
M Scholar
A Turnbull
A Tyrie

In addition to the above names Ministers' Private Secretaries who are on the Permanent Box list, will also be attending.

We will, of course, be operating a roster.

Yours sincerely

R.C Berwick.

R C BERWICK
Parliamentary Section

003/2768

Anaw
Pwt

CHIEF SECRETARY TO THE TREASURY

FROM: **M C FELSTEAD**

DATE: **17 December 1986**

PS/FINANCIAL SECRETARY

cc:
PS/Chancellor
PS/Economic Secretary
PS/Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Cassell
Mr Scholar
Mr Turnbull
Mr Peretz
Mr H P Evans
Mrs Lomax
Mr Robson
Mr Sedgwick
Mr Culpin
Mr Mowl
Miss O'Mara
Mr Riley
Miss C Evans
Mr Hudson
Mr Tyrie
Mr Ross Goobey
Mr P Lilley MP

AUTUMN STATEMENT DEBATE SPEECH: FIRST DRAFT

The Chief Secretary has seen your minute of 16 December recording, among other things, the Financial Secretary's point that 60 per cent of the 5 million who came into the British Gas offer opted for bonus shares, which strongly implies that they expect to retain their shares for at least three years.

2 The Chief Secretary entirely agrees with this point; he has been making it wherever he can. I have already passed this on to Mr Hudson.

Mr Felstead

M C FELSTEAD
Assistant Private Secretary

presentation on an aggregate which includes debt interest I note it now seems to want me to go back to the planning total.

To sum up, as I said in my Lombard Association speech in April,

"The policy we are pursuing today is identifiably the same as that which we embarked on seven years ago. But it has clearly evolved — in terms both of presentation and of substance."

Indeed, it would be extraordinary had it not evolved. Since 1979, there have been enormous changes in world economic conditions, in the position of the United Kingdom, in technology, and in the operation of the financial markets. The Select Committee, the House, and indeed the country would be rightly concerned if Government policy had not evolved in the light of these developments. But to depict this evolution as

"a substantial change of policy"

is absurd.

If the Committee needs to be reminded of what a real shift of policy is, it need look no further than the last Labour Government — pre and post the flight to the International Monetary Fund. Indeed, if ever there was a year in which I might have been expected to change policy, it would have been this year, 1986, with the halving of the oil price. Many people duly advised me to make such a change. I rejected that advice, and maintained the same course, and there has been no crisis. Inflation has fallen to levels not seen for almost 20 years. After a short pause, growth has continued steadily. The number of people in work has continued to rise, and unemployment now looks to be firmly on a downward trend.

The way that both the private sector and the public finances have withstood the fall in the oil price is remarkable. That is the best possible vindication of the economic policy which we have pursued since 1979, a policy which has brought five years of steady growth, low inflation, and a million new jobs since 1983.

For 1987, I foresee a continuation of this pattern, with growth slightly faster than this year, and inflation staying low. The figures that have been released since the autumn statement confirm that picture. Output and exports have both picked up, with industrial production and exports in the three months to October both $1\frac{1}{2}$ per cent. higher than in the previous three months and manufacturing output up 3 per cent. since the beginning of the year. And the latest estimate that the surplus on invisibles was some £750 million a month in the third quarter of this year, with a still larger surplus likely in the fourth quarter, puts into perspective the advice confidently given to the Select Committee by one of its specialist advisers that the earlier projection of £600 million a month was "particularly optimistic".

Seasonally adjusted unemployment fell by 25,000 in October, making a total fall of 56,000 over the last three months, the best performance for 13 years. While the inflation rate did rise last month, chiefly as a result of the rise in the mortgage rate, the underlying inflation rate remained broadly stable.

The outlook for the British economy will, as ever, be critically affected by developments in the wider world economy. One clear danger, which is more acute now following the recent Congressional elections in the United States, is that world trade will become much less free. A retreat into protectionism would be a disastrous step backwards. Following the agreement on a new GATT round, it would be tragic if unilateral action were to undermine this progress. The United States would do well to recognise that multilateral negotiation, and moderation where disputes arise, are in all our interests.

The past year or so has seen substantial changes and discontinuities—the halving of the oil price, sharp falls in other commodity prices, and the major realignment of exchange rates following the Plaza agreement. The world economy is adjusting to all this, with, so far, merely a pause in the growth of world trade. In part at least, this is because the major countries have co-operated in pursuing soundly based policies. The world outlook for 1987, at the present time, like our own, is good; and it is crucial that we do not lose our way through a retreat into protectionism.

1986 has also been a notable year in the annals of the Labour party. It is the year in which it has reassembled carefully all the economic policies that have failed before, and been rejected by the electorate before. It is the year too in which it has broken with the traditions of previous Labour Governments by abandoning the effective defence of this nation. But I had better be careful, because if I am too critical of the right hon. Member for Sparkbrook, he may cancel his reply, just as he refused to speak to the Confederation of British Industry last week because it criticised his policies. We have sought in vain for clarity about how he would run either monetary policy or fiscal policy. Even on public spending, his views are—shall we say — less than entirely clear. Ever since my right hon. Friend the Chief Secretary and I costed Labour's programme at some £28 billion — and that was before we had heard about the £6 billion training levy — the right hon. Gentleman has consistently failed to explain how he would finance it, whether by taxation or by borrowing, or by both. If he intends to drop any of the pledges, he should say very clearly which.

Mr. Alan Howarth (Stratford-on-Avon) *rose*——

Mr. Lawson: I am coming to the end.

I have, of necessity Mr. Speaker, ranged widely in my speech, and I hope that this has helped the House in its consideration of the autumn statement, even though it is clear that the Opposition are not the slightest bit interested in the economy or in the report by the Select Committee.

In conclusion, let me come back to the autumn statement itself. The forecast it contains offers the prospects of another year of low inflation and steady growth. It sets out public expenditure plans which make increases in spending in priority areas, within a framework in which public expenditure in total continues to fall as a proportion of national output. It is the latest step in a firm economic strategy which has been pursued consistently since 1979, and I commend it to the House.

Mr. Alan Howarth On a point of order, Mr. Deputy Speaker. Is it not a gross abuse of the House——

Mr. Michael Forsyth (Stirling): On a point of order, Deputy Speaker. Is it not a gross abuse of the House— *[Laughter.]*

Mr. Deputy Speaker: I shall take the hon. Member for Stirling (Mr. Forsyth).

Mr. Michael Forsyth: I suspect that it may be the same point of order as my hon. Friend the Member for Stratford-on-Avon (Mr. Howarth) was going to make. Is it not a gross abuse of the House that throughout the

3120/304

PWT

FROM: ANDREW TYRIE
DATE: 17 December 1986

CHIEF SECRETARY

cc Chancellor
Financial Secretary
Economic Secretary
Minister of State
Mr Cropper
Mr Ross Goobey
Mr Pickering

You asked for a page of text on Alliance spending plans for use in the Debate today should you found yourself obliged to comment on the leaks about their plans in the Independent, attached.

2. As I mentioned, the SDP will be more than happy for you to attack the spending plans set out in the article. Their motive in leaking the working document to the Independent (Colin Brown is an SDP supporter) was to draw our fire on their spending plans and to put pressure on the Liberals to moderate their commitments. On the principle that it is generally better to do what the Opposition don't want I suggest we keep our powder dry until the end of January if possible.

3. On the other hand I see some advantage in needling the Alliance over the Liberals' breach of the pact not to make more pledges, see attached article. This has come out while the 'agreed' second version of "Partnership for Progress" is still at the printers. My draft reflects this.

AGT.

ANDREW TYRIE

3120/003

DRAFT SPEAKING NOTE FOR THE CHIEF SECRETARY ON ALLIANCE SPENDING PLANS

Credibility has never been the SDP/Liberals strongest suit.

2. It has always been a safe bet to assume that on most issues the SDP/Liberals don't have any policies. In the few areas where they do they came in pairs.

3. In recent weeks we have heard reports of a "policy steering group" that is finally going to fill the void. Of course, I will have my calculator at the ready.

4. The whole nation has seen how the costing of Labour's spending proposals has shattered their credibility in economic matters.

5. The lesson was not lost on the SDP/Liberals. They saw it happening to Labour and it sent shivers down both their spines.

6. How long will the SDP/Liberals be able to act out this charade of unity? How long will they be able to remember their lines?

7. According to the Independent last month the SDP/Liberals have costed and revised that pledge-heavy document "Partnership Progress". Donning his hair shirt David Owen has been laying down the law, so we are told.

8. But it seems that even while "Partnership Progress" is at the printers, before they have even had a chance to launch it, the actors in this drama are departing from their lines and doing some ad libbing.

9. On Tuesday the Liberals blew a hole in David Owen's plans. They have added, by their own estimates, £1.5 billion in a pledge to increase pay in the NHS. So the Liberals have broken their promises while the printing presses are still whirring on their so-called joint document.

THE INDEPENDENT

Alliance manifesto spending plans face deep cuts

4
5

By Colin Brown
Political Correspondent

SDP-LIBERAL Alliance leaders have been told to make cuts of £9.5bn in their manifesto commitments in an internal report leaked to *The Independent*. The report by the Alliance joint public expenditure working party shows that cuts required to bring the manifesto into line with Alliance spending plans will have to be twice as high as originally reported.

Pledges to raise pensions in line with pay and to let everyone retire at 60 will have to be dropped.

The Alliance leaders were warned that they would have to cut their manifesto commitments to accommodate the £4.5bn increase in public expenditure announced by the Chancellor in his Autumn Statement.

But the report by the working party, chaired by Ian Wrigglesworth and David Penhaligon, the SDP and Liberal treasury spokesmen, says a further £5bn will have to be cut from the manifesto programme if the Alliance's existing spending plans are to add up.

David Owen, the SDP leader, has told colleagues to take a "hair shirt" approach to public expenditure commitments to avoid the Alliance being subjected to the damaging attacks which John MacGregor, the Chief Secretary to the Treasury, has inflicted on Labour.

The report says spending plans will have to be cut from £15bn to £5.5bn if they are to stick to their policy of raising public expenditure by no more than 2 per cent a year in real terms. The document, being considered today at a final meeting of the drafting committee on "Partnership for Progress," the joint Alliance manifesto, rejects the alternative of allowing spending to rise in line with growth in the economy.

"Whatever guideline is adopted, considerable scaling down of existing policy commitments will be necessary," the report says. "The first-year cost of our policies, at £5bn-6bn, is far too high in the light of the Government's plans to increase spending by 2 per cent in real terms in 1987/8.

"To fit our plans within a 2 per cent per annum spending framework, we need to reduce our plans for 1989/90 from £11bn to £3bn and for 1991/2 from £15bn to £5.5bn. Those figures make no allowance for contingencies such as higher public sector pay." That includes the teachers, who are being offered 16.4 per cent over two years.

The report says a number of commitments have been added to the manifesto and not accounted for in previous Alliance spending plans.

"On the expenditure side, pledges to introduce a job guarantee, restore the link between pensions and earnings and equalise retirement ages could add upwards of a further £8bn to the cost of our policies. In view of the capital our political opponents could make of this, we recommend those specific commitments are deleted from the document.

"On the revenue side, "Partnership" contains a number of proposals that would seriously erode the tax base: with the exception of payroll incentives for profit sharing and lower pay deals, which are essential to our main economic strategy, we recommend these commitments are either excised or made explicitly for the longer term."

According to the working party, the economic outlook for the next Parliament has deteriorated and it warns against much higher spending to reduce unemployment.

"Whereas at any time since 1981, a more expansionary policy to tackle unemployment would have been a reasonable risk without putting too much of a burden on hopes of income restraint — at least in the early stages — this option no longer looks available in the light of the current consumer spending boom."

The report says cost of the Alliance tax and benefits proposals has grown from £500m to around £1bn as the Alliance committee in charge of the policy has tried to reduce the number of couples on low incomes who would lose under the scheme. A further meeting to sort that out will be held later this week.

The report says that other commitments will have to be dropped or delayed but some SDP sources say that delaying tactics are "a cop-out". There will be pressure at today's meeting for a firm stand against fudging on expenditure decisions.

Commitments which the report says should be delayed include:

- The doubling of the arts council budget from £135m this year;
- A big expansion of part-time and continuing education;
- Entitling all adults who have missed higher education to further free education (£400m);

Pledges the report says should be dropped are:

- A job guarantee for everyone after one year of unemployment (£2bn gross).
- Restoration of the link between pensions and earnings as well as prices (£2.5bn).
- Phased equalisation of the pension age with flexibility up to 65 but moving towards retirement at 60. (Treasury estimate — £3bn).

The report also recommends that some promises on tax incentives should be revised. It says the reductions in employers' national insurance contributions would have to be considerable to offer a payroll incentive — they may have to be cut by 10 per cent, costing £1.2bn, but this could be balanced by an inflation tax on pay rises which exceeded the pay norm.

The report estimates that between 250,000 and 500,000 jobs could be created, depending on training schemes, at a cost of £1bn in the first year and £2bn in the final year.

But the working party has left it to the leadership at today's meeting to decide where the cuts of £9.5bn will fall.

They will have to make the cuts from this £15.5bn shopping list for the fifth year: job creation £2bn; tax and benefit reform £1.5bn; health innovation fund £450m; NHS 2 per cent growth £740m; adult education entitlement (phased over 15 years) £400m; first year preschool experience £250m; teacher training £200m; double higher and further education students £500m; a training package for 16-19 year olds £1.25bn; housing schemes £2.8bn; water and sewage £55m; roads £150m; local transport £50m; rail £200m; urban renewal £260m; regional development agencies £500m; new technology £650m; overseas aid £1.4bn; payroll incentive £500m; profit sharing incentives £500m; doubling arts budget £135m; legal aid and prisons £150m; relaxing spending controls on local authorities £1bn.

8/1.

All. spending plans.

18 NOV 1986

Alliance plans over target by £5 billion

CX/3 BC

By Colin Brown
Political Correspondent

ALLIANCE LEADERS have been warned in a confidential internal report that their spending plans could exceed their targets by about £5bn. They are now faced with cuts in their manifesto plans or higher spending.

Radical proposals for the reform of tax and social security benefits are likely to be modified at a meeting of Alliance leaders today to soften the impact on low income couples and reduce the overall cost.

But the Alliance's difficulties over its tax reforms, although intensely embarrassing, are only part of deeper spending problems which have been intensified by the Chancellor's £4.5bn increase in public expenditure in his Autumn Statement.

Alliance leaders are extremely worried by the report from their treasury spokesmen, Ian Wrigglesworth for the SDP and David Penhaligon for the Liberals, that the spending plans contained in Partnership for Progress, their draft manifesto for the next election, will have to be cut or paid for by an increase of about £5bn.

One leading Alliance source said: "Their report is dynamite. It looked at the Alliance public expenditure commitments across the board. We have a public expenditure overshoot in a number of areas and we have to claw things back. It amounts to billions."

The report told the Alliance leaders their manifesto commitments could not be afforded if the Alliance stuck to its original intention to increase public spending by £10bn.

The Chancellor's Autumn Statement swallowed £4.5bn, largely on pay and revenue spending, leaving only £5.5bn for improvements in services.

Mr Wrigglesworth and Mr Penhaligon set out the options: to delay or scrap some commitments, or to increase public expenditure by around another £5bn.

A series of private meetings are being held to wittle down the spending bids for the manifesto.

The Alliance leaders are anxious to avoid the proposals being undermined like Labour's by John MacGregor, the Chief Secretary to the Treasury.

They have been told that additional spending may not lead to more borrowing if the economy grows by three per cent a year as the Government has forecast. But some sources say cuts in manifesto commitments are now inevitable.

Commitments likely to be scrapped include restoring the link between increases in pensions and pay rises. Others, such as improvements in higher education, will be delayed. Much tougher public sector pay restraint is also certain to be endorsed by the Alliance leaders. Rises will have to be cut from an average seven per cent to three or four per cent.

THE INDEPENDENT

Liberals publish NHS policy despite Alliance 'ban'

By Colin Brown
Political Correspondent

6

THE LIBERALS today published a report calling for substantial pay rises for low-paid NHS workers despite an insistence by the Liberal-SDP Alliance Treasury team that no promises should be made until they have reviewed their policy on public sector pay.

Alliance leaders tried to stop the Liberals' NHS pay policy paper from being published because it breached the Alliance moratorium on individual party policy documents. But the Liberal Party health panel insisted that the document had been sent to the printers before the moratorium came into effect.

The report, *Fair Pay in the NHS*, by the health panel under Archie Kirkwood, the Liberal spokesman, says that the low-paid workers need "catch-up" increases to compensate them for losing out under the Tories.

This will be seen as an attempt to increase the pressure on the Alliance Treasury team to agree to a commitment for inflation-proof increases for low-paid NHS workers.

No figures are given in the document but the panel believes the SDP-Liberal Alliance should be prepared to increase the pay of ancillary workers in the NHS by about 3 per cent on top of the current inflation rate. This would imply rises of about 7 per cent next year.

But the Alliance Treasury team, led by Ian Wrigglesworth for the SDP and David Penhaligon for the Liberals, is refusing to sanction promises of any high pay rises for health staff or other public workers until a complete review of Alliance policy on public sector pay has been carried out in the New Year.

They have held up publication of a separate joint SDP-Liberal Alliance paper on general NHS policy because it contained a commitment to give a fully funded real terms pay increase to the low paid NHS workers. Charles Kennedy, the SDP health spokesman, supported the policy in principle but he has not agreed any figures with the Liberals.

The Liberal document calls for reforms to the NHS pay system with comparability awards for low-paid clerical and ancillary workers, a simplified pay structure, and more money to pay for changes in working practices.

But the panel states: "Action cannot wait for completion of the reform of the pay determination system . . . we will have to start from where we are, using the machinery which already exists."

They say that pay in the NHS needs to catch up with that in comparable occupations and also keep up with further movements so that the gap does not widen again.

"Priority should be given first to establishing minimum earnings levels which will improve the position of low-paid workers and relieve poverty; then to improving other earnings to reduce the largest deficiencies in 'comparability' rates measured in percentage terms," says the report.

The Liberals privately estimate that the ancillaries have lost about 20 per cent in pay comparability since 1980 and that about £1.5bn will have to be spent in "catching-up" pay awards for the NHS workers, spread over seven years.

The Alliance Treasury team is likely to reject the demands for the Alliance to commit itself to substantial pay awards. The team is deeply concerned that the Treasury will use demands in Alliance policy papers to attempt to discredit Alliance spending plans. However, they are more likely to support the Liberals' demands for the simplification of the NHS pay structure for the ancillary workers who are currently covered by a number of negotiating bodies called Whitley Councils.

The Liberal health panel says: "A move towards common conditions of service for all or most staff groups would emphasise the essential unity of the service.

"As the catching-up process proceeds and internal relativities are stabilised, opportunities should be sought to draw together grades in different occupational groups with broadly equivalent pay. Progressively, all grades in the NHS could eventually be grouped in a number of pay bands . . .

"Simplifying the pay strcuture in this way would make it easier to ensure that health service pay is kept broadly in line with movements in pay elsewhere."

Tuesday, 16 December 1985

1/41

48:1

PWP

FROM: MISS M O'MARA
DATE: 17 DECEMBER 1986

CHIEF SECRETARY

cc PS/Chancellor
Mr Scholar
Mr Turnbull
Mr Gray
Mr Mowl
Ms Sinclair
Mr Pickering
Mr Tyrie
GC/01

TODAY'S DEBATE: MR KINNOCK'S CRITICISMS

I understand you wanted a line to take on the charges Mr Kinnock made in the attached extract from the debate on the Address on 19 November.

2. Cumulative borrowing

[1974-75 to 1978-79 PSBR averaged £8.2 billion cash, £20.6 billion in real terms, 6¾ per cent of GDP.

1979-80 to 1985-86 PSBR averaged £9.4 billion cash, £11.7 billion in real terms, 3½ per cent of GDP.

Since present Government already in office for more than 7 years, foolish to attempt to cumulate PSBR for first 5 years only.]

RHG seems unaware that, adjusting as we must for inflation, PSBR under this Government has averaged virtually half figure achieved by Party opposite, both in £billion and as share of GDP.

3. Increase in tax burden

[Non-North Sea tax and NICs as percentage of non-North Sea GDP risen from 34.1 in 1978-79 to estimated 37.7 in 1986-87. Increase in taxes necessary in early 1980s to restore prudent public finances and ensure PSBR brought down to levels compatible with reduction in inflation. More or less stabilised since 1982-83.]

Compared with indexed tax regime of 1978-79, income tax now down by £8,000 million. [IF PRESSED: Our record more generally reflects our determination to pursue prudent fiscal policies and to bring down inflation. I make no apology for that.]

4. High spending

[In real terms, estimated outturn of £159.9 billion for GGE in 1986-87 is higher than highest figure of £144.6 billion reached under Labour Government in 1974-75 and 1975-76].

Under Labour, public spending (GGE) rose to 48½ per cent of GDP in 1975-76. Well above any figure reached under this Government [46¾ per cent in 1982-83] and almost 5 percentage points higher than projected figure for 1986-87 [43¼].

MOM

MISS M O'MARA

[Mr. Lawson]

line with the PSBR envisaged at the time of the Budget. Yesterday's figures confirm that this year's PSBR is well on track, too.

The Leader of the Opposition claimed in a recent radio broadcast that the Government were the

"highest borrowing, highest spending, highest taxing Government ever".

This is pretty rich——

Mr. Kinnock: You are rich.

Mr. Lawson: —coming from the Leader of a party whose last spell in Government witnessed the PSBR rise to the equivalent of £35 billion in today's terms, public spending taking the highest share of national output ever in time of peace, and income tax at a basic rate of 35p in the pound. What is more, they would do the same all over again.

Mr. Kinnock: On those three issues, the first, as I am sure the right hon. Gentleman cannot deny, is that, cumulatively, given five years for five years, the borrowing of the Government of which he has continually been a member is higher than the borrowing of the five years of Labour Government. On the second, the right hon. Gentleman cannot quarrel with the fact that the tax burden as a proportion of gross national product has been higher—as much as 18 and 20 per cent. higher—under the Government of which he has been a member than under the last Labour Government. As for the third, the highest spending has been the direct consequence of the policies that the right hon. Gentleman has supported and run — maintaining unemployment at outrageous rates which has cost taxpayers and others immensely. I hope that the right hon. Gentleman will withdraw the idea that he is not part of the highest spending, highest borrowing, highest taxing Government in British history.

Mr. Lawson: I certainly will not withdraw. On taxes, however, I welcome the right hon. Gentleman's conversion to the cause of lower taxation. I hope that we shall now experience a totally new Labour plan. The right hon. Gentleman knows that public expenditure grew so fast under Labour that the economy had to be handed over from the Chancellor of the Exchequer to the International Monetary Fund so that it could sort the mess out. As for borrowing, the right hon. Gentleman is completely wrong. It was substantially greater under Labour than it has been during our period of office.

Much of the press reaction to the "Autumn Statement" has been fairly predictable, too. On most subjescts the press seems to have only two headlines to choose from.

Mr. Nellist: Will the right hon. Gentleman give way?

Mr. Lawson: No.

Mr. Nellist: I asked about 15 minutes ago.

Mr. Lawson: The hon. Gentleman has been somewhat pre-empted by his leader. He might have a word with his leader to give more time to Back Benchers. It is not a matter for me.

On public spending, the headline is either, "Cut, cut, cut," or "Spend, spend, spend." The truth is more prosaic. We are continuing on the path we have consistently pursued throughout this Parliament. Our declared objective has been to reduce the proportion of national income taken by the public sector. We have a
every year since 1982, and we plan to go on do
the next three years, as set out in the "Autumn S

Mr. Nellist: Will the hon. Gentleman give

Mr. Lawson: I shall give way to the hon.
but before I do, I shall say one other thing to th
Member for Sparkbrook. He made an astonish
about the public expenditure plans. He said th
increase in the plans, to a significant exte
increase in the British contribution to the
budget. The House may be interested to know
as planning totals are concerned, contribut
European Community budget are down by £
for 1987-88, and down by £510 million for 1
right hon. Gentleman got that wrong as well.
way.

Mr. Nellist: Is the Chancellor aware tha
minutes ago, he spoke about the necessity to
wage costs? Is he aware that in the west
according to the West Midlands Engineering
Association, 46 per cent. of all wage supplem
past 12 months were below 4 per cent., and 8
were below 5 per cent., yet unemployment is
The right hon. Gentleman wants to do some
rising wages. Why does he not have a word
members of the president's council of the C
calling for zero wage rises? Those 40 indiv
themselves a 19 per cent. wage rise last yea
himself a 207 per cent. wage rise. Why does th
Gentleman not get the beam out of his eye bef
motes in other people's eyes?

Mr. Lawson: I assure the hon. Gentleman t
have a beam in my eye. My salary has not
anything like that amount.

Of course, it is well known that, in
contributions to the European Community
since 1978-79.

Mr. Nicholas Budgen (Wolverhampton, S
rose——

Mr. Lawson: I must get on. I have given
deal — far more than the right hon. M
Sparkbrook did.

In the decade prior to our election in 1979, p
spending grew at an average annual rate of
cent. in real terms. In our first Parliament, be
world recession and the post-dated cheque
inherited, we managed only to slow the growth
to an average rate of $2\frac{1}{4}$ per cent. a year. But s
this Parliament, we have managed to curb th
spending to $1\frac{3}{4}$ per cent. a year. The increas
over the next three years is at the still slower r
cent. a year. All these figures, incidentally,
proceeds of privatisation, so as to show the
trend.

The second element of continuity is our de
that spending should not be financed by
borrowing. That is why I have made it clear
coming year, 1987-88, I will not allow the p
borrowing requirement to exceed the 1·75 p
GDP indicated in the medium term financial

I can well understand that continuity
unfamiliar concept in the party of the right ho
for Sparkbrook. The last Labour Government

3020/005

Andrew

14/12

FROM: ANDREW TYRIE
DATE: 17 December 1986

PLP

CHIEF SECRETARY

cc Chancellor
Financial Secretary
Economic Secretary
Minister of State
Mr Cropper
Mr Ross Goobey
Mr Pickering
Mr Turnbull

Jill said you would like a line on the £28 billion, ~~their~~ Labour's abandonment of pledges, Meacherisms, and the recent updating of the costings. I attach a draft passage for you to use on the £28 billion tonight.

2. **Abandonment of pledges**

At the moment we are ignoring statements by Labour which imply that they are discarding policies so I think the best line is to hammer on with the £28 billion figure.

3. I think the line to take on the attached extract from Hansard (Prescott) which Jill passed to me for comment, should be:

(i) is the HM telling us that the Labour party has dropped its commitment to a 35 hour week, to the reduction of the retirement age, to a minimum wage?

(ii) is the HM still backing Southwark's extraordinary scheme to try and create a million jobs at a cost of £20 billion over two years?

4. **Updating and Meacherisms**

I think you have the choice of either deploying the further

£9 billion of pledges made at Labour's Party Conference or Meacherisims in general. Para 5 of the speaking note takes the former line. I attach the extract from the Chancellor's speech which sets out Mr Hattersley's conference bill - the extra £9 billion.

5. For knockabout at the end Bryan Gould seems the most appropriate target. He is a new target, and I have not seen the quotations I circulated earlier in the week used against him.

AGT.

ANDREW TYRIE

Last week my RHF the Chief Secretary wrote to the RHG for Sparkbrook to ask whether the RHG for X's (Prescott) £6 billion levy on businesses for training was now Labour policy. Punch drunk with fending off these pledges he has passed the buck to (Gould).

2. But the RHG for Sparkbrook has had an excuse - he's been standing in for his leader, playing the statesman in America.

3. This visit has surely snuffed out the last flicker of credibility in Labour's fitness to govern. The RHG for Islwyn's attempts to reassure our US and NATO allies that Labour has a credible defence strategy has met with no more success than the RHG for Sparkbrook's attempts to convince the British public that Labour have an economic strategy.

4. What credibility can Labour hope to salvage when one of their front backbench spokesmen (Prescott) endorses a plan which would increase local authority spending by £20 billion over 2 years?

5. What credibility can there be for a Party whose conference responds to the exposure of £28 billion of spending plans not by cutting them, but by adding a further £9 billion?

6. What credibility can a Party have with British industry when it comes forward with a plan to impose a £6 billion levy on them?

7. (This is a good lead in to the Gould quotation from Tribune, attached)

7. No wonder the RHG for Sparkbrook has given up the task. And even before the dust has settled on these plans we have a report that the shadow Cabinet are considering a proposal to increase Corporation Tax by £3 billion. (see Independent 9 December).

Tuesday, 9 December 1986

Lab. tax plans"

THE INDEPENDENT

Labour in research cash call

2 =

By Barrie Clement

PLANS FOR a future Labour Government to raise an extra £3bn from corporation tax in its first term to fund civil technological research are being considered by the Shadow Cabinet.

A document drawn up by Jeremy Bray, the party's spokesman on science and technology, seeks a commitment to force industry to recycle profits into research and development.

It says that Britain spent only 1.6 per cent of its national income on research in 1983, compared with 2.5 per cent in West Germany and Japan.

The paper was launched at a conference to announce a pressure group set up by the white collar union ASTMS to promote an "industrial and political lobby" for science and technology.

10|1

[Mr. Lawson]

"The idea that there should be a 1 per cent. levy is not policy. It wasn't described as policy by John, and I can't imagine it's going to be policy."

Yet last night, when winding up for the Opposition in this very debate, the hon. Member for Kingston upon Hull, East reaffirmed his commitment to a 1 per cent. levy on business turnover, today, when asked a straight question by my hon. Friend the Member for Glanford and Scunthorpe, the right hon. Member for Sparkbrook was totally unable to give a straight answer.

We are always pleased to have the contribution of the hon. Member for Kingston upon Hull, East to our parliamentary debates. The House will recall how earlier this year he said of the right hon. Member for Sparkbrook's pledge to create a million jobs:

"How did we get this policy of 1 million jobs? Who worked on the programme? Promises such as this simply label us with targets we cannot achieve and expose our credibility."

That is what the hon. Gentleman said, and quite right too. The right hon. Member for Sparkbrook and his hon. Friend should speak to each other occasionally as that might save them one or two problems.

As for income tax, the right hon. Member for Sparkbrook tried for some weeks to maintain that while Labour's plans would mean a savage increase in the higher rates of income tax, there would be no increase in the basic rate. Needless to say, no one believed him, but the gaffe was well and truly blown by his NEC colleague, Mr. David Blunkett, who said:

"In my view there will have to be a return to a higher standard rate of income tax and people will respect us for saying so."

So much for the right hon. Member for Sparkbrook.

Where do the Opposition stand on the other interesting question of national insurance contributions? Last year the right hon. Member for Sparkbrook was somewhat dismissive about the reductions that I announced in the Budget in the rates of national insurance contributions for the lower paid. During Second Reading of the Finance Bill the right hon. Gentleman said:

"the Labour party has never believed that such changes to the cost of labour and employment could contribute to the solution of the central problem of the economy, which is the reduction in unemployment."—[*Official Report*, 25 April 1985; Vol. 78, c. 35.]

Yet within a year he was on the air telling Mr. Jimmy Young:

"If we make jobs less expensive for companies by reducing national insurance contributions that employers pay, then they'll take on more labour. So we'd like to cut the national insurance contributions."

In other words, on this, as on every other issue, the right hon. Member for Sparkbrook stands on his head.

About the only area of economic policy where we get a measure of unity and clarity from the Opposition is public spending. They all want as much of that as they can get. As a result, the total cost of their irresponsible pledges is rising all the time.

The Labour party conference was always likely to be an expensive week for the right hon. Member for Sparkbrook. In conjunction with my right hon. Friend the Chief Secretary, I have costed five new pledges that Labour made at Blackpool. A winter heating premium would cost nearly £200 million; a higher Christmas bonus for pensioners, another £100 million; the abolition of standing charges for pensioners, £550 million; new policies on energy, at least £350 million; and the latest pension increase promised by the hon. Member for Oldham, West (Mr. Meacher), a cool £8 billion a year. All in all, that means yet further spending commitments of some £9 billion a year—an expensive week indeed.

Once again, the right hon. Member for Sparkbrook has been knocked over in the rush to spend more, and the hon. Member for Dagenham (Mr. Gould), who is sitting quietly, has been brought in, far too late, to try to put Humpty Dumpty together again.

Mr. Hickmet: What analysis does my right hon. Friend make of the promise of the hon. Member for Kingston upon Hull, East (Mr. Prescott) to use the nationalised industries to employ more men as part of a Socialist policy to reduce unemployment?

Mr. Lawson: My hon. Friend is right. As I said earlier, massive overmanning was one of the problems with which we had to deal when we came to office. That is what Labour is pledged to recreate in the areas in which it believes it will have responsibility.

Mr. Dave Nellist (Coventry, South-East) *rose*——

Mr. Lawson: The economic strategy set out in the Gracious Speech continues the strategy that we have pursued consistently since 1979. Over the past seven years we have gradually brought down the growth of money GDP, so as to squeeze inflation out of the system and hence make room for real growth. We have brought inflation down from the appallingly high levels generated by the policies of the previous Government—when it averaged more than 15 per cent. a year—to the lowest levels seen for a generation.

Ever since inflation first dropped into single figures in April 1982, the Opposition have made confident predictions that it would rise again. During the last general election campaign the right hon. Member for Sparkbrook told the nation that:

"Inflation is ready to rocket again. By this time next year, it will be back in double figures."

At the time I said that that was poppycock, and so it proved. Each time the Opposition have predicted higher inflation, and each time they have been wrong.

To give them their due, it used to be the case in this country that we could not have sustained economic growth without a pick-up in inflation—at least, that is what the record seemed to show. Commentators used to debate endlessly the trade-off between growth and inflation as if they were bound inexorably together. But over the past five years we have shown that we can have steady and sustained growth without a revival in inflation—indeed, while inflation continues to come down. In each of the three years during which I have been Chancellor, the growth rate and the inflation rate have been within 2½ percentage points of each other. In no Labour year was that even remotely true. Indeed, in one of Labour's years the gap was as much as 25 per cent.

For the past five years, economic growth has averaged almost 3 per cent. a year and is set to continue at this steady rate in 1987. Again, there has been no shortage of predictions that growth was about to peter out. Indeed, such predictions have occurred regularly, year in, year out—ever since 364 economists claimed that the economy could never recover from the Budget of 1981.

As recently as a few months ago, I was told that the effects of the halving of the oil price would spell the end of the upswing unless I boosted Government borrowing,

[Mr. Prescott]

several of the industrial training boards and witnessed a collapse in the number of apprenticeships. If British companies invested only 1 per cent. of turnover on training, that would raise between £6 billion and £8 billion. The taxpayer would then not have to find the £2 billion now needed for the skivvy youth training and community programme schemes.

The Chancellor asked me how much Labour's programme would cost. The Chief Secretary to the Treasury has made some scandalous charges. He should be thrown out of accountancy in view of what he said about the costing of Labour's programme. The Chief Secretary has trawled through various speeches and documents, some of them quite wrong, and discovered, apparently, that our training programme would cost £900 million. Let me tell him, the analysis was incorrect. More importantly, why should we not impose a levy on industry to pay for training? Previous Tory Governments used to believe in levies because industry would not invest in training. Do not be surprised, industry will pay for training as our competitors and many industries abroad already do. We are short of every kind of skill in this country and we have to make a rapid and radical change in our training programme. There is no doubt about that. We know that it costs money. Industry is not paying anywhere near its fair share, even on the Chancellor's own evidence.

Many of the 26 proposals mentioned in the document are wrong. The Chief Secretary has already admitted that perhaps on education he was wrong. He quotes speeches and documents. The Labour party will put through its commitments in the manifesto when we decide them in the normal way. I shall give the House some examples. The Chief Secretary said that there is a commitment to a 35-hour week. That is not a commitment anywhere in our document although we might like to move towards it. The Chief Secretary gives us a bill of £3,000 million for that. He also mentions early retirement at 60. That is something that the Government have regrettably changed. He gives us a bill of £2,600 million, but that is not a commitment. We also have no commitment as to precisely what the minimum wage would be. There is a commitment to a minimum wage but one cannot possibly estimate the cost without knowing what that wage will be. Yet, the Chief Secretary tells us that it will cost £1,000 million. Therefore, there is a total bill of £6,600 million and no commitments. It is a charade. The Chief Secretary should answer those questions.

If the Chief Secretary looks at our document he will also see that money should be made available for housing. We are witnessing the building of for2,000 houses fewer per week than we did under a Labour Government. That is one indictment of the Government. The local authorities have the money — £6 billion in capital receipts — and there are 500,000 building workers unemployed. My constituency has worked out a programme for 1,000 houses at a cost of £66 million a year. That would provide 4,000 jobs and good training. I can give the House many public expenditure examples where the Chief Secretary calls for the money from the EEC.

We are working extremely hard to see where the extra jobs will come from, whether in nationalised industries, local authorities or the private or public sectors. Yes, they can do much more to provide jobs and they will, make no mistake about it.

There is one carefully costed document that I would like to give the Chief Secretary. It has been worked out in detail with the financial people and spells out precisely what the jobs are and where they will come from. It is an inner city authority with a massive housing problem and is in massive decline, which is recognised by the Government in their inner city partnership schemes. That authority is Southwark. It has produced a plan which shows precisely where the jobs will come from. There will be 5,800 jobs, 25 per cent. of them in housing and about 20 per cent. in social services. I notice that many of the jobs provided in social services are to deal with the problem created by the Government when they kicked people from mental hospitals in the name of community care and dumped them on local authorities without providing the resources for the authorities to deal with that.

I hear the Government talking about £4·5 billion they are giving to local authorities to assist them in their expansion programmes. Local authorities have lost over £20 billion in the reduction in the rate support grant. That is why we have seen a reduction in jobs and services. We must be prepared to look at the needs of our inner cities, the needs of our services, the need to build houses and the need to train. Many of our local authorities, which have been doing a valiant task trying to create jobs and improve services, could provide a considerable amount of the jobs we are talking about.

I shall let the Chancellor into a secret. A proportion of the 1 million job target that we have set to achieve over the two-year period will almost certainly come from local authorities. I have three projects before me now; Lancashire enterprise body, Southwark and the Hull corporation. We could certainly put together 10,000 jobs there if he is prepared to take those targets now. We can do that if the resources are available. Local authorities are engines of growth. They are important in the development of our economy. It is all very well for the Chancellor to smile but his proposals today hope to use the local authorities in the spirit of election because they learned a lesson. In 1983, the only time when the figures showed a flip upwards in reducing unemployment, the Chancellor told local authorities to spend, spend, spend public money because he wanted to reduce unemployment before the general election. The Chancellor has done the same today. No doubt the Budget statement in March will add to the tax cuts in today's proposals.

The Opposition believe that local authorities and nationalised industries can play a role in keeping real jobs, with real money, meeting real need. We shall provide the alternative to the skivvy community programme and YTS schemes which the Government have used to reduce the figures. We shall provide real jobs and real money to meet real need.

9.40 pm

The Chief Secretary to the Treasury (Mr. John MacGregor): One of the penalties of trying to allow everyone to speak in the debate and therefore having only short wind-ups is that I cannot, alas, refer to as many contributions as I would have liked.

All of us recognise—and no one would claim to the contrary — that, despite the improvement in the economy, there are still, and always will be, enormous

Bryan Gould

TRIBUNE, FEBRUARY 1, 1985

The Left must take electoral policies seriously

by

BRYAN GOULD

AS IS so often in the case of politics, the debate about the direction the Labour Party should take is in danger of over-simplification. The debate is often presented as a straight Left/Right conflict.

The party activist is told he must choose between the Right's claim, on the one hand, that Labour is fatally handicapped by policies which alienate the electorate and which must therefore be abandoned, and, on the other hand, the Left's argument that a concern for "mere electoral success" should not be allowed to stand in the way of a renewed commitment to those policies.

Dichotomy

But what if neither of those propositions is correct? What if the dichotomy between Labour's policies and electoral success is a false one? What if the Right's analysis is mistaken and the Left is, as a consequence, led to draw the wrong conclusions itself?.

There is a good deal of evidence to show that it is not Labour's policies which prevent it from winning popular support. It is rather the credibility of the party as a whole, quite apart from its individual policies, which raises doubts in the minds of the electorate and which then spills over into a scepticism about the policies.

This process was seen quite clearly at the time of the 1983 general election. After years of conflict and squabbling, the party looked more like a rabble than a potential government; and, having made it painfully clear that our own internal preoccupations were infinitely more important than the views of the electorate, we had no right to be surprised when voters declined the sudden invitation to become involved again on election day.

The sheer ineptitude of our campaign, and our incompetence in some of the basic political skills, reinforced this impression. The consequence was that even on those issues where the electorate would normally have backed the Labour position, public support declined. It was not that Labour was handicapped by unpopular policies, but that Labour's general risk of credibility destroyed support for policies which would otherwise have been supported.

Let us take a concrete example.—The question of Cruise missiles was an issue which featured strongly in the run-up to and during the general election campaign. The table below shows the extent of opposition to Cruise missiles in the period before and after the 1983 elections campaign, and the level of support for Labour over the same period. (Source: MORI and NOP)

Clear majority

What this table shows very clearly is how closely opinion on the desirability of Cruise missiles was linked to the general level of support for the Labour Party as a whole. At the beginning of the year, when Labour support was running at 36 per cent, there was a clear majority against Cruise missiles.

As Labour support dropped to 28 per cent in the run-up to and during the election campaign, the anti-Cruise majority first dwindled and was then reversed altogether. With the election of a new party leadership and the revival of Labour's standing — to 37 per cent, the anti-Cruise majority re-asserted itself.

The conclusion is unmistakable. It was Labour's general unpopularity and lack of credibility which affected attitudes towards one of Labour's main policies. It was not the policy which handicapped Labour, but the party's loss of standing with the electorate which jeopardised the policy.

A similar point can be made in respect of other major planks in Labour's platform. Anti-EEC sentiment was running strongly before the election; the party's policy on the issue should have been a vote-winner. Yet, in line with Labour's loss of credibility, the public lost faith in our EEC policy, only for anti-EEC feeling to re-assert itself strongly once the nadir in Labour's fortunes had passed.

In the same way, it is now generally assumed that our economic policy was a vote-loser. Yet nothing should have been easier than to show people that we did not have to endure over 3 million unemployed. Again, it was the party which lacked credibility, rather than the policy. People could not see Labour as a potential Government; they were therefore disclined to believe the remedies we offered.

The lessons for the Left are clear. We do not have to abandon our policies in order to seek electoral support. On the contrary, the two objectives go hand in hand. Furthermore, if we fail to pay sufficient attention to the electorate, we forfeit their support for our policies.

In other words, the Left (and particularly the so-called hard Left) has allowed itself to swallow a false analysis. Commitment to policies does not require that the wider electorate (from which we shall need 3 million extra votes on 1987/88) should be ignored or treated with contempt. There is nothing unsocialist about wooing the wider electorate, since this is the pre-condition, not just for gaining power, but for retaining and building support for our policies.

Demo-politics

Each time we reduce our credibility with the electorate by resorting to demo-politics, or by speaking the language of violence or by pretending to be some sort of revolutionary movement, we betray the issues we claim to care about, and we abandon the people we claim to defend.

We must consiously eschew the introversion and self-delusion which have weakened our appeal to, and our understanding of, people whose support we have lost. It is time for the Left to take electoral politics seriously.

1983	Support for Cruise Missiles Yes	No	Support for Labour
January	36	54	36
May	42	44	33
June	48	38	28
September	45	44	27
October	43	51	37
November	38	50	37

Bryan Gould is the Labour MP for Dagenham.

ps 11H

pup

UNCLASSIFIED

FROM: A P HUDSON
DATE: 17 December 1986

SIR P MIDDLETON

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir T Burns
Mr Cassell
Mr Scholar
Mr Turnbull
Mr Peretz
Mr H P Evans
Mr Sedgwick
Mr Culpin
Miss O'Mara
Mr Allan
Mr Robson
Mr Mowl
Mr Riley
Mr Cropper
Mr Tyrie
Mr Ross Goobey

AUTUMN STATEMENT DEBATE SPEECH: FINAL DRAFT

I attach the final draft of the speech for today's Autumn Statement Debate, which the Chancellor drafted yesterday evening.

2. Please could I have any comments as soon as possible.

A P HUDSON

MR /3

CHANCELLOR'S SPEECH IN AUTUMN STATEMENT DEBATE, 17 DECEMBER 1986

MR SPEAKER

I BEG TO MOVE THE MOTION THAT STANDS IN MY NAME AND THOSE OF MY RT HON FRIENDS.

THIS IS THE NOW TRADITIONAL DEBATE ON THE AUTUMN STATEMENT.

IT IS, OF COURSE, A RELATIVELY RECENT TRADITION.

THIS IS ONLY THE FIFTH AUTUMN STATEMENT.

THE FIRST WAS THE INVENTION OF MY PREDECESSOR, MY RT HON FRIEND THE PRESENT FOREIGN SECRETARY, IN 1982; AND I HAVE BEEN RESPONSIBLE FOR THE SUBSEQUENT FOUR.

BUT THE TRADITION IS NONE THE WORSE FOR THAT.

This year, however, unusually, we have already had our debate on the Autumn Statement - by courtesy of the Opposition - on the day of the Oral Statement itself.

But that does not mean that this debate has to go over the same ground as the first.

For it gives the House the opportunity to consider for the first - and no doubt the only - time the report on the Autumn Statement produced by the Treasury and Civil Service Select Committee under the distinguished Chairmanship of my Rt Hon friend the Member for Worthing.

Certainly I feel compelled to do so.

For who could not fail to be moved by the poignant wail of neglect implicit in the Committee's sole recommendation - namely that I should make any statements on what it calls macro-economic policy in the House and not outside it, as I did with my lengthy exegesis of the Government's fiscal and, in particular, monetary policy to the Lombard Association earlier this year.

MOREOVER, THE RHM THE LEADER OF THE OPPOSITION REFERRED APPROVINGLY TO THIS RECOMMENDATION ONLY LAST WEEK.

SOME OF US MAY BE A LITTLE SURPRISED TO DISCOVER THAT THE RHG HAS DEVELOPED A TASTE FOR THIS SORT OF THING, GIVEN THE MANIFEST INADEQUACY OF HIS UNDERSTANDING OF IT. BUT I SUPPOSE THE SAME COULD BE SAID OF HIS RECENT EXCURSIONS INTO THE FIELD OF STRATEGIC DEFENCE.

BE THAT AS IT MAY, I HAVE TO TELL THE COMMITTEE, AND THE RHG, THAT I PROPOSE TO CONTINUE AS I HAVE STARTED DURING MY FIRST 3½ YEARS AS CHANCELLOR - AND AS MY PREDECESSORS HAVE BEFORE ME - MAKING SOME SPEECHES, SUCH AS THE BUDGET, IN THE HOUSE, AND OTHERS, SUCH AS THE ANNUAL SPEECH TO THE LORD MAYOR'S MANSION HOUSE BANQUET, OUTSIDE IT.

I READILY CONCEDE THAT SOME MAY FEEL A SENSE OF DEPRIVATION FROM THE FACT THAT THIS GOVERNMENT HAS

REVERTED TO THE OLD-FASHIONED PRACTICE OF HAVING ONLY ONE BUDGET A YEAR, UNLIKE THE PREVIOUS LABOUR GOVERNMENT, WHICH WAS FORCED TO HAVE THEM EVERY FEW MONTHS.

BUT I AM NOT SURE THAT THE SENSE OF DEPRIVATION IS SHARED THROUGHOUT THE HOUSE.

WHEN, IN THIS YEAR'S BUDGET SPEECH, TOWARDS THE CONCLUSION OF A RELATIVELY BRIEF PASSAGE, I UTTERED THE WORDS "I WILL SAY NO MORE ABOUT MONETARY POLICY", THE REACTION WAS SCARCELY ONE OF PROFOUND DISAPPOINTMENT.

INDEED, HANSARD RECORDS HON MEMBERS AS HAVING INTERJECTED "HEAR, HEAR".

NONETHELESS, THIS IS CLEARLY THE OCCASION TO RESPOND TO THE SELECT COMMITTEE'S REPORT, UNIMPRESSIVE THOUGH IT IS.

LET ME HASTEN TO ADD THAT I DO NOT BLAME THE MEMBERS OF THE COMMITTEE FOR THE POOR QUALITY OF THEIR REPORT - CERTAINLY NOT THOSE ON THIS SIDE OF THE HOUSE.

THE SUBJECT-MATTER IS INHERENTLY COMPLEX AND DIFFICULT, AND IT IS CLEAR THAT THEY HAVE BEEN ~~CONSPICUOUSLY~~ ILL-

SERVED BY THEIR ~~ON THE WHOLE RATHER MOTLEY COLLECTION~~ OF ~~SO-CALLED~~ SPECIALIST ADVISERS.

THE REPORT LEVELS TWO MAIN CHARGES.

THE FIRST IS THAT "THE OPERATION OF MONETARY POLICY HAS BECOME INCREASINGLY OBSCURE."

THE SECOND IS THAT IN A NUMBER OF AREAS - TO QUOTE THE REPORT'S CONCLUDING PARAGRAPH CONTRIBUTED BY THAT DISPASSIONATE SEEKER AFTER TRUTH, THE HON MEMBER FOR GRIMSBY - "THERE HAS BEEN A SUBSTANTIAL CHANGE OF POLICY".

I WILL DISCUSS EACH CHARGE IN TURN.

THE FIRST CAN BE QUICKLY DISMISSED.

AS MR GORDON PEPPER, WHO HAS FORGOTTEN MORE ABOUT MONETARY POLICY THAN MOST OF THE COMMITTEE'S SPECIALIST ADVISERS HAVE EVER UNDERSTOOD, PUT IT IN A TALK TO THE FOREX ASSOCIATION OF LONDON EARLIER THIS MONTH,

> "Mr Lawson has gone out of his way to explain how monetary policy is being operated in practice, and how it has evolved, probably more so than any previous Chancellor."

As I have time and again made clear, the central task of monetary policy is to create monetary conditions that, over time, will bring steady downward pressure on the rate of growth of money GDP, and hence on inflation.

The principal <u>indicators</u> of monetary conditions are the rate of growth of both narrow and broad money, and the behaviour of the Exchange rate.

In present circumstances, when the behaviour of broad money has been particularly difficult to interpret, it is the behaviour of narrow money, most conveniently measured by M0, and the exchange rate, that have assumed greatest importance. And the essential instrument of monetary policy is the level of short-term interest rates.

IMPORTANT COMMA

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The Committee appear to suggest that monetary policy is uncertain because the Government is unwilling to raise interest rates when it is necessary to do so.

If that were true, it is difficult to understand how interest rates have come to stand at the level they do today.

BREAK

So let me now turn to the Committee's second charge; that is, that there has been a substantial change of Government policy.

It is important to be clear on what is in question here. The Committee allow that our central objective has been the same since 1979 - to reduce inflation and to create the conditions for sustainable growth.

And they accept that economic policy has always had two essential elements: firm control of monetary conditions and the reduction of public borrowing.

WHAT THE COMMITTEE - AND SOME OTHERS - CLAIM TO HAVE FOUND ARE CHANGES, IN THE WAY WE HAVE PURSUED AN UNCHANGING OBJECTIVE.

LOOKING FIRST AT MONETARY POLICY, LET ME START WITH WHAT HAS NOT CHANGED, AND COME ON TO WHAT HAS.

THERE HAS BEEN NO CHANGE WHATEVER IN THIS GOVERNMENT'S VIEW THAT MONETARY POLICY IS THE KEY TO CONTROLLING INFLATION.

THERE HAS BEEN NO CHANGE IN OUR VIEW THAT INTEREST RATES ARE - AND MUST BE - THE ESSENTIAL INSTRUMENT OF THAT POLICY.

AND THERE HAS BEEN NO CHANGE IN OUR VIEW THAT A SOUND MONETARY POLICY NEEDS TO BE ACCOMPANIED BY A PRUDENT FISCAL POLICY - BY WHICH I MEAN A LOW BUDGET DEFICIT.

THE COMMITTEE SUGGEST THAT WHAT THEY CALL "THE ENHANCED ROLE" FOR INTEREST RATES IS NEW.

BUT THAT IS SURELY EXAGGERATED, TO SAY THE LEAST. MONETARY POLICY, EVERYWHERE AND ALWAYS, HAS TO OPERATE THROUGH INTEREST RATES, FOR THE SIMPLE REASON THAT INTEREST RATES ARE THE PRICE OF MONEY.
EVEN AS FAR BACK AS 1980, IN THE GREEN PAPER ON MONETARY CONTROL, IT WAS EXPLICITLY ACKNOWLEDGED THAT, ALONGSIDE FISCAL POLICY, THE MAIN INSTRUMENT FOR CONTROLLING MONETARY GROWTH WAS INTEREST RATES.

I READILY CONCEDE, THOUGH, THAT IN THE IMPLEMENTATION OF POLICY, A NUMBER OF THINGS HAVE CHANGED.

FIRST, INTEREST RATES HAVE COME TO BEAR MORE WEIGHT IN RESTRAINING MONEY AND CREDIT BECAUSE WE HAVE - QUITE RIGHTLY - SWEPT AWAY A WHOLE APPARATUS OF CONTROLS.
WHEN WE TOOK OFFICE, WE INHERITED A CORSET FOR BANKS, FOREIGN EXCHANGE CONTROLS FOR EVERYONE, AND MORTGAGE RATIONING FOR THOSE BUYING HOUSES.
SUCH CONTROLS HAVE INCREASINGLY BECOME UNWORKABLE, AS THE FINANCIAL SYSTEM BECOMES MORE SOPHISTICATED.

THEIR DEMISE

~~This~~ inevitably puts more immediate weight on interest rates as the instrument of policy.

Second, we did for a while come to use systematic overfunding - the practice of selling more gilts than needed to fund the PSBR - as a way of reducing the recorded growth of £M3.

This led to undesirable distortions in financial markets,

AND ~~which~~ also made policy harder to operate.

We concluded that the practice could not be justified - a point made forcefully in the past, as I recall by the Select Committee itself - and I explained that fully in last year's Mansion House speech.

Third, I accept that in setting interest rates it has become harder to use as a guide the particular measure known as £M3.

But this is in no sense a bolt from the blue.

The 1980 Green Paper said that "no single statistical

MEASURE OF THE MONEY SUPPLY CAN BE EXPECTED FULLY TO ENCAPSULATE MONETARY CONDITIONS".

IN 1980, IT DID MAKE SENSE TO HAVE ONLY ONE TARGET AGGREGATE, AND ONE WITH WHICH THE MARKETS WERE ALREADY FAMILIAR, BECAUSE IT WAS IMPORTANT TO GIVE A CLEAR AND SIMPLE INDICATION OF OUR COMMITMENT TO FINANCIAL DISCIPLINE.

BUT IN THE DAY-TO-DAY OPERATION OF MONETARY POLICY, WE RECOGNISED, TO QUOTE THE GREEN PAPER AGAIN, THAT "IT IS INSUFFICIENT TO RELY ON ONE MEASURE ALONE".

WE ALSO RECOGNISED THAT THE DEFINITION USED AND THE CHOICE OF TARGET AGGREGATES MIGHT NEED TO BE ADJUSTED, IN THE WORDS OF THE GREEN PAPER, "AS CIRCUMSTANCES CHANGE" AND "IN THE FACE OF LONG TERM CHANGES IN THE INSTITUTIONAL STRUCTURE".

AND, OF COURSE, THAT IS WHAT HAS HAPPENED.

CIRCUMSTANCES HAVE CHANGED, AND THE INSTITUTIONAL STRUCTURE HAS ALTERED, WITH THE RESULT THAT THE BEHAVIOUR OF £M3 HAS BECOME INCREASINGLY HARD TO INTERPRET.

IN WHAT ATTEMPTS TO BE A SERIOUS DISCUSSION OF MONETARY POLICY, THE COMMITTEE'S REPORT MAKES HARDLY ANY MENTION OF THESE DEVELOPMENTS.

AND IT IS EVEN MORE EXTRAORDINARY THAT THERE IS NO REFERENCE AT ALL TO EXPERIENCE OVERSEAS.

FOR UK EXPERIENCE HAS BEEN SIMILAR TO THAT OF THE OTHER MAJOR COUNTRIES, MOST OF WHICH - INCLUDING GERMANY - HAVE FOUND THEIR MONETARY TARGETS OVERSHOOTING THIS YEAR, WHILE INFLATION HAS UNAMBIGUOUSLY COME DOWN.

WE CANNOT AND DO NOT IGNORE THE CONTINUED RAPID GROWTH OF £M3 AND OTHER MEASURES OF BROAD MONEY.

BUT FOR A LONG PERIOD NOW, THIS GROWTH HAS PROVED CONSISTENT WITH DOWNWARD PRESSURE ON INFLATION.

SO IT MUST BE LOOKED AT IN CONJUNCTION WITH THE EVIDENCE OF OTHER INDICATORS.

PRINCIPAL AMONG THESE IS M0 - THE BROAD MONETARY BASE - WHICH HAS PROVED A RELIABLE INDICATOR, WITH A STABLE TREND IN VELOCITY. ~~FROM YEAR TO YEAR.~~

THIS IS WHY, THROUGHOUT MY TIME AS CHANCELLOR, I HAVE CHOSEN TO SET TARGETS FOR NARROW MONEY IN TERMS OF M0.

THE SELECT COMMITTEE SAY THEY ARE NOT CONVINCED THAT M0 IS A USEFUL INDICATOR OF MONETARY CONDITIONS.

THEY DO NOT SAY WHY.

~~SO I SUGGEST THEY EXAMINE THE EVIDENCE.~~

IT IS ABSURD TO IMPLY THAT ALL NARROW AGGREGATES ARE MISLEADING BECAUSE THE BEHAVIOUR OF M1 IN THE EARLY 1970s DID NOT FORESHADOW THE SUBSEQUENT INFLATION.

HAD THEY LOOKED AT THE BEHAVIOUR OF M0 IN THE EARLY 1970s INSTEAD, THEY WOULD HAVE SEEN THAT IT DID, INDEED, WARN OF COMING INFLATION.

IN OPERATING AND FORMULATING MONETARY POLICY, THE EXCHANGE RATE IS VERY IMPORTANT BOTH AS A TRANSMISSION MECHANISM AND AS AN INDICATOR OF MONETARY CONDITIONS.

IN THIS COUNTRY, AS IN THE OTHER MAJOR ECONOMIES, IT HAS COME TO PLAY A MORE PROMINENT POLICY ROLE IN RECENT

YEARS, AS INSTITUTIONAL DEVELOPMENTS HAVE MADE THE MONETARY AGGREGATES MORE DIFFICULT TO INTERPRET.
BUT AS LONG AGO AS 1980 AND EARLY 1981, INTEREST RATES WERE REDUCED BECAUSE THE EXCHANGE RATE WAS INDICATING THAT CONDITIONS WERE TIGHT, DESPITE A MONETARY OVERSHOOT.
THE 1982 MTFS EXPLAINED THAT - AND I QUOTE -

> "THE BEHAVIOUR OF THE EXCHANGE RATE CAN HELP IN THE INTERPRETATION OF MONETARY CONDITIONS, PARTICULARLY WHEN THE DIFFERENT AGGREGATES ARE KNOWN TO BE DISTORTED ... THE GOVERNMENT CONSIDERS IT APPROPRIATE TO LOOK AT THE EXCHANGE RATE IN MONITORING DOMESTIC MONETARY CONDITIONS AND IN TAKING DECISIONS ABOUT POLICY".

SO THERE NEED BE NO SURPRISE ABOUT AN INEVITABLE AND, MANY WOULD SAY, DESIRABLE DEVELOPMENT IN THE APPRAISAL OF MONETARY CONDITIONS.

NOR, AS THE DATE OF THAT QUOTATION SHOWS, IS THERE ANYTHING PARTICULARLY RECENT ABOUT THIS EVOLUTIONARY CHANGE.

Fiscal policy

Let me now turn to fiscal policy.

The Committee's complaint here is not that the government's policy has changed, but rather that it is the same.

Specifically, they are unhappy that the Autumn Statement reaffirmed the Government's commitment to the same fiscal stance as was set out in the 1986 MTFS.

The reasoning in this part of the Report is, Mr Speaker, frankly obscure.

The Committee, spurred on no doubt by their advisers, have decided after all these years to abandon the PSBR as the measure of the fiscal stance.

No reasons are given for this change of mind other than the fact that the PSBR can be measured inclusive or exclusive of asset sales.

THEY THEN GO ON TO ARGUE THAT THE PUBLIC SECTOR FINANCIAL DEFICIT IS - I QUOTE - A MORE "RELEVANT AND USEFUL FIGURE".

TABLE 1 OF THE REPORT SETS OUT WHAT PURPORT TO BE THE PUBLIC SECTOR FINANCIAL DEFICITS FOR EACH OF THE PAST SEVEN YEARS, AND ESTIMATES FOR THIS YEAR AND NEXT YEAR.

FOR FOUR OUT OF THE PAST SEVEN YEARS, THE FIGURES IN THE TABLE ARE WRONG - THE AVERAGE ERROR IS APPROXIMATELY £1 BILLION.

FOR THIS YEAR, THE ESTIMATE GIVEN IS A PERFECTLY REASONABLE ONE; BUT THE ESTIMATE GIVEN FOR NEXT YEAR - A MATTER OF SOME IMPORTANCE - IS ~~WORSE THAN IMPLAUSIBLE: IT IS~~ WHOLLY INCOMPITABLE, BY A WIDE MARGIN, WITH THE PSBR FIGURE TO WHICH I HAVE ALREADY UNEQUIVOCALLY COMMITTED MYSELF, AND WHICH IS INCONGRUOUSLY PLACED ALONGSIDE IT IN THE COMMITTEE'S OWN TABLE.

BUT MORE IMPORTANT, ON THE CENTRAL ISSUE OF FISCAL POLICY, THE COMMITTEE HAVE, I FEAR, NO ADVICE TO OFFER THE HOUSE.

THEY QUESTION VAGUELY WHETHER THE PSBR <u>SHOULD</u> BE HELD TO 1¾ PER CENT OF GDP NEXT YEAR.

BUT THEY EXPRESS NO VIEW AT ALL AS TO WHAT WOULD BE THE APPROPRIATE LEVEL AT WHICH TO SET IT, OR, FOR THAT MATTER, AT WHICH TO SET THE PSFD.

THIS DEFICIENCY, THOUGH INEXCUSABLE, IS PERHAPS UNDERSTANDABLE.

I RECALL THAT LAST YEAR ONE OF THE COMMITTEE'S SPECIALIST ADVISERS WAS URGING A PSBR OF £16 BILLION THIS YEAR AND £17 BILLION NEXT YEAR - SOMETHING HE MAY WELL WISH TO FORGET.

BUT I FIND IT VERY HARD INDEED TO UNDERSTAND THE JUSTIFICATION FOR THE DOUBT WHICH THE COMMITTEE ATTEMPT TO CAST ON THE GOVERNMENT'S COMMITMENT TO HOLD THE PSBR NEXT YEAR TO 1¾ PER CENT OF GDP.

THE REASON GIVEN IN THE REPORT FOR THIS - THAT ANY FORECAST OF THE PSBR IS UNCERTAIN AND SUBJECT TO A MARGIN OF ERROR - IS BESIDE THE POINT, AND REVEALS SOMETHING OF A MISCONCEPTION.

When the Chancellor of the Exchequer on Budget day sets the borrowing requirement at a particular figure, he is not making a <u>forecast</u>.

He is above all making a <u>judgement</u> about the appropriate fiscal stance.

And this judgement is an essential counterpart to monetary policy in the Government's overall economic strategy.

Clearly, the PSBR set at the time of the Budget has to be validated by events.

But let's have a look at the record.

I have so far introduced three Budgets - in 1984, 1985, and 1986.

In 1984/85 the PSBR did indeed overrun - but that was solely because of the cost of successfully resisting the coal strike - an exceptional event which it was clearly right to take on the PSBR.

Last year, 1985/86, the PSBR undershot the figure I had set at the time of the Budget.

AND THIS YEAR, 1986/87, THE PSBR IS CLEARLY WELL ON TRACK.

INDEED, AS THE FIGURES FOR THE FIRST EIGHT MONTHS PUBLISHED YESTERDAY SHOW, IF ANYTHING IT IS MORE LIKELY TO UNDERSHOOT THAN OVERSHOOT THE £7 BILLION FIGURE I SET AT THE TIME OF THE BUDGET.

SO THE COMMITTEE'S IMPLICATION THAT ANY FIGURE SET IN THE BUDGET IS LIKELY TO BE EXCEEDED CAN BE SEEN TO BE WHOLLY WITHOUT FOUNDATION.

WE SET OUT TO REDUCE THE LEVEL OF THE PSBR, AND THAT IS WHAT WE HAVE DONE.

AT AN ESTIMATED 1¾ PER CENT OF GDP, THIS YEAR'S PSBR IS LOW BY ANY RECKONING, BELOW THE GENERAL LEVELS OF RECENT YEARS, BELOW THE COMPARABLE LEVELS OF MOST OTHER COUNTRIES, AND FAR BELOW THE GROSSLY EXCESSIVE LEVELS FROM 1974 TO 1979, WHEN IT AVERAGED NEARLY 7 PER CENT OF GDP OR OVER £20 BILLION A YEAR AT TODAY'S PRICES.

Moreover, this would still be true had there been no privatisation proceeds at all, and it clearly fulfils the objective set out in successive versions of the MTFS right back to 1980.

I do, of course, take account of the estimated proceeds of privatisation in setting fiscal policy.
But, as I have always made clear, privatisation is a policy that is fully justified on its merits.
It is emphatically not a policy undertaken to massage the PSBR.
Ask the five million successful subscribers to British Gas.

<u>Tax cuts</u>

Like other commentators, the Treasury Committee have speculated about the outlook for tax cuts.
I decided last year no longer to publish a projection for the fiscal adjustment in the Autumn Statement, so as to

DISCOURAGE THE POINTLESS AND MISLEADING CALCULATIONS WHICH ARE ALWAYS MADE AT THIS TIME OF YEAR.
SUBSEQUENT EVENTS LAST WINTER PROVED HOW RIGHT I WAS.
BUT SPECULATION PERSISTS.

LET THERE BE NO MISTAKE ABOUT THIS.
AS I HAVE SAID REPEATEDLY, A POUND USED IN ADDITIONAL EXPENDITURE IS A POUND WHICH IS NOT AVAILABLE FOR REDUCTIONS IN TAXATION, UNLESS BORROWING INCREASES.
AND I HAVE CATEGORICALLY RULED OUT HIGHER BORROWING.

THE HOUSE SHOULD THEREFORE BE IN NO DOUBT THAT THE SIZABLE INCREASE IN NEXT YEAR'S PUBLIC SPENDING PLANS WHICH I ANNOUNCED IN THE AUTUMN STATEMENT MEANS THAT I SEE LITTLE IF ANY SCOPE FOR REDUCTIONS IN TAXATION IN NEXT YEAR'S BUDGET.

PUBLIC EXPENDITURE

ON PUBLIC EXPENDITURE, THE COMMITTEE HAVE AGAIN ENGAGED IN A TEXTUAL CRITIQUE WORTHY OF BIBLICAL OR SHAKESPEAREAN SCHOLARS TO TRY TO DEMONSTRATE A MAJOR CHANGE IN DIRECTION.

WHICH IS PARTICULARLY ODD SINCE MUCH OF THE MATERIAL AT THE BACK OF THE REPORT DEVELOPS THE THEME THAT PUBLIC SPENDING IS RETURNING TO A TREND.

THE TRUE POSITION IS VERY SIMPLE.

WE HAVE LONG MAINTAINED THAT THE STATE TAKES TOO MUCH OF THE NATION'S INCOME AND ITS SHARE SHOULD BE REDUCED -THIS FORMULATION CAN BE TRACED BACK NOT ONLY TO THE 1979 MANIFESTO, BUT EVEN BEFORE THAT TO OUR POLICY DOCUMENT "THE RIGHT APPROACH TO THE ECONOMY".

AND WE HAVE PURSUED THIS OBJECTIVE CONSISTENTLY.

IT IS TRUE THAT SOME OF THE TARGETS WE HAVE SET OURSELVES HAVE IN THE EVENT PROVED TOO AMBITIOUS.

AND I HAVE ALREADY EXPLAINED TO THE HOUSE THAT WE THOUGHT IT RIGHT TO INCREASE THE PLANNING TOTALS THIS YEAR.

BUT IT IS BETTER TO ATTEMPT TO MEET DEMANDING TARGETS THAN TO HAVE THE COMPLETE ABSENCE OF FINANCIAL DISCIPLINE WHICH THE PARTY OPPOSITE IS PLEDGED.

THE PROGRESS WE HAVE MADE IS CONSIDERABLE.
AS I EXPLAINED AT THE TIME OF MY AUTUMN STATEMENT, THE RATE OF INCREASE OF PUBLIC SPENDING IN REAL TERMS, EVEN EXCLUDING PRIVATISATION PROCEEDS, HAS COME DOWN FROM 3 PER CENT IN THE DECADE TO 1978-79, TO 2¼ PER CENT IN THE LAST PARLIAMENT AND TO 1¾ PER CENT SO FAR IN THE PRESENT ONE.
OUR LATEST PLANS CONTINUE THIS PROCESS.

WE HAVE ALSO REVERSED THE TREND OF PUBLIC SPENDING AS A PROPORTION OF GDP.
UNTIL 1982-83, THE PREVIOUS LONG-TERM GROWTH PATTERN CONTINUED, MAINLY AS A RESULT OF THE SEVERE WORLD RECESSION.
BUT IN THE FOUR YEARS SINCE THEN, THE PROPORTION HAS FALLEN PROGRESSIVELY.

OUR PRESENT PLANS MEAN THAT THIS DOWNWARD TREND WILL CONTINUE, SO THAT BY THE END OF THE EIGHTIES PUBLIC SPENDING AS A PROPORTION OF NATIONAL INCOME WILL BE BACK TO LEVELS LAST SEEN IN THE EARLY 1970S.

[THIS ANALYSIS, I ADMIT, IS BASED ON GENERAL GOVERNMENT EXPENDITURE.
I HAD HOPED THE COMMITTEE WOULD WELCOME THIS APPROACH, BECAUSE LAST YEAR THEY CRITICISED ME FOR FOCUSSING ON THE PLANNING TOTAL AND SO IGNORING DEBT INTEREST.
THIS YEAR, I HAVE FOLLOWED THEIR ADVICE, BUT THEY NOW SEEM TO WANT ME TO GO BACK TO THE PLANNING TOTAL.]

SUMMING-UP OF RIPOSTE TO THE COMMITTEE

TO SUM UP, AS I SAID IN MY LOMBARD ASSOCIATION SPEECH IN APRIL, "THE POLICY WE ARE PURSUING TODAY IS IDENTIFIABLY THE SAME AS THAT WHICH WE EMBARKED ON SEVEN YEARS AGO.
BUT IT HAS CLEARLY EVOLVED - IN TERMS BOTH OF PRESENTATION AND OF SUBSTANCE."

INDEED, IT WOULD BE EXTRAORDINARY HAD IT NOT DONE.

SINCE 1979, THERE HAVE BEEN ENORMOUS CHANGES IN WORLD ECONOMIC CONDITIONS, IN THE POSITION OF THE UK, IN TECHNOLOGY, AND IN THE OPERATION OF THE FINANCIAL MARKETS.

THE SELECT COMMITTEE, THE HOUSE, AND THE COUNTRY WOULD BE RIGHTLY CONCERNED IF GOVERNMENT POLICY HAD NOT EVOLVED IN THE LIGHT OF THESE DEVELOPMENTS.

BUT TO DEPICT THIS EVOLUTION AS "A SUBSTANTIAL CHANGE OF POLICY" IS ABSURD.

IF THE COMMITTEE NEED TO BE REMINDED OF WHAT A REAL SHIFT OF POLICY IS, THEY NEED LOOK NO FURTHER THAN THE LAST LABOUR GOVERNMENT - PRE- AND POST THE FLIGHT TO THE IMF.

INDEED, IF EVER THERE WAS A YEAR IN WHICH I MIGHT HAVE BEEN EXPECTED TO CHANGE POLICY, IT WOULD HAVE BEEN 1986, WITH THE HALVING OF THE OIL PRICE.

MANY PEOPLE DULY ADVISED ME TO MAKE SUCH A CHANGE.

I REJECTED THIS ADVICE, AND MAINTAINED THE SAME COURSE.

AND THERE HAS BEEN NO CRISIS.

INFLATION HAS FALLEN TO LEVELS NOT SEEN FOR ALMOST TWENTY YEARS.

GROWTH HAS CONTINUED STEADILY, AFTER A SHORT PAUSE IN THE EARLY PART OF THE YEAR.

THE NUMBER OF PEOPLE IN WORK HAS CONTINUED TO RISE, AND UNEMPLOYMENT NOW LOOKS TO BE FIRMLY ON A DOWNWARD TREND.

THE WAY THAT BOTH THE PRIVATE SECTOR AND THE PUBLIC FINANCES HAVE WITHSTOOD THE FALL IN THE OIL PRICE IS A REMARKABLE ACHIEVEMENT.

THAT IS THE BEST POSSIBLE VINDICATION OF THE ECONOMIC POLICY WE HAVE PURSUED SINCE 1979, A POLICY WHICH HAS BROUGHT FIVE YEARS OF STEADY GROWTH, LOW INFLATION, AND A MILLION NEW JOBS SINCE 1983.

FOR 1987, I FORESEE A CONTINUATION OF THIS PATTERN, WITH GROWTH SLIGHTLY FASTER THAN THIS YEAR, AND INFLATION STAYING LOW.

THE FIGURES THAT HAVE BEEN RELEASED SINCE THE AUTUMN STATEMENT TEND TO CONFIRM THAT PICTURE.

OUTPUT AND EXPORTS HAVE PICKED UP, WITH INDUSTRIAL PRODUCTION AND EXPORTS IN THE THREE MONTHS TO OCTOBER BOTH 1½ PER CENT HIGHER THAN IN THE PREVIOUS THREE MONTHS AND MANUFACTURING OUTPUT UP THREE PER CENT SINCE THE BEGINNING OF THE YEAR.

AND THE LATEST ESTIMATE THAT THE SURPLUS ON INVISIBLES WAS SOME £750 MILLION A MONTH IN THE THIRD QUARTER, WITH A STILL LARGER SURPLUS LIKELY IN THE FOURTH QUARTER, PUTS INTO PERSPECTIVE THE ADVICE CONFIDENTLY GIVEN TO THE SELECT COMMITTEE BY ONE OF THEIR SPECIALIST ADVISERS THAT THE EARLIER PROJECTION OF £600 MILLION A MONTH WAS "PARTICULARLY OPTIMISTIC".

SEASONALLY ADJUSTED UNEMPLOYMENT FELL BY 25,000 IN OCTOBER, MAKING A TOTAL FALL OF 56,000 OVER THE LAST THREE MONTHS, THE BEST PERFORMANCE FOR THIRTEEN YEARS.

THE INFLATION RATE ROSE LAST MONTH, CHIEFLY AS A RESULT OF THE RISE IN THE MORTGAGE RATE, BUT THE UNDERLYING

INFLATION RATE REMAINS BROADLY STABLE, AND I SEE NO REASON TO REVISE MY FORECAST FOR NEXT YEAR.

THE WORLD ECONOMY

THE OUTLOOK FOR THE BRITISH ECONOMY WILL, AS EVER, BE CRITICALLY AFFECTED BY DEVELOPMENTS IN THE WIDER WORLD ECONOMY.

ONE CLEAR DANGER, WHICH IS MORE ACUTE FOLLOWING THE RECENT CONGRESSIONAL ELECTIONS IN THE UNITED STATES, IS THAT WORLD TRADE WILL BECOME MUCH LESS FREE.

A RETREAT INTO PROTECTIONISM WOULD BE A DISASTROUS STEP BACKWARDS.

FOLLOWING THE AGREEMENT ON A NEW GATT ROUND, IT WOULD BE TRAGIC IF UNILATERAL ACTION WERE TO UNDERMINE THIS PROGRESS.

THE UNITED STATES WOULD DO WELL TO RECOGNISE THAT MULTILATERAL NEGOTIATION, AND MODERATION WHERE DISPUTES ARISE, ARE IN ALL OUR INTERESTS.

THE PAST YEAR OR SO HAS SEEN SUBSTANTIAL CHANGES AND DISCONTINUITIES - THE HALVING OF THE OIL PRICE, FALLS IN OTHER COMMODITY PRICES, AND THE MAJOR REALIGNMENT OF EXCHANGE RATES FOLLOWING THE PLAZA AGREEMENT.

THE WORLD ECONOMY IS ADJUSTING TO ALL THIS, WITH SO FAR MERELY A PAUSE IN THE GROWTH OF WORLD TRADE.

IN PART AT LEAST, THIS IS BECAUSE THE MAJOR COUNTRIES HAVE COOPERATED IN PURSUING SOUNDLY BASED POLICIES.

THE WORLD OUTLOOK FOR 1987, LIKE OUR OWN, IS GOOD; AND IT IS CRUCIAL THAT WE DO NOT LOSE OUR WAY THROUGH A RETREAT INTO PROTECTIONISM.

ATTACK ON LABOUR

MR SPEAKER, 1986 HAS ALSO BEEN A NOTABLE YEAR IN THE ANNALS OF THE LABOUR PARTY.

IT IS THE YEAR IN WHICH THEY HAVE REASSEMBLED ALL THE ECONOMIC POLICIES THAT HAVE FAILED BEFORE, AND BEEN REJECTED BY THE ELECTORATE BEFORE.

And the year in which they have broken with the traditions of previous Labour Governments by abandoning the effective defence of this nation.

But I had better be careful, because if I am too critical of the RHM for Sparkbrook, he may cancel his reply, just as he refused to speak to the CBI last week because they criticised his policies.

We have sought in vain for clarity about how he would run either monetary policy or fiscal policy.

Even on public spending, his views are - shall we say - not entirely clear.

Ever since my RHF the Chief Secretary and I costed Labour's programme at some £28 billion - and that was before we had heard about the £6 billion training levy - the RHG has consistently failed to explain how he would finance it, whether by taxation or by borrowing, or both.

If he intends to drop any of the pledges, he should say which ones.

I HAVE WAITED FOR MONTHS FOR A CLEAR ANSWER.

SO I ASK HIM AGAIN - OUT OF THE MASSIVE PROGRAMME OF SPENDING PLEDGES, WHICH WOULD HE PROPOSE TO DROP? AND, WILL HE ALSO TELL THE HOUSE HOW HE PROPOSES TO RAISE THE MONEY TO PAY FOR THE REST?.

CONCLUSION

MR SPEAKER, I HAVE, OF NECESSITY RANGED WIDELY IN MY SPEECH, AND I HOPE THIS HAS HELPED THE HOUSE IN ITS CONSIDERATION OF THE AUTUMN STATEMENT.

IN CONCLUSION, LET ME COME BACK TO THE AUTUMN STATEMENT ITSELF.

THE FORECAST IT CONTAINS OFFERS THE PROSPECT OF ANOTHER YEAR OF LOW INFLATION AND STEADY GROWTH.

IT SETS OUT PUBLIC EXPENDITURE PLANS WHICH MAKE INCREASES IN SPENDING IN PRIORITY AREAS, WITHIN A FRAMEWORK IN WHICH PUBLIC EXPENDITURE CONTINUES TO FALL AS A PROPORTION OF NATIONAL OUTPUT.

IT IS THE LATEST STEP IN A FIRM ECONOMIC STRATEGY WHICH HAS BEEN PURSUED CONSISTENTLY SINCE 1979, AND I COMMEND IT TO THE HOUSE.

ps4/12H

PWP

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

The Editor
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House of Commons
LONDON
SW1

18 December 1986

Dear Sir,

CHANCELLOR'S SPEECH IN AUTUMN STATEMENT DEBATE

I should be grateful if you could make the two changes marked below in the Chancellor's Speech in the Autumn Statement Debate, for the bound volume.

Yours sincerely,

Andrew Hudson

A P HUDSON

presentation on an aggregate which includes debt interest I note it now seems to want me to go back to the planning total.

To sum up, as I said in my Lombard Association speech in April,

"The policy we are pursuing today is identifiably the same as that which we embarked on seven years ago. But it has clearly evolved — in terms both of presentation and of substance."

Indeed, it would be extraordinary had it not evolved. Since 1979, there have been enormous changes in world economic conditions, in the position of the United Kingdom, in technology, and in the operation of the financial markets. The Select Committee, the House, and indeed the country would be rightly concerned if Government policy had not evolved in the light of these developments. But to depict this evolution as

"a substantial change of policy"

is absurd.

If the Committee needs to be reminded of what a real shift of policy is, it need look no further than the last Labour Government — pre and post the flight to the International Monetary Fund. Indeed, if ever there was a year in which I might have been expected to change policy, it would have been this year, 1986, with the halving of the oil price. Many people duly advised me to make such a change. I rejected that advice, and maintained the same course, and there has been no crisis. Inflation has fallen to levels not seen for almost 20 years. After a short pause, growth has continued steadily. The number of people in work has continued to rise, and unemployment now looks to be firmly on a downward trend.

The way that both the private sector and the public finances have withstood the fall in the oil price is remarkable. That is the best possible vindication of the economic policy which we have pursued since 1979, a policy which has brought five years of steady growth, low inflation, and a million new jobs since 1983.

For 1987, I foresee a continuation of this pattern, with growth slightly faster than this year, and inflation staying low. The figures that have been released since the autumn statement confirm that picture. Output and exports have both picked up, with industrial production and exports in the three months to October both 1½ per cent. higher than in the previous three months and manufacturing output up 3 per cent. since the beginning of the year. And the latest estimate that the surplus on invisibles was some £750 million a month in the third quarter of this year, with a still larger surplus likely in the fourth quarter, puts into perspective the advice confidently given to the Select Committee by one of its specialist advisers that the earlier projection of £600 million a month was "particularly optimistic".

Seasonally adjusted unemployment fell by 25,000 in October, making a total fall of 56,000 over the last three months, the best performance for 13 years. While the inflation rate did rise last month, chiefly as a result of the rise in the mortgage rate, the underlying inflation rate remained broadly stable.

The outlook for the British economy will, as ever, be critically affected by developments in the wider world economy. One clear danger, which is more acute now following the recent Congressional elections in the United States, is that world trade will become much less free. A retreat into protectionism would be a disastrous step backwards. Following the agreement on a new GATT round, it would be tragic if unilateral action were to undermine this progress. The United States would do well to recognise that multilateral negotiation, and moderation where disputes arise, are in all our interests.

The past year or so has seen substantial changes and discontinuities — the halving of the oil price, sharp falls in other commodity prices, and the major realignment of exchange rates following the Plaza agreement. The world economy is adjusting to all this, with, so far, merely a pause in the growth of world trade. In part at least, this is because the major countries have co-operated in pursuing soundly based policies. The world outlook for 1987, at the present time, like our own, is good; and it is crucial that we do not lose our way through a retreat into protectionism.

1986 has also been a notable year in the annals of the Labour party. It is the year in which it has reassembled carefully all the economic policies that have failed before, and been rejected by the electorate before. It is the year too in which it has broken with the traditions of previous Labour Governments by abandoning the effective defence of this nation. But I had better be careful, because if I am too critical of the right hon. Member for Sparkbrook, he may cancel his reply, just as he refused to speak to the Confederation of British Industry last week because it criticised his policies. We have sought in vain for clarity about how he would run either monetary policy or fiscal policy. Even on public spending, his views are—shall we say — less than entirely clear. Ever since my right hon. Friend the Chief Secretary and I costed Labour's programme at some £28 billion — and that was before we had heard about the £6 billion training levy — the right hon. Gentleman has consistently failed to explain how he would finance it, whether by taxation or by borrowing, or by both. If he intends to drop any of the pledges, he should say very clearly which.

Mr. Alan Howarth (Stratford-on-Avon) *rose*——

Mr. Lawson: I am coming to the end.

I have, of necessity Mr. Speaker, ranged widely in my speech, and I hope that this has helped the House in its consideration of the autumn statement, even though it is clear that the Opposition are not the slightest bit interested in the economy or in the report by the Select Committee.

In conclusion, let me come back to the autumn statement itself. The forecast it contains offers the prospects of another year of low inflation and steady growth. It sets out public expenditure plans which make increases in spending in priority areas, within a framework in which public expenditure in total continues to fall as a proportion of national output. It is the latest step in a firm economic strategy which has been pursued consistently since 1979, and I commend it to the House.

Mr. Alan Howarth On a point of order, Mr. Deputy Speaker. Is it not a gross abuse of the House——

Mr. Michael Forsyth (Stirling): On a point of order, Deputy Speaker. Is it not a gross abuse of the House— *[Laughter.]*

Mr. Deputy Speaker: I shall take the hon. Member for Stirling (Mr. Forsyth).

Mr. Michael Forsyth: I suspect that it may be the same point of order as my hon. Friend the Member for Stratford-on-Avon (Mr. Howarth) was going to make. Is it not a gross abuse of the House that throughout the

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DIRECTOR-GENERAL: R.G. TAYLOR

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Mr Culpin Mr Gilhooly
Mr Cropper Mr Tyrie
Mr Ross Goobey

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

19 December 1986

Dear Chancellor

A recent meeting of the ABCC's Economic and Industrial Committee discussed your Autumn Statement and its accompanying proposals for Government spending, and also the reply from your office, dated 27th November, to my letter of 31st October.

The Committee welcomed the fresh emphasis in the Autumn Statement of the value of specific increases in planned public capital expenditure. The ABCC has consistently given emphasis to investment in housing repairs and maintenance and the increase of £450m next year is most welcome. Subsequently the Housing Minister has made statements on the breakdown of the new spending ensuring that it goes to areas of greatest need, and has also emphasised the importance the Government attaches to reviving the private rented sector. This latter objective is another priority shared by the ABCC and we endorse Mr Patten's statement that "flexible housing provision is central to successful job provision and mobility".

The Committee also welcomed the measures to remedy the relative neglect of local authority roads, with 100 new schemes expected to start next year.

Your letter of 27th November referred to the expected improvement in exports next year and suggested that export order books had already risen sharply. You will be interested, therefore, to know that the businessmen present at our meeting, from a number of business sectors, and representing all the major regions in Great Britain, gave evidence which broadly endorsed the view that between late September, when most of Chambers' third quarter regional business surveys were carried out, and late October there was a significant revival in export orders and business generally. More detailed impressions were given at the meeting as follows: Yorkshire and Humberside, a substantial improvement between mid-September and late October but business continues to be variable; textiles in the North West had picked very recently and there was beginning to be concern about skill shortages; the motor industry in the West Midlands improved substantially; however, engineering remains firmly flat both in Yorkshire and in the West Midlands.

.../...

The Committee believes that the exchange rate is now at the competitive level which the ABCC has long sought: similarly, we would suggest that now would be the appropriate time to implement another longstanding ABCC objective: entry into the ERM of the EMS. My colleagues suggested that there was some evidence that British producers were benefitting from a tendency to substitute for imports, particularly as foreign motor vehicle prices were rising sharply in UK terms. However, those from Greater Manchester and West Yorkshire in particular doubted whether UK exports would rise by 5½% in 1987, as your letter suggested.

Finally, your letter of 27th November contrasts the cost of a rise of one percentage point on pay with that of one percentage point on the cost of borrowing. The Committee believed that, on the whole, manufacturing industry facing fierce competition was paying lower than average pay increases, often accompanied by productivity agreements. Reference was made to the consequences of large increases in London based professional salaries on professional salaries in the provinces. Last and by no means least we must reiterate that the pay increases already agreed for local authority manual workers and now being offered to teachers (however justifiable the latter may be in terms of the whole package) have worrying implications for pay as a whole. So far as interest rates are concerned it remains our major priority to see them reduced: many good investment projects with prospects of a reasonable long term return, which would almost certainly be undertaken in competitor countries like Germany, are stillborn or at the very least delayed in the UK because the returns are uncompetitive because of the cost of financing.

We shall be submitting our Main Representations for the 1987 Budget in mid-January. Meanwhile on behalf of my colleagues may I send you and your Treasury team our best wishes for Christmas and the New Year.

I am sending copies of this letter to the Secretaries of State for Trade and Industry, Employment and Transport, the Chief Secretary, the Paymaster General and the Minister for Housing.

Yours sincerely

R S Burman
Chairman of the Economic and Industrial Committee

FROM: GWYN HACCHE
DATE: 5 January 1987

PRINCIPAL PRIVATE SECRETARY

cc Miss O'Mara

DRAFT REPLY TO ABCC

Attached is a draft reply to Mr Burman's letter of 19 December 1986.

2. We think it best not to enter into further discussion with ABCC (indeed they raise few new points), and so the draft reply is very brief.

3. Mr Burman's letter was copied to a number of Government Ministers. Given the nature of the suggested reply you may consider it sufficient to inform their offices by telephone that we are merely sending an acknowledgement.

Gwyn Hacche
GWYN HACCHE

RC6.37

PWP

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

6 January 1987

R S Burman Esq
Chairman of the Economic and Industrial Committee
Association of British Chambers of Commerce
Sovereign House
212A Shaftesbury Avenue
LONDON
WC2H 8EW

Dear Mr Burman,

The Chancellor has asked me to thank you for your letter of 19 December 1986 and for the welcome you gave to his Autumn Statement of 6 November. He was pleased to note the revival in export orders and business generally to which you draw attention, and looks forward to receiving your Budget representations later this month.

Yours sincerely,

Cathy Ryding

CATHY RYDING
Assistant Private Secretary

~~DRAFT~~ PRIVATE SECRETARY LETTER TO

R S Burman Esq
Chairman of the Economic and Industrial Committee
Association of British Chambers of Commerce
Sovereign House
212A Shaftesbury Avenue
LONDON
WC2H 8EW

The Chancellor has asked me to thank you for your letter of 19 December 1986 and for the welcome you gave to his Autumn Statement of 6 November. He was pleased to note the revival in export orders and business generally to which you draw attention, and looks forward to receiving your Budget representations later this month.

CR.

PWP

1252/22

FROM: A ROSS GOOBEY
DATE: 9 JANUARY 1987

CHIEF SECRETARY

cc Chancellor
Financial Secretary
Economic Secretary
Minister of State
Mr Culpin
Mr Hudson

AUTUMN STATEMENT DEBATE: MR GOULD

I attach a note prepared by Mr Hacche analysing Mr Gould's speech as you requested.

ARG

A ROSS GOOBEY

ENC

pts

UK's relative mfg productivity

record performance

Inflation

Mr Gould stated:

> '... since 1979, our record on inflation has been worse than the average of the leading OECD countries. In 1979, our inflation rate was 117 per cent of the average for the seven OECD countries. Today it is 144 per cent and rising'

Mr Gould's remarks are broadly correct. (In fact, in October UK inflation was more than double the average for the Major 7.) However, he fails to refer to the markedly better relative inflation performance under this Government than under the last Labour Government. A more complete picture is given in the table below.

Year on year inflation rate

	OECD Total	Major 7	EC(12)	UK	Difference UK-OECD (percentage points)	Difference UK-M7 (percentage points)	Difference UK-EC(12) (percentage points)
Feb '74-Apr '79	9.4	8.6	11.0	15.5	6.1	6.9	4.5
May 1979	8.6	9.0	8.8	10.4	1.8	1.4	1.6
May '79-Oct '86	6.8	6.2	8.2	8.2	1.4	2.0	0.0
June '83-Oct '86	3.9	3.5	5.2	4.5	0.6	1.0	-0.7
Oct '86	2.3	1.4	3.0	3.0	0.7	1.6	0.0
	-6.3	-7.6	-5.8	-7.4			

Under the last Labour Government, UK inflation was on average some 7 percentage points higher than for the OECD Major 7 and 4½ points higher than for the EC (although this includes Greece, Spain and Portugal). Under this Government the gap has been 2 percentage points compared with the Major 7, and zero compared with the EC. Indeed since the last election UK inflation has on average been lower than for the EC and only 1 point above the Major 7.

From the point of view of competitiveness, it is these absolute differences in inflation rates that matter rather than the percentage differences to which Mr Gould refers. For example, inflation double that of our competitors is more harmful when UK inflation is 10 per cent and theirs 5 per cent than if ours is 2 per cent and theirs 1 per cent. In any case, the gap in percentage terms between the UK and Major 7 is also much lower under this Government (30 per cent) than under the Labour Government (80 per cent).

Line to take

HG conveniently fails to point out that since 1979, the gap between inflation in the UK and the Major 7 has averaged 2 percentage points compared with 7 under Labour when inflation in this country reached its highest level in living memory.

Manufacturing

Mr Gould made the following references to manufacturing:

> 'As manufacturing output and investment fell and 1.3 million jobs were lost [job loss 1979Q1 to 1981Q4], as the balance of trade deteriorated ...'
>
> '... when manufacturing output is 7 per cent lower than it was in 1979, when hundreds of thousands of jobs are lost and investment is down'
>
> 'Will he nominate those of our main industrial rivals against which we have made up grounds in terms of productivity, efficiency, unit labour costs and competitiveness? I do not dispute that he may be able to find some, but I wonder whether he would find them among the ranks of our important rivals such as Japan, Germany and the United States.'

The figure of 7 per cent for the fall in manufacturing output since 1979 exaggerates the decline, being based on the change since 1979Q2 where the level was artificially high because of the recovery from the winter of discontent. The fall since 1979H1 is 5 per cent.

Mr Gould failed to refer to:

1. The recovery in manufacturing in recent years

   - manufacturing output up over 13 per cent since trough in 1981Q1 and over 10 per cent since June 1983 election
   - manufacturing investment up 30 per cent since 1983 trough
   - manufacturing exports at record levels
   - manufacturing profitability highest since 1973
   - manufacturing productivity growth since 1979 over 3½ per cent a year

2. The fact that manufacturing output and employment fell in all the major European economies in the early 1980s

3. Manufacturing employment also fell under last Labour Government (rate of fall since last election slightly lower than under Labour).

Lines to take

HG challenged me to nominate any of our major competitors against whom our manufacturing industry has made up ground since 1979. I am delighted to do so. Our manufacturing productivity growth since 1979 has been second only to Japan. Over the last 5 years, our exports of manufactures have grown at least as fast in volume terms as those of our major competitors, after years of relative decline. And we are now seeing an improvement in our unit labour cost performance too.

Real interest rates

Mr Gould asked:

'Why do we have record real interest rates - the highest in our history and among the highest in the advanced world - and why are our real interest rates twice as high as those of West Germany?'

Mr Gould fails to note that real interest rates are historically high in all major industrialised countries. He also exaggerates the difference between UK and West German real interest rates. Real interest rates, using current 3 month inter-bank rates and latest (November) consumer prices/RPI, are 7.5 per cent in UK, 6 per cent in Germany.

The Chancellor dealt with Mr Gould's accusation of inconsistency in the generation of monetary policy in his opening speech.

Lines to take

Estimates of real interest rates are inevitably crude. But clear that those in this country are nothing like twice as high as those in Germany. Real interest rates are historically high in all major industrialised countries. Level of real interest rates in UK evidence of Government's determination to take no risks with inflation.

Gwyn Hacche

GYWN HACCHE