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part B

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Begins: 29/11/84
Ends: 3/12/84

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Part. B.

Chancellor's (Lawson) Papers:
Treasury and Civil Service Committee
Enquiry Into The Autumn Statement -

*Stink & Suck.
WR 2 (v)*



FROM: R J BROADBENT
DATE: 29 November 1984

MR SCHOLAR

cc: PPS
PS/FST
PS/MST
PS/EST
Mr Bailey
Mr Battishill
Mr Burgner
Mr I Evans
Mr Jameson
Mr Lovell
Mr Mountfield
Mr Watson
Mr Culpin
Mr Folger
Mr P Gray
Mr M Williams
Mr Cropper
Mr Lord

C
CST knows about the
possibility that
Sir J may be asked
to wind up if there is the
student grant amendment.
But you might mention
this to him yourself like the
messages of prayers.
DJP

AUTUMN STATEMENT DEBATE

The Chief Secretary will wind up the Autumn Statement debate on 6 December.

2 He intends to devote his comments largely to public expenditure. He does not require a speech for this purpose, but he would like a series of short speaking notes dealing with main themes which he can build his remarks around. The themes he would like to focus on are:

- i The importance of controlling public expenditure for achieving the government's overall economic policies;
- ii the process by which expenditure decision are reached (perhaps drawing on paragraphs 24-29 of the Chief Secretary's speech on 26 November to the International Herald Tribune);
- iii the credibility of the 1985-86 totals the light of the forecast overshoot in 1984-85;

iv criticism that the government has only reached its expenditure target by "finding" up to £2 billion, from asset sales (£0.5 billion), council house sales (£0.4 billion), cutting the Reserve (£0.75 billion) and adding ^{back} the NIS adjustment (£0.3 billion). You mentioned that the TCSC had commented particularly on the level of asset sales and a background note setting out the figures and the main arguments would be helpful;

NO

v the suggestion that the fiscal adjustment, as in some past years, may turn out to be greater than is now being estimated;

vi the positive side of public expenditure - that increased efficiency and reduced administrative costs allow more services to be provided by a given amount of expenditure.

3 The Chief Secretary would in addition be grateful for short background notes on a number of topics. I have indicated where I know material already exists and unless there are new points to add I will use that briefing:

i the aid programme;

ii student grants (Mr Faulkner's minute of 28 November);

iii the cost of the miners' stike (Mr Williams' minute of 27 November);

iv regional industrial assistance (the notes attached to Mr Lamont's letter of 28 November);

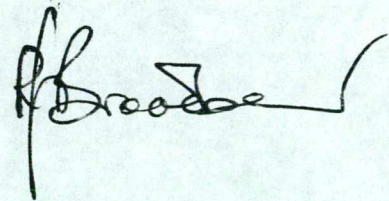
v efficiency in the NHS;

vi facts on the uprating of social security benefits;

vii the balance of capital versus current expenditure
(the attached material prepared for the Chief
Secretary's speech on 21 November,);

viii debt interest.

4 I should be grateful if speaking notes could reach this
office on Monday, 3 December and background notes by Tuesday,
4 December.

A handwritten signature in black ink, appearing to read 'R J Broadbent', with a stylized flourish at the end.

R J BROADBENT
Private Secretary

EXTRACTS FROM A SPEECH BY

THE RT HON PETER REES QC., MP.,

AT THE NINTH MEETING OF THE NATIONAL UNION INDUSTRY AND TRADE FORUM:
WEDNESDAY 21 NOVEMBER 1984

PUBLIC INVESTMENT: THE FACTS

"The Subject of public investment seems to come for many people under the heading "This is a Good Thing". Images are conjured up of the fabric of the nation rotting away".

"The Government is indeed determined to control public spending. That is my job. The Autumn Statement, published last week, showed that for the third year running the public expenditure total has been held to the level set in earlier plans."

"Within this total, there is no "right" level of public capital spending. Just as in the private sector, each capital proposal must be justified on its merits - its rate of return".

"What does this approach mean in practice? The facts are these. Aggregate capital spending by the public sector has been maintained broadly in real terms at the level of 1978-79. In 1984-85 it is planned to be £24 billion - about one-fifth of the expenditure total:

"This is not the whole story. The Government believes in reducing the role of the public sector. Through privatisation, for example, it has taken major steps in this direction. The position in the whole economy, public and private, is important."

"For the economy as a whole, these are the facts. Fixed investment in 1984 and in 1985 is expected to reach post-war record levels."

"Construction output is estimated to have risen 5½ per cent in the first six months of this year compared to the same period a year earlier."

"Investment in private dwellings in the first half of this year was running at a record level, more than 8 per cent up on the first half of 1983."

"Manufacturing investment is estimated to have been up nearly 15 per cent in the first 9 months of 1984 compared with the same period a year ago."

"Investment in construction and services was up 12½ per cent over the same period."

"This is where the real answer to unemployment lies - a more vigorous and enterprising economy, competitive and able to sustain real jobs."

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FROM: A M W BATTISHILL
 DATE: 29 November 1984



MR SCHOLAR

cc Chancellor of the Exchequer
 Chief Secretary
 Sir Peter Middleton
 Sir Terence Burns
 Mr Bailey
 Mr Cassell
 Mr Burgner
 Mr H P Evans
 Mr Culpin
 Mr Folger
 Mr Pratt

TCSC: AUTUMN STATEMENT ENQUIRY

As I told you, I spoke this morning to the Clerk to the TCSC about outstanding business and the Committee's programme for producing their report on the Autumn Statement.

2. The Clerk was very anxious to get from us as quickly as possible the second of the two notes mentioned in his letter to me of 27 November, dealing with the costs of the coal strike. Once the Chancellor has approved it I will arrange to get the note by hand to the Committee.

*Amendments
 passed to
 officials 29/11*

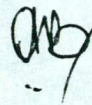
3. However, following Mr Pratt's conversation with the Assistant Clerk yesterday, the Committee are not now looking for any further comment from us on Mr Terry Ward's paper. They have decided to publish it along with the evidence in a modified form. The Clerk has promised to send me a copy later today. Also to be published will be notes by Mr Bill Robinson and by Phillips & Drew. Again, copies are promised.

4. The Clerks want to see the transcript of yesterday's hearing before deciding whether further notes are needed from us.

5. The remainder of the Committee's timetable looks like this. The Clerks are now working on a draft report which they hope to clear with Mr Higgins on Sunday so that it can be put before the Committee for agreement at their meeting on Monday afternoon. It would then go to the printers on Tuesday, so that it can be published in time for a debate

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with revised
on Thursday. If, for any reason, the debate were to be advanced to Wednesday the House would have to be content with roneoed copies. On this basis, I hope we may be able to see a copy of the Committee's draft report sometime on Monday morning - giving us, if we wish, a few hours in which to take up any points informally with the Clerk before the Committee meet. I can then speak to him again the following morning to see what changes the Committee have made.



A M W BATTISHILL

CONFIDENTIAL



FROM: MISS M O'MARA
 DATE: 29 November 1984

MR M L WILLIAMS

cc PS/Chief Secretary
 Sir P Middleton
 Mr Bailey
 Mr Monck
 Mr Anson
 Mr Cassell
 Mr Battishill
 Mr Scholar
 Mr Watson
 Mr Gilmore
 Mr Jameson
 Mr Burgner
 Mr Fitchew
 Mr H Evans
 Miss Peirson
 Mr Stibbard
 Mr Robson

TCSC: 1984-85 OUTTURN

The Chancellor has seen the draft note attached to your minute of 28 November. As I have told you, he is content that it should be sent to the Committee subject to the following amendments:

Paragraph 1, line 7: substitute "excess" for "overrun".

Paragraph 6,(1): insert "current expenditure" after ".... budgeting to overspend".

Paragraph 6 (5): delete "somewhat" from line 3.

2. The Chancellor sees no need to clear this note with Mr Walker.

MOM

MISS M O'MARA

MR SCHOLAR

FROM: R PRATT
DATE: 30 NOVEMBER 1984

cc PS/Chancellor
PS/Chief Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Cassell
Mr Burgner
Mr Battishill
Mr H P Evans
Mr Culpin
Mr Folger

TCSC: AUTUMN STATEMENT ENQUIRY

I attach copies of notes provided to the TCSC by Mr Bill Robinson and by Phillips & Drew, as trailed in Mr Battishill's minute of 29 November to you.

Richard Pratt

R PRATT

**
These are the ones
from the 15 Feb 84 memo
Catt's report, & will
be included in
the 10 Feb 84
memo.*

c Chancellor
Chief Secretary
P. J. Venter Middleton
P. C. Terence Burns
Mr Banks

TR 62
Mr Cassel
Mr Burgess
Mr Schiller
Mr Evans

Mr Colpin
Mr Folger

The Autumn Statement

Memorandum by Bill Robinson, Specialist Adviser to the Committee

The economic environment has worsened since the Budget. The miners' strike has reduced growth. Interest rates are higher and the exchange rate lower than seemed probable at Budget time. Yet the Chancellor has announced that there will still be scope for tax cuts in 1985-6 (though £4bn less than in the Budget projections). Is this optimism justified?

On the expenditure side the government has succeeded in holding the 1985-6 spending plans inside the Planning Total. This has been done less by cutting spending than by raising charges, by 'finding' more asset sales (including council houses) and by reducing the contingency reserve.

Public Expenditure Plans : changes (£m) from White Paper
(Cmd 9143)

Departmental spending	+770
Nationalised industries	+180
Local authorities	+200
Special Asset Sales	-500
Contingency reserve	-750
Total	-100

The spending estimates are arguably on the low side. Departmental figures depend on the assumption of 3 per cent increases in rates of pay and allowances (not the total wage bill). This contrasts with the latest data on manufacturing, where pay increases are running at 9 per cent. The Nationalised Industries figure includes a provisional estimate of the National Coal Board external financing limit of £723m (the pre-strike estimate for 1984-5 was £1103m).

Although the Planning Total has been adhered to, the Treasury is admitting that General Government expenditure in national accounts terms could be some £2bn or more above the estimate made at Budget time :

	1983-4	1984-5	1985-6
General Government Expenditure in national accounts terms			
Budget Statement	139	146	152
Autumn Statement	139½	148½	154

The changes are due to higher interest payments (interest rates and borrowing are both higher than seemed probable at Budget time) and to a higher National Accounts adjustment. (We might ask officials to confirm that this reflects the Departmental overspending, which is offset in the Planning Total but not in the National Accounts Total, by asset sales).

This increase in spending is balanced by a similar increase in receipts, mostly from North Sea revenue.

	1983-4	1984-5	1985-6
General Government receipts			
Budget Statement	128½	138½	146½
Autumn Statement	129½	140	148½
of which North Sea revenues			
Budget Statement	9	10	9½
Autumn Statement	9	12	12

The sterling dollar exchange rate has fallen from 1.49 at end February to around 1.25, and this easily explains the extra revenue. The crucial assumption made by the Treasury is that "... the sterling index in 1985 will not change much from the current level". Compared with Budget projections this produces a gain of £2½bn in North Sea revenues, which covers the overspending and leaves the 1985-6 fiscal adjustment largely intact.

To complete the story, the Treasury assumes that the fiscal adjustment is made, and with this extra fiscal stimulus they are forecasting higher consumer spending, and higher GDP growth than in the most recent LBS forecast. The table below contrasts the two forecasts.

	1983 to 1984	1984 to 1985
Output and expenditure at constant 1980 prices		
Gross domestic product (factor cost)		
HMT	2½	3½
LBS	2.3	3.1
Consumer spending		
HMT	2	3
LBS	1.8	2.2
General government current spending		
HMT	1½	1
LBS	1.0	0.7
Fixed investment		
HMT	7½	3
LBS	8.8	2.8
Exports		
HMT	5½	4½
LBS	5.5	6.5
Changes in rate of stockbuilding as a percentage & level of GDP		
HMT	- ½	+ ½
LBS	-0.6	+0.7
Imports		
HMT	7½	4
LBS	7.2	6.5
	1984	1985
Balance of payments on current account (£bn)		
HMT	0	2½
LBS	-0.1	0.6
Retail prices index (4th quarter)		
HMT	4¾	4½
LBS	4.6	4.2

Assessment

The economic forecasts underpinning the Autumn Statement are internally consistent, but (like all forecasts) depend crucially on a number of questionable assumptions. The £1½bn available for tax cuts in 1985-6 could quickly disappear if

- 1) The exchange rate recovers (as LBS forecast it will)
- 2) The coal strike drags on into 1985 (the costs to the NCB are in any case likely to be higher than currently assumed)
- 3) Public sector wages start to move more closely in line with manufacturing wages.

As regards (1), it is worth noting that the Treasury assume a lower exchange than the LBS forecast despite a much stronger current account. If the exchange rate rises but tax cuts are enacted nevertheless, the short-term prospects for output and inflation are fairly encouraging, but the resulting PSBR overshoot could store up trouble for the future.

Phillips & Drew

ECONOMICS UNIT

TR 64

-1-

20 November 1984

The Autumn Statement

An assessment for the House of Commons Select Committee on the Treasury and Civil Service by Dr Paul Neild, Phillips & Drew, Specialist Advisor to the Committee

There is one outstanding feature of the Autumn Statement which has so far not been extensively commented upon in the press. Yet we regard it as highly enlightening for the proper interpretation of fiscal policy, its present relationship with monetary policy and with the real wage/unemployment debate. It is not one of the following, all of which have appeared

repeatedly elsewhere:

- (a) Planned public sector spending on programmes in 1985/86 has been raised by some £1.5bn as compared with the White Paper (Cmd 9143) after the Budget changes.
- (b) This has effectively been obtained through a £750m reduction in the contingency reserve from £3.75bn to £3bn, a £500m increase in the expected proceeds of special asset sales from £2bn to £2.5bn and a £300m increase in the planning total, from £131.7bn to £132bn.
- (c) Within the changes in programmes, it is interesting that the expected proceeds of council house sales have been increased by perhaps £400m.
- (d) Public sector pay and allowances are assumed to increase on average by 3% from due settlement dates. No doubt the use of this optimistic assumption will serve in the outturn to deplete the £3bn contingency reserve for 1985/86.
- (e) The Treasury economic forecasts are notable for their generally unexceptionable content. As regards both growth and inflation they are slightly more optimistic than our own, but well within the boundaries of normal forecasting error. The Treasury foresees real GDP growth of 3.5% in calendar 1985 against our 3%, while they have retail prices rising 4.5% in the 12 months to the fourth quarter of 1985 against our 5-5.5%. Both sets of forecasts make the formal assumption of an effective end to the miners' dispute at the close of this year.

PAUL NEILD DAVID ROBINS BRENDAN BROWN TIM O'DELL
STEPHEN LEWIS CHRIS ANTHONY BILL MARTIN JOHN SILLS

Rather, the really important feature to our mind is the upward revision in North Sea oil revenues in sterling terms, much of which, on our calculations, has resulted from the fall of the pound against the US dollar since the beginning of this year. The oil revenue figure for 1985/86 has been revised up from £9.5bn in the March Budget to £12bn in the Autumn Statement. This revision is the most important single item which allows the Chancellor to assume scope for a £1.5bn positive fiscal adjustment (tax relief) in the 1985 Budget, yet stay within the MTFs guidelines laid down in the 1984 Budget. Just think what would have happened to the Chancellor's calculations if sterling had not fallen in the first place. Without the pound's fall against the US dollar, the whole of the assumed scope for tax relief would have been wiped out.

Let us consider its implications further for a moment. What we are saying here is that the Chancellor is supposedly willing to give away in tax relief, which represents a continuous revenue loss to the Exchequer, a sum of money which derives from a perhaps temporary fall in the value of our currency relative to the US dollar. Is this prudent conduct of fiscal policy? It is all the more questionable in the light of the Treasury's comments in para 1.11 (page 4) of the Autumn Statement, which describes the prospects for the United States economy:

".....It is assumed that the (US) deficits continue to be funded without any major break in confidence. Although the US policy imbalance is unsustainable, it is difficult to foresee when or how it will be resolved." (author's emphasis added.)

It is an understatement to say that, in the light of this paragraph, the Treasury appears somewhat perturbed about the future course of the US economy and its currency. Is it wise therefore to build practically the whole of sterling's fall against the US dollar into the Autumn Statement figures?

Presumably, taking this argument further, the more sterling fell, the more the Chancellor would be willing to give away in tax relief and to spend. In other words, if the pound falls he can and will cut taxes. How does this square with the Chancellor's posture that he is a defender of "sound money"? It does not. Instead, we have the paradox of a "sound money" Chancellor whose Autumn Statement calculations rest on the currency staying weak against

the US dollar. The argument may be put forward that all the Chancellor is doing through this mechanism is redistributing the burden from direct to indirect taxation. A rise in sterling oil prices would effectively represent higher indirect taxation of the consumer, who should therefore be compensated by returning the proceeds of higher oil taxes in the form of lower taxes on income. This is all very well, but the Autumn Statement figures carry with them the danger that fiscal policy will be as volatile as the exchange rate. It might well be more prudent to set aside at least a significant part of the windfall benefit to oil revenues in a separate account to guard against the possibility of a major rebound in sterling against the US dollar.

As it is, the action the Chancellor apparently proposes is almost exactly contrary to that seen in the days before North Sea oil came on stream. When the pound fell in the seventies we had tax hikes and spending cuts. The Chancellor now responds in entirely the opposite way. Indeed, the crucial question to ask now is: if the pound rises against the US dollar in the next few months, will the Chancellor increase taxes in the Budget? This may be an entirely logical way of proceeding under conditions of North Sea oil but it is as well to bring it out into the open and to highlight the fragile base on which the Autumn Statement figures rest.

Clearly, in order to safeguard his positive fiscal adjustment as much as possible, it would be to the Chancellor's advantage to minimise any sterling rebound against the US dollar between now and Budget time. This is where the Autumn Statement properly fits in with the present conduct of monetary policy. We paraphrase current monetary policy by saying that the Chancellor's objective is to "lower interest rates to the limits of sterling's resilience". Such a course would indeed help him to achieve some of the Autumn Statement figures while simultaneously promoting higher economic activity and lower unemployment than otherwise. There have been several occasions through this year where the Chancellor's attitude to interest rates has been consistent with this approach. Lower interest rates would constrain sterling's rebound.

Finally, the real wage/unemployment debate can be made to fit neatly into this fiscal/monetary policy mix. In the long run, it is argued that lower real wages will stimulate employment. Given overseas conditions and abstracting from productivity considerations, lower real wages imply wage growth below the

rate of domestic price increases. For this to persist over time, it probably means that pay settlements perennially fail fully to reflect that part of domestic inflation which emanates from a decline of the currency. This would have the effect of reducing that proportion of domestic inflation which resulted from movements in labour costs. The movement of relative labour costs provides one measure of competitiveness while an improvement in competitiveness is another way of saying that the real exchange rate has fallen. Hence, in these circumstances a lower nominal exchange rate would lead to a lower real exchange rate and would be one mechanism for reducing real wages in the long run. This lower real wage profile, partly induced by a fall in the currency, would in turn help employment, or so it is argued. However, this fortunate sequence of events could only be expected to occur under certain conditions. Several conditions might be described in which pay settlements would perennially fail fully to "knock-on" that part of domestic inflation resulting from lower sterling. One might be where the monopolistic power of trade unions remained weak. Another might be where the deterrent effect of unemployment remained high.

If such conditions existed, as they might exist at present, it would be an entirely sensible approach to design fiscal and monetary policy within the context of a weaker currency. However, whether one builds the whole of the present weakness into one's Autumn Statement calculations is quite another matter. It is incautious to say the least.

19



FROM: MISS O'MARA
DATE: 30 NOVEMBER 1984

MR PRATT

cc Sir P Middleton
Mr Bailey *Sir T Burns*
Mr Scholar
Mr Battishill
Mr Evans

TCSC: AUTUMN STATEMENT ENQUIRY

The Chancellor has seen the note by Sir Terence Burns attached to your minute of 30 November. He is content that this should be sent to the Committee.

MOM

MISS O'MARA

C. Needs your approval today, since Clerks are preparing their Report over the weekend. Sir Peter has not seen yet, but will forward any comments he has.

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ppp.

Minute on Monday

FROM: R PRATT
DATE: 30 NOVEMBER 1984

- Pwo 30/11
1. SIR PETER MIDDLETON
 2. CHANCELLOR OF THE EXCHEQUER

cc Mr Bailey
Mr Scholar
Mr Battishill
Mr Evans

TCSC: AUTUMN STATEMENT ENQUIRY

I attach a note, prepared by Sir Terence Burns, showing how the housing components of the RPI forecast given in Table 1.3 of the Autumn Statement can be reconciled with the projections of debt interest.

2. This note was requested by the Committee on Wednesday 28 November.
3. The Committee Clerks have asked us to let them have this note by this evening (Friday 30 November) if at all possible.

Note on M.

Richard Pratt

R PRATT

The RPI forecast given in table 1.3 of the Autumn Statement showed a projected rise in the housing component of the index of 10 1/2 per cent in the year to the fourth quarter of 1984. This is mainly due to the behaviour of the mortgage rate. Its average value for the fourth quarter of 1984 is likely to be about 12 1/2 per cent compared to 11 1/4 per cent in the fourth quarter of 1983. In the 1984 FSBR, the figure for the housing component given for the same period was 7 per cent. This upward revision in the Autumn Statement largely reflects the rise in mortgage interest rates in August 1984.

A reduction in mortgage interest rates has recently been indicated by the Building Societies Association, and this reduction will start to take effect from the beginning of December. Even if mortgage interest rates were to fall no further during the financial year 1985-86, they would still be exerting a downward influence on the annual rise of the housing component of the RPI to the fourth quarter of 1985. This is because the December 1984 cut in mortgage rate affects only one month of the fourth quarter of 1984.

The figures for debt interest payments for 1984-85 and 1985-86 shown in Table 1.7 of the Autumn Statement have been revised upwards. This is largely because the assumption for the average level of interest rates is higher than in the 1984 FSBR. The figure shown for 1985-86 is £1/2bn higher than the expected outturn for 1984-85. This is consistent with a lower average level of interest rates in 1985-86 than in 1984-85. The £1/2bn increase in the level of debt interest payments is expected to be more than accounted for by the higher level of public sector debt outstanding.

(Mr Lawson) Yes.

398. You have said that with the benefit of rate-capping and the other factors you talked about - falling school rolls - when we look at the Autumn Statement next year we will not be looking at slippage, we will not be looking at ----

(Mr Lawson) ---- a further increase in provision, yes.

399. We should believe these figures?

(Mr Lawson) Yes. The increase in provision here has something of a special nature about it in order to adjust both to the new framework and also to the experience of the past.

Mr Wainwright

400. Chancellor, my question relates to page 9 of your Statement, paragraph 1.32 and table 1.3 on retail prices. You say in paragraph 1.32 that "The annual increase in the RPI may stay near to its recent rate of around $4\frac{3}{4}$ per cent through the first half of 1985 before falling in the fourth quarter." If we may then turn to the table below, 1.3, and the final two columns where you have set alongside each other the forecast for the last quarter of this current year and the forecast for the last quarter of 1985, if we go through the categories, the RPI food forecast for the last quarter of 1985 is not falling, it is in fact for a higher figure than the forecast increase for the present year. The same is true of nationalised industries; in fact, there is a rather larger rise of annual rate of inflation forecast for the end of 1985. Then if we drop to the bottom of the table, to other items, again there is a rise. So it is clear from the figures that the whole of the expected drop in the fourth quarter arises from your estimate of the very steep drop in the annual rate of inflation on housing. Could I ask, first of all,

if that is, as you hint in your paragraph, almost entirely due to your estimate of what mortgage rates will be in the last quarter of 1985?

(Mr Lawson) That is certainly a major element in it, yes.

401. If you are anticipating no increase whatever in the mortgage rates from now, how does that square with your estimates in other public spending parts of the Autumn Statement of a very substantial increase in the cost of interest on public debt?

(Mr Lawson) That is quite a different matter.

402. They are both interest rates, Channellor.

(Mr Lawson) We did have an exchange, I remember, across the floor of the House, Mr Wainwright, on this very point.

403. But I had not then the advantage of this very interesting table of yours.

(Mr Lawson) No, but you had the advantage of my answer, which really dealt with the matter! I think I have got it here. What has happened is that interest rates have gone higher this year and particularly interest rates generally are higher this year than we had expected. We also now think they will be higher next year than we previously expected, so that goes up and the debt interest burden goes up as a result. Starting from where we are now, however, we expected interest rates to be coming down. Is that clear? Because you see they have already gone up this year.

Mr Wainwright: Yes.

Chairman

404. Is there not an apparent inconsistency between the assumption you are making in the section on the mortgage/housing side, and the assumption you are making elsewhere in your Statement?

(Mr Lawson) No, I do not see it. What is the inconsistency?

Chairman: The reason Mr Wainwright mentioned. We may well be wrong, but it seems to us there was some inconsistency.

Mr Wainwright

405. There does seem to me to be an enormous drop - your forecast goes from a $10\frac{1}{2}$ per cent. annual rate of increase in this current quarter of this present year down to a mere 4 per cent. annual rate of increase next year, and I still find it difficult to reconcile that.

(Mr Lawson) Well, the RPI changes depending on which months - the mortgage impact on RPI changes can be very considerable. This is not the only factor but perhaps if you would like to go into details I am sure Sir Terence would be happy to enlighten you.

406. It would be helpful.

(Sir Terence Burns) I think the difficulty you are having in seeing the consistency of these figures is partly because of the way in which the mortgage rate affects the RPI. The fact that we have the $10\frac{1}{2}$ per cent. figure in the fourth quarter of 1984 reflects the relative position of the mortgage rate in the fourth quarter of 1984 relative to the fourth quarter of 1983. The figure for the 1985 fourth quarter reflects the expected level of the mortgage rate in the fourth quarter of 1985 relative to the fourth quarter of 1984. The fact that the "4" is a good deal less than the " $10\frac{1}{2}$ " has got much to do with the extent to which the mortgage rate in the fourth quarter of this year is higher than it was in the fourth quarter of 1983, and you cannot deduce from that any inconsistency with the levels of debt interest payments. I can assure you that they are totally consistent.

407. Well, it would be very interesting, without doubting your

assurance, if we could have the break down of the figures, so that there is something rather more concrete to go on.

(Mr Lawson) You would like a note on this point, would you?

408. Yes.

(Mr Lawson) We will let you have a note on this point.

(Sir Terence Burns) Also can I emphasise of course, ~~that as~~ we were discussing when I was here on Monday, the comparison you were making ^{is} between the expectations at the time of the Budget and the expectations now. That does not tell us anything about the level in 1985-86 compared to the level in 1984-85. The Chancellor has suggested the numbers here are quite consistent with a low ^{er} level of interest rates in 1985-86 than ⁱⁿ with 1984-85.

409. At the very least then are we entitled to derive from these figures that you are assuming that there is to be no rise in the mortgage rate at all from now to and including the last quarter of 1985? There must have been an assumption made.

(Mr Lawson) That is right.

(Sir Terence Burns) Yes. We are not expecting the mortgage rate in the fourth quarter of 1985 to be higher than the average in the fourth quarter of 1984. In fact we would expect it to be lower.

Chairman: Thank you. I think it would be helpful if we could have a note on that particular point.

Mr Wainwright

410. During a recent debate on the floor of the House on unemployment you gave the House the very interesting and useful calculation that no doubt in approximate terms the 1 per cent. reduction in real wages would tend to raise employment by about 200,000. Because nobody questioned you at the time, can I ask you now whether you were speaking of 200,000

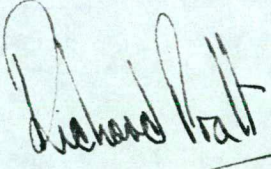
FROM: R PRATT
DATE: 30 NOVEMBER 1984

MR PERETZ
SIR PETER MIDDLETON
SIR TERENCE BURNS
MR SCHOLAR

TCSC: AUTUMN STATEMENT ENQUIRY

I attach copies of the transcript of the evidence given on Wednesday 28 November. We are invited to make any necessary corrections and return the transcript to the Clerk by Monday 3 December.

2. May I suggest that you make any necessary corrections on your copy and return them to me. I will then send a consolidated corrected copy back to the Clerk.


R PRATT

C
I've taken a copy to check through
over the w/e.
DLP



COMMITTEE OFFICE
HOUSE OF COMMONS
LONDON SW1A 0AA
01-219 5769 (Direct Line)
01-219 3000 (Switchboard)

TREASURY AND CIVIL SERVICE COMMITTEE

30th November 1984

Dear Mr Lawson,

I enclose a transcript of the evidence given by you to the Committee. I should be grateful if you would examine this and make in ink, in your own handwriting, such alterations as are:

- i) restricted to the correction of inaccuracies in the reporting of the evidence; or
- ii) restricted to the correction of matters of fact which do not materially alter the general sense of any answer.

Minor alterations to the style or grammar of any answer should not be made.

You should not alter any question, and if you wish to explain or give any additional information, you may either submit a footnote to your evidence at the appropriate point, or submit a memorandum.

I should be grateful further if you would return the corrected copy to reach me as early as possible on Monday 3rd December. If special circumstances make this impossible, please let me know, but if I do not hear from you to that effect, and do not receive the corrected transcript on that date, the evidence will be published in its original form.

Although your evidence was taken in public, you should not make any public reference to this transcript without indicating clearly that it is an uncorrected document, and that the final form of its publication has not yet been approved by the Committee.

Yours sincerely,

S.D. Barrett

Assistant to the Clerk to the Committee

Enc.

HOUSE OF COMMONS
MINUTES OF EVIDENCE
TAKEN BEFORE
TREASURY AND CIVIL SERVICE COMMITTEE
WEDNESDAY 23 NOVEMBER 1984

RE HON NIGEL LAWSON, MP, SIR PETER MIDDLETON, KCB,
SIR TERENCE BURNS and MR M.C. SCHOLAR

Evidence heard in Public

Questions 308 - 433

MEMBERS' CORRECTIONS

Any Member of the Committee who wishes to correct the Questions addressed by him to a Witness is asked to send the correction to the Committee Clerk as soon as possible.

Members receiving these Minutes of Evidence are asked to ensure that the Minutes are confined to the object for which they are printed the special use of the Members of the Committee - and are not given wider circulation.

WEDNESDAY 28 NOVEMBER 1984

Members present:

Mr Terence L. Higgins, in the Chair
Mr Nicholas Budgen
Mr Mark Fisher
Mr Roger Freeman
Mr Ralph Howell
Mr Richard Wainwright

THE RT HON NIGEL LAWSON, a Member of the House, Chancellor of the Exchequer, examined. SIR PETER MIDDLETON, KCB, Permanent Secretary, SIR TERENCE BURNS, Chief Economic Adviser, and MR M.C. SCHOLAR, Under Secretary, General Expenditure Policy Group, H.M. Treasury, called in and examined.

Chairman

308. Mr Chancellor of the Exchequer, we are most grateful to you and your officials for coming before the Committee again on what has now become a traditional occasion following your Autumn Statement on the economy. We are particularly glad to see also on your right Sir Peter Middleton and on your left Sir Terence Burns and Mr Scholar. Sir Terence and Mr Scholar have already been helpful to us in giving evidence last Monday, as indeed were some of your other officials the Monday before. I should explain one or two of my colleagues are particularly concerned about constituency matters arising on the statement on the floor of the House going on at the same time. I am assured that reinforcements will arrive shortly. May we ask you first of all if there are any particular opening remarks you would like to make before we begin the questioning itself?

(Mr Lawson) Mr Chairman, thank you very much. I am sure those who are at the table are well able to keep their end up without

the need for reinforcements, whether they arrive or not. You kindly invited me to make a few opening remarks. If I may make some remarks of a general scene-setting nature, the Committee has already studied our revised expenditure plans for 1985-86 outlined in the Autumn Statement. The results of this year's Public Expenditure Survey, which are summarised in just five pages of the Statement, represent the outcome of the usual detailed review of all programmes. I think it is interesting to note that since 1979 the Government has brought about a substantial reordering of priorities within public expenditure programmes and this year's review has been no exception to that. As indicated in the Statement, we now expect the public expenditure in 1984-85 to be some $\text{£}1\frac{1}{2}$ billion above the planned level and this has led us in the review of the provision for 1985-86 to pay even greater regard to the realism of the plans and to the adequacy of the Reserve provision.

Of course, no one can be sure what will be needed to cover unforeseen developments, but we have taken a number of steps to ensure the realism of the 1985-86 figures to the best of our ability. On local authority expenditure we have increased provision by nearly $\text{£}1$ billion and matched this by much tougher penalties for over-spending and, of course, the introduction of rate capping. The calculation of our European Community contributions - another item which has caused problems in the past - is now much more securely based following the Fontainebleau settlement. Even after the normal annual process of reducing the Reserve for the year ahead as the plans are firmed up, we have provided for a figure of $\text{£}3$ billion, which is $\text{£}\frac{1}{2}$ billion more than the provision for 1984-85 in the last White Paper.

All these adjustments, both up and down, have once again been carried out within an unchanged public expenditure planning total.

In real terms this is the same level as that planned for 1984-85, but, of course, as I indicated, this year we shall be overrunning and, therefore, it is below the expected outturn for this year, implying a further reduction in the ratio of public expenditure to GDP.

As last year, the Autumn Statement brings together a number of announcements which fall to be made at this time of year. In particular it allows the public expenditure plans for the year ahead to be set in the context of a fresh economic forecast. It is not an occasion - although some might wish it were - for a general restatement of updating of economic strategy which is primarily a matter for the Budget. But I would emphasise the overall objectives and strategy remain unchanged, and those objectives are to continue to bring down inflation and to create the conditions that will enable progress to be made in bringing down unemployment.

We continue to make better progress on inflation than most commentators have expected and I would expect this downward pressure to continue over the next year. Although our forecasters are not expecting much of a change in the inflation rate over the coming twelve months, this would still mean a significant period when inflation has been below 5 percent; and because expectations are now, after a lag, adjusting to this lower rate, it should provide the basis for the further downward movement of inflation that policy is designed to achieve.

The framework of policy remains as set out in the MIFS with target ranges for both Sterling M3 and M0 and an illustrative path for the PSBR. So far this year both monetary aggregates are within the target range and, although the PSBR is now expected to be above the level planned as the time of budget, it will still represent

the lowest proportion of GDP for well over a decade. Many commentators continue to refer to the years since 1981 as a period of weak recovery. But a closer examination of the figures shows that the pace of recovery of output has been far from weak. If we are right about the rate of growth for 1985 then the growth of output over the four years cumulatively will have been almost 12 percent. This is very respectable by past standards in this country. It more than matches the growth of output during the previous recovery period 1975-79. On the basis of annual data the highest four year growth period since the war was 1962-66 when 15 percent growth over that four-year period was registered. The only four-year period since then, since 1966, which has seen growth clearly faster than 12 percent was the period 1969-73.

Unfortunately growth during the present recovery period has still not been fast enough to bring down unemployment and during the recovery period unemployment has tended to turn out higher than we assumed or expected. It is important to recognise the reasons, I think, why unemployment has turned out higher than expected.

The first reason for this is on average the growth of output has been matched by equivalent growth in productivity. That is to say, productivity growth has been faster than we expected, particularly after the disappointing productivity performance of the 1970s. The second reason for the continued rise of unemployment is that the labour force has grown more than we expected - that is, the total labour force. This has particularly been the case for women enjoying part-time employment. This is a trend we have seen for many years, but it has continued at a more rapid pace than we expected during the period of recovery.

Finally, of course, I have argued on a number of occasions that the level of unemployment would have been improved if real wages had grown at a less rapid pace. I hope to publish some further analysis of this important topic in the not too distant future.

~~Chairman:~~ Thank you very much indeed for the opening statement. There are, I think, a number of points in it we would wish to pursue in questions later. We thought we might slightly vary the procedure we adopted recently and will in fact call colleagues round the table starting on my right - your left - with no political implication at all since we are an all-party group and the seating arrangements are quite accidental. I call first Mr Freeman.

Mr Freeman

309. I hasten to assure you I am not sitting on your left, although on your left! I have three questions on spending priorities and the decision-making process. My first question relates to the sequence of expenditure plans and then tax plans. Our understanding is that you believe that expenditure should be determined, or rather that the available finance in the economy should be determining the level of public expenditure. I think you have said that to the Committee several times before. But the sequence appears to be a fixing by the Cabinet of the total level of planned expenditure for a forthcoming year in the summer and then, through a series of bilateral negotiations, fixing of expenditure for changes in expenditure by department heads during the course of the summer and autumn.

So in reality it seems that expenditure is determined before tax revenue is determined. Would it not be more appropriate and more in keeping with your earlier statement, earlier belief, to start from the basis of a medium term tax band and then fit expenditure programmes into that?

(Mr Lawson) In a sense that is what we do do, Mr Freeman. I think that your account of the sequence is absolutely correct, except that you missed the first stage. The first stage is the Government's strategy which was set out implicitly in the Green Paper that we published at the time of the Budget. This stated a clear intention of bringing ~~the rate of~~ the burden of taxation down, and specifically bringing non-North Sea taxation down. It went then, from the taxation, to what level of public expenditure, given our policy on bringing the borrowing requirement down, was consistent with that. We took the view that it was really necessary, for two alternative periods but certainly for the medium period ahead (the period of the current Medium Term Financial Strategy), that public expenditure should remain constant in real terms. That was, as it were, our revenue and our taxation plan determining the level of expenditure. Then, having got the level of expenditure, we had to decide what that meant in cash terms, because it is all cash planning, if you are going to get a flat line in real terms. That gives you an envelope, a cash envelope, for public expenditure which we then seek to apportion among the various programmes, and so on, in the way that you describe. Then finally, at the end of the day there does come the Budget, of course, which is primarily a matter of taxation, but the first stage is the medium term tax objective, which determines what we think is the public expenditure we can afford.

310. So you are saying available finance does determine expenditure?

(Mr Lawson) That is right.

311. Because you have decided to reduce the threshold, reduce the burden of taxation?

(Mr Lawson) That is right, and that has implications for the rate of growth, which is zero growth in real terms, of public expenditure which we are prepared to accept.

312. Can I move onto my second question which concerns how you make decisions in Government about various priorities within public expenditure. Could you tell us what the machinery first of all available to Government is for comparing the relative priorities of expenditure under different departmental heads, and also tell us where those decisions are taken? Are they taken in the Treasury? Are they taken in the Cabinet? And if they are taken by Ministers, in the Cabinet, the central focus of political decision making, who is providing the support? Who is providing the analysis so that Ministers can make judgments about the relative priority of different heads of expenditure?

(Mr Lawson) I do not think that the procedure can be as scientific as you imply. I do not know how you determine the priorities in your own personal expenditure. I would be interested to learn. I suspect that when it comes down to it it is by the same sort of process that the Government determines its priorities. It is not a very scientific business, but nevertheless it is a matter to which you give a great deal of thought, as we do. It occurs in a number of ways during the year, and in a number of places. The Treasury will have views; departments will have views; they have views about expenditure within their own particular departmental budget. There are matters that are decided in Cabinet Committees. There is the series of

bilaterals at which the Treasury is certainly able to assess the strength of various different cases put forward for various different items of expenditure. There is the Star Chamber too, at which the Ministers will hear a number of cases made by different Ministers for different forms of expenditure, and are able to assess the relative merits of each. There are the Government's declared policies, obviously, which guide everything. There are constraints which, within the real world, often have more bearing on the actual pattern of expenditure than some abstract sense of priorities. These constraints can be very considerable. Then, at the end of the day, there is Cabinet. There is the right of any Minister, obviously, to take any issue to Cabinet if he is dissatisfied with the decision that is reached at a lower level.

313. All these are ad hoc procedures, and ad hoc measures. Are you saying to the Committee that there is no machinery in Government for the review of relative priority expenditure under different departmental heads? It is all a matter of pressure.

(Mr Lawson) It is not a matter of pressure. It is a matter of, as I say, common sense and judgment in the same way as you decide the priorities within your own personal expenditure. You tell me, Mr Freeman, how you decide between how much you are going to spend on, say, food, and how much you are going to spend on clothing, and how much on books and newspapers. How do you do that?

314. Well, Chancellor, with great respect, I do not think the analogy is perfect.

(Mr Lawson) You just tell me. It might be very helpful to me.

315. I sit down at the beginning of each fiscal year and zero budget all my heads of expenditure, and that is not something the Government does.

My question was what mechanism is there in the Treasury or in the Cabinet Office for reviewing the relative heads of priority, and you tell me there is none.

(Mr Lawson) I am interested in your saying you sit down and zero budget everything. That still does not answer how you decide what you are going to spend, and I think it is a matter of judgment which is a judgment in which the Treasury obviously has a large part to play, but so do all other departments, and a conclusion is reached in the same way as a conclusion is reached on other issues in Cabinet Government. There is nothing special. There is no scientific way in which you can say in some objective sense how much defence and how much social security, and what is the precise absolute relationship between defence and social security. It is a nonsense question.

316. It is not a nonsense question. I was not asking about the conclusions. Could I ask my next question, which is how much flexibility the Chancellor has each year in varying the level of expenditure under different departmental heads. Once you have taken account of commitments and legal obligations of the sort that Government has under certain heads, how much flexibility do you have to reduce expenditure in one department and increase it in another? Can you put any kind of percentage figure on total public expenditure, where there is room for manoeuvre?

(Mr Lawson) No, I cannot. Certainly not off the cuff, and again it is not an absolute figure. There are certain commitments - it is not an absolute issue. It varies in degree. Sometimes there is a high degree of freedom and sometimes there is none at all. Sometimes it is in between, and over the long run you have a greater degree of freedom than you do in the short run, and so on. But there

is no doubt about it: when you have international agreements, when you have particular pledges that the Government has made which have to be honoured, when you obviously enter into long term commitments of one kind or another which, if you kept chopping and changing these, would clearly disrupt the economy, then the level of flexibility on a practical level that you have, certainly in the short term and maybe in the medium term, is very much less than a Treasury minister I think would wish, and that is one of the difficulties. The level of manoeuvrability and flexibility is somewhat limited. We have an example, now, before us where we are changing regional industrial policy. There will be a public expenditure saving as a result of the measures that are being announced now, but you cannot change your regional policy every year. It would be an impossible climate for industry to operate within, so that there are all these sorts of constraints.

Mr Budgen

317. Chancellor, I was attracted to your argument that there is an analogy (homely but in this instance true) between the family budget and the national budget, and plainly you are right in saying that, just as the family mortgage interest payments may be enormous but are not variable by the family, the political world is more often interested in those discretionary elements of expenditure which come suddenly, and about which political judgment has to be exercised. I would like you to describe to us the extent to which we do have Cabinet Government at this time, because it is often spoken of that there are some people who suggest that it is a diminishing feature of our nation's affairs, and it is surely the Cabinet Government which, taking the family analogy, is the thing which decides whether the wife shall have that unexpected and very expensive dress, is it not?

Let me just ask you a bit about that. Since the Autumn Statement there have been two areas of some contention: 1) before the Autumn Statement you were letting it be known that you intended to reduce or even obliterate domestic capital grants for agriculture, is that not true?

(Mr Lawson) No, I do not think I made any statements about domestic capital grants for agriculture.

318. It was widely and improperly leaked, and you did little to abate that spate of leaks.

(Mr Lawson) Oh, all sorts of rumours fly around, but if I spent my time denying rumours, I would not have time to do anything else!

(Sir Peter Middleton) You could add that it is a general problem for the Treasury: if we deny every rumour that comes out, of course we confirm them.

319. Will you take it from me, Chancellor, that the Minister of Agriculture is going round saying that he has beaten off the Treasury and that expenditure upon agriculture has diminished by only 1.7 per cent. Is that, in your opinion, an example of the way in which good Cabinet Government ought to run?

(Mr Lawson) I think that without accepting any of your premises or characterisations, I would say this: that it is well known that from time to time there are differences of opinion between the Treasury and spending departments and ministers; the Chancellor and Chief Secretary on the one hand and spending ministers on the other. That is true today, and it always has been true, and it is true in every country in the world. I think that it is better for Cabinet Government if these differences are not aired in public.

320. Well, all right, Chancellor, you are jointly responsible, as the rest of the Cabinet is, for all that was agreed for the Autumn Statement. Will you please justify a reduction of only 1.7 per cent. in domestic grants to agriculture?

(Mr Lawson) Yes, readily. What the Treasury was concerned to do was in a sensible way to achieve a figure for public expenditure, that is to say, the so-called planning total which was within the White Paper figure published earlier this year for 1985-86; also to get a satisfactory outcome for the two later years which would be published in due course, which would maintain this flat trend in real terms that I was talking about earlier. That we have secured. Agriculture has played a part in that.

321. Well, you have not answered the question at all, with respect, Chancellor, have you? The point I am putting to you is, as I have put to you many times before, that at the time when agriculture is grossly over-producing, what is the point of having these second lines of grants designed to increase production?

(Mr Lawson) These capital grants have been reduced, as you mentioned —

322. By 1.7 per cent.

(Mr Lawson) Well, no, that is total expenditure on agriculture. The capital grants have been reduced proportionately by very much more than that. I do not know whether Mr Scholar has the figures?

(Mr Scholar) £40 m in capital grants.

(Mr Lawson) What is that in percentage terms? Anyway, considerably more than that reduction corresponding with agricultural capital grants.

323. And as a percentage?

(Mr Scholar) I am afraid I have not got that number with me.

(Mr Lawson) We can easily let you have the percentage.

324. I daresay in presenting it as 1.7 per cent. it is being presented by comparison with all agricultural expenditure and I agree that that is a figure which is unfair to you but it is designed to be unfair to you. Is that a good example of Cabinet Government?

(Mr Lawson) I do not think Finance Ministers in any country ever expect fairness.

325. Then can I ask you a second question again about the equivalent of this difficult marginal expenditure in the family. One of the advantages of Cabinet Government is said to be, is it not, that it provides a sort of political sieve which may be used against the activities of the perhaps over-enthusiastic doctrinaire in his own department? We have at present, do we not, a nice little row brewing about the increase in contributions that parents will have to make to their children's university education? Do you agree that there is a row about that?

(Mr Lawson) I think, yes, that that particular decision has not been welcomed in all quarters.

326. You would agree with me that from a narrow Tory party point of view it is doctrinally perfect?

(Mr Lawson) It is not a question of whether it is doctrinally perfect or not. It is a question that the Secretary

of State for Education felt that, given the need to make economies, it was right to make this change in order to protect the scientific budget. I do not think there is anything particularly doctrinal about that. That was his priority.

327. But it is also being justified, quite rightly, on the ground that it enables the state to be more generous to those parents who are less well off?

(Mr Lawson) Certainly. I cannot speak for the Secretary of State for Education but I am quite sure that that was a view that he took, yes, that is right.

328. But, Chancellor, if there were Cabinet Government ought you not to be able not merely to say that the Secretary of State for Education had decided this but that you had considered it and you approved of it because it would be part of the political process?

(Mr Lawson) Of course I approve of every decision the Cabinet takes. That must be the case. But I thought you were implying that somehow I personally, not just as a member of Cabinet along with all other members of Government, had some special interest in this. The plain fact of the matter is, of course, that I have an interest in the Cabinet along with all other members of the Cabinet but the only Minister who has a special interest in priorities in education is the Secretary of State for Education, and it is the same with other departments round the Cabinet table. I have an interest, of course, in the decision in the same way as every member of the Cabinet does. I must say I am not quite sure whether what you are getting at is the question of Cabinet Government or whether you approve or disapprove of the results of Cabinet Government.

329. No, I was asking the extent to which there is Cabinet Government and Cabinet consideration of these politically sensitive areas?

(Mr Lawson) There is undoubtedly Cabinet Government.

330. Or are we seeing a Government which deals entirely on a bilateral basis (as I believe the Government calls it). I do not know about these things. Is that right or do we have a proper collective decision so that politically sensitive decisions such as cutting grants to agriculture, such as increasing contributions of parents who have young persons at university, are considered by Cabinet so that the collective wisdom of the Cabinet is applied, not just to their own departmental problems but to the departmental problems of others, or is it, in fact, that this Government operates on a federal basis?

(Mr Lawson) Not at all. The final outcome of the public expenditure negotiations has to be approved by Cabinet. The whole lot has to be approved by Cabinet and is approved by Cabinet, and members of Cabinet are perfectly entitled, and often do, to discuss something or open up a discussion, not merely to take part in one, on something which has nothing to do with their own particular department. That is quite right.

Chairman

331. Mr Howell wants to raise questions on another subject but might I pick up a point which was made implicit in ~~what~~ both Mr Freeman and Mr Budgen were saying, without necessarily taking a view on whether homely comparisons with domestic expenditure are not a good idea. What is of some concern is that the impression is created that the decisions on public expenditure are largely made in bilateral negotiations between the Treasury and the spending

departments; in other words, the matter is dealt with largely in a vertical way, if I may put it in those words, but there is comparatively little analysis or discussion across departments as against decisions within departments, which are obviously a matter for the department, by and large, compared with little discussion across departments, so that the question of whether one should spend less on agriculture or more on education is appraised in any sort of coherent way with advice from officials and so on. Of course, it must be the case at the end of the day that Cabinet looks at it but the amount of Cabinet time is really very limited and what we are rather concerned about is the extent to which priorities are appraised between departments in a coherent and sensible way as might be the case in, let us say, a well-run family?

(Mr Lawson) The amount of discussion is very substantial indeed. Of course, by no means all of it or the majority goes on in Cabinet. It would be quite impossible for that to be so, but during the course of the year there are all sorts of discussions on various items of expenditure which lead to a view among colleagues about priorities at a particular time, and these views are taken into account when the Treasury is beginning the public expenditure round, which it does first by the Chief Secretary having a number of bilateral discussions with individual Ministers. Of course, the Ministers themselves are aware not only of their own departmental needs as they see them but also the overall objectives of the Government and they have that very much in mind. So, all these matters are already very much in the minds of the Treasury when it goes about trying to reduce the inevitably excessive demands or bids that spending Ministers make, and then

where there cannot be agreement - and this year that was the case on a number of programmes - there is a sub-committee of Ministers with a wide range of experience and background who themselves try and help determine this. Of course, they are able to weigh up, as I said earlier, the strength of one case against the strength of another and so on, and then the whole thing at the end of the day does go to Cabinet and everybody is conscious that it is going to Cabinet and that if a series of proposals were going to Cabinet which did not accord with Cabinet's sense of priorities and Cabinet's views, then it would not have much chance of going through and, therefore, that would not be put forward. It is one of the oldest tricks in the book, incidentally, but is not tried so often because I think certain spending ministries realise that the Treasury has tumbled to it, but they will put forward perhaps spending cuts in their own programme of a highly sensitive nature, hoping that the Treasury will be foolish enough to say, "Right, that is what we want. Okay, you can have the rest of your programme," in the full knowledge that if that were to go to Cabinet it would be overturned in Cabinet and there would be no saving. That trick, which I have known tried in past years, I do not think was attempted this year. I use this illustration to show that the Cabinet decision at the end of the day is very much of a reality which is present in people's minds. If I may draw an analogy within the political world, there are very few bills put forward by governments which do not get through the House of Commons but that does not mean that governments pay any attention to the House of Commons or that they can get anything through. It is that they form a view in advance of what they ~~can~~ get through the House of Commons and what they cannot and introduce only those bills which, in their judgment, they can

get through the House of Commons. It is the same in the public expenditure round, that very little is overturned in Cabinet in the public expenditure sense because the Treasury and, indeed, spending Ministers, have in mind what might be acceptable to colleagues when they are conducting their negotiations and do not try and put something forward which will not be acceptable to colleagues. What is interesting is that I referred earlier to the Green Paper. If you look at the Green Paper, chart 4 on page 7 does show the tremendous shift that there has been in the pattern of public expenditure since 1978/79. It goes up to 1983/84 and it shows huge increases in real terms on some programmes, others being roughly static and on others a big reduction. It also shows how constraints, as it were force majeure, has been a major factor in some of these changes, whereas in other areas, where, for example, we have had a definite policy of shifting the provision to housing for the most part from the public sector to the private sector, the priorities have affected the relative picture. I think that this particular pattern came about not by chance, as you might have expected equal cuts across the board if it came about by chance. It certainly did not come about by chance; it came about by a mixture of the Government's priorities being reflected in public expenditure and the constraints within which we have to operate.

Chairman: Thank you very much. We would like to change the subject now. Mr Howell has some questions.

Mr Howell

332. Chancellor, I would like to talk about table 2.1 and social security, which is the largest increase, £470 m, something like 20 per cent. above what was anticipated. How much of that is due to the increase in unemployment?

(Mr Lawson) Only a minor proportion of that is due to increase in unemployment. I do not know whether Mr Scholar has the precise figure.

(Mr Scholar) The Command 9123 plan assumed unemployment level of 2.895 million in GB narrow terms and the plans here assume a level of 3.0 million on the same basis.

(Mr Lawson) There are other things and, speaking from memory, one of the big elements here, for example, has been housing benefit which has come to cost considerably more than we had expected. That is not directly related to unemployment at all. So I think the amount of this increase which is related to unemployment is, if I remember rightly, a minor part of the total.

333. In view of what you have just said, would it not be advantageous for everybody to understand these figures if a separate line were established for the cost of unemployment so that we could see exactly what was happening in that area? It seems to me to be quite misleading that we have the Department of Employment and -70 there and no particular heading to show what the cost of unemployment is, because this is one of the major problems confronting the country now (and I am sure everybody agrees on that point) and I believe, in order to understand these accounts in the expenditure plans, it would be in everybody's interests if we knew what the cost of unemployment was.

(Mr Lawson) The detailed figures, as you know, are given in the White Paper and in the Public Expenditure White Paper you can make your own calculations of what the cost of unemployment is. It is very difficult to define the cost of unemployment because, for example, the Youth Training Scheme, which is a training measure and providing very valuable training for school leavers, is more than just

a cost of unemployment and yet clearly if there were no unemployment at all you would assume that the training would probably be given by the companies concerned, by the employers primarily rather than by the state, or at least to a very large extent. There might still be some state training arrangement but it would not be of that size. So it is genuinely difficult with the various elements involved. Regional policy again is another bit of that. To what extent do you attribute spending on regional policy to unemployment? So I think you have to make your own judgments. We will provide you with all the detailed figures in the White Paper and you can make your own best estimates, Mr Howell, as to how much of that is attributable to unemployment. When you have got the answer, of course, I am not sure whether that gets you any farther because the problem of unemployment is not "What is the cost of unemployment?": the problem of unemployment is "What measures can sensibly be taken which will lead to a sustainable reduction in the level of unemployment?" That is what matters.

334. I hate to disagree with you, but I think the cost of unemployment and the cost of job creation and all that is very important. It is one of the biggest areas of expenditure there is and I think it ought to be clearly defined so that we can see just how much it is costing in the round and what it would cost if we adopted other methods to get over this problem, such as "workfare" which is being adopted in the United States.

(Mr Lawson) Oh, yes, if you were to reduce the level of unemployment benefit, which is inherent in the "workfare" proposals, I agree. It is more complicated than that but that is the essential element: if you do not take work you get the lower level of benefit. If you reduced the level of unemployment benefit you would reduce the

cost of unemployment to the taxpayer.

335. Following on from that, what steps have we taken to find out what is going on in the United States, because you often refer to the fact that unemployment levels in the United States are lower than in Britain but there are two fundamental reasons why this should be. One is unemployment benefit stops in general after six months and the other thing is that they are instituting "workfare" programmes which really does mean applying a work test.

(Mr Lawson) I think the tougher social security rules in the United States are certainly one element. But there is, I think, an even more important element: that is the much greater degree of flexibility of both the labour market and the product markets in the United States and the fact that the trades unions have proportionately far fewer members in the United States and there is far less of a closed shop. The closed shop is far less prevalent in the United States. All these factors I think lead to a level of wage settlements which is conducive to job creation and the whole enterprise culture, as I have called it, which is a matter of the attitudes of management, the formation of new businesses, all those sorts of thing, does have a great effect too on the better performance in the United States, in my judgment, in creating new jobs. But you are right, the welfare system is a more rigorous one, a harsher one, in the United States than it is in this country.

336. But have you or your Department made a study of what goes on in the recent "workfare" systems which are being set up there?

(Mr Lawson) Oh, yes. We are very interested in how other countries conduct their economies and their social legislation and so on, certainly.

337. You have not made a specific inquiry into the American

"workfare" system?

(Mr Lawson) I cannot speak for them, but I think probably the DHSS or the Department of Employment probably have in their files an account of the American system. I would be surprised if they do not.

338. From the point of view of expenditure?

(Mr Lawson) We have no plans to introduce a "workfare" system in this country if that is what you are asking me.

339. You do not want to know anything about it?

(Mr Lawson) I am very happy to read anything you write about it. I always enjoy reading your booklets.

340. I would rather you read what goes on in the States because you want some way of having employment figures in one specific area.

(Mr Lawson) I shall be interested to know whether this Committee in its report comes out with a recommendation that we should introduce the "workfare" system into this country. I look forward with even greater eagerness to reading the report than I did when I entered this room.

(Sir Peter Middleton) On the general point, we have spent a lot of time studying the United States and, of course, the relationship between job creation in the United States and Europe is not only studied here but is being studied in every international organisation you can think of. An enormous amount of effort is going in, as you know.

341. Can I just tackle you on something you said at the beginning when you said the labour force has grown. The figures I am looking at do not indicate that the labour force has grown. In fact, between March 1980 and March 1984 it decreased by 400,000.

(Mr Lawson) What figures are those?

342. Figures from the Department.

(Mr Lawson) Figures of what?

343. The total working population has gone down by 300,000 in between those two dates.

(Mr Lawson) The total working population at work?

344. No, the total working population - everybody including the unemployed.

(Mr Lawson) If I misled you inadvertently I apologise. My impression was certainly in the past year or so that the working population had been growing.

345. And the total work force, the employed labour force, has only been below what it is now.

(Mr Lawson) I would like to see your figures - I really would. Can you hand them over? (Document handed to witnesses) What are you comparing?

346. 1980 with 1984. I think they are both marked.

(Mr Lawson) This is March 1980 with - there is not much difference - March 1984. You are taking different months? There is a seasonal pattern. The working population, according to your figures, is in March 1980 26.6 million and in March 1984 27 million, which I work out as an increase.

Chairman: I think perhaps we should reverse the normal procedure and we will let you have a note.

Mr Howell

347. Can I just ask you if you are not a little complaisant on the slowness of the increase in unemployment because we are not working on the same criteria that we were working on a few years

ago and the fact that a mistake was made last year in thinking unemployment was going to fall when, in fact, it did rise because we are not including all the categories in the unemployment figures that we did previously; therefore, we are getting wrong results, we are deceiving ourselves on this point which is achieving nothing.

(Mr Lawson) I do not think we are deceiving ourselves at all. We have made it very clear what the differences in definition and season have produced. You can easily work out what the figures would be on the old definition. Nothing has been concealed, there is no self-deception, and, of course, you could adjust for all sorts of reasons in different ways beyond that. Some people suspect - and I think you are one - that many of those who are registered unemployed in many parts of the country are in fact doing work in the black economy. So that the whole thing is extremely difficult to get to grips with. So I think it is best to rest on the proposition that the level of unemployment is too high, it is still rising, though rising more slowly now, and that it is important that we devise a whole battery of policies which will enable business and industry (because it is business and industry that create the jobs, not government) to create the jobs of the future.

Mr Wainwright

348. Chancellor, in your opening statement this afternoon you claimed that the total of public expenditure envisaged for 1985-86 and set out in your recent Autumn Statement would be the lowest percentage of GDP for a decade, but in table 2.2 of your Autumn Statement, which is a table of comparisons of 1985-86 projected expenditure with that of the previous six years - and table 2.2 is on page 23 -----

(Mr Lawson) Can I interrupt you? I think you may be labouring under a misapprehension. What I was saying would be the lowest for over a decade was the PSBR, the Public Sector Borrowing Requirement, as a proportion of GDP. What you are talking about now is public expenditure as a proportion of GDP. These are obviously two different things.

349. If I misheard I apologise, Chancellor. You have also frequently in recent months dwelt on the point that the likelihood of North Sea oil being very near its peak over this year and next is a further reason - I am quoting you - for seeking to make rapid progress in reducing the PSBR. Does this mean that, if next March you find yourself with the scope for a fiscal adjustment which is set out in this Autumn Statement, you will apply this fiscal adjustment for further reducing the PSBR?

(Mr Lawson) As you know, Mr Wainwright - and we had this discussion, I think, on this occasion last year - the decision on what is the appropriate PSBR for 1985-86 will be taken at the time of the Budget and not now, and it will be taken at the time of the Budget in the light of all the various considerations which have to be taken into account including updated information, including the composition of the public expenditure total, including the consonance of the borrowing requirement with the need to reduce the rate of growth of the money supply at tolerable levels of interest rates. All these things go into the assessment that is made at budget time to reach what is called the Budget judgment.

There is a presumption that obviously we will stick to the figures in the Medium Term Financial Strategy, but that is not always precisely the case. The spirit and the essence of the MIEFS will be adhered to, but as you know this year the figure for the PSBR (which I set at the time of the Budget) was in fact below the figure that had been published in the previous year's Red Book.

350. Of course, certainty as to your plans must await next March, as you have just very lucidly explained, but you have, you see, already lifted the curtain a little on the scenario next March by these remarks/^{of}yours that having regard to North Sea oil being at its peaks, these are the two years when really you must seek to get the PSBR down. It is a special opportunity, and there is a special requirement to get the PSBR down. Having perhaps rather tantalisingly lifted the curtain on next March's scenario a little, can you not move it a little further aside and say whether, if your implied fiscal adjustment figure of $1\frac{1}{2}$ billions in the Autumn Statement materialises, it will in fact be devoted to yet further reduction of the PSBR at this golden moment for doing so.

(Mr Lawson) I do not know about the particular "golden moment". I thought it was an important moment to do so in this March's Budget, and did so accordingly, but the answer to your question is no, I am not going to "lift the curtain a little more" now. What is more, Mr Wainwright, if every time I lift the curtain in response to requests from this Committee all I am told is I ought to be lifting it still further, then that does not give me much incentive to lift the curtain in the first place.

351. I am sorry if you should treat us like children in a nursery.

(Mr Lawson) Oh, no, it is not children in a nursery. I am treating you on your merits!

Likely to be a relatively transitory situation, or could be, have you from the strength of the dollar vis a vis sterling, which is quite adjustment will be due to the considerably enhanced revenue resulting with at all, it is quite clear that most of this implied fiscal

353. But since on your own figuring, which I do not seek to quarrel

which is where we came in.

It has been in this country as a proportion of GDP for well over a decade, to work out as low as I had envisaged, but it will still be the lowest "in reducing the PSBR." That is what we have done. It is not going

reason for seeking to make rapid progress this year" - that is 1984-85 -

Likelihood that they may be near their peak in 1984-85 is a further it said "The pattern of North Sea oil revenues is also relevant. The

actual passage in the Red Book this year, the Budget Red Book, where that most other countries have. Sir Lawrence Burns refers me to the

of GDP, but it is lower in some cases - considerably - than the PSBR countries. Not, I think, as low as the German PSBR as a proportion

right. We do have a low PSBR if you compare us with most other moment, this is an opportunity to have a low PSBR - I think that is

given the fact that North Sea oil revenues are at a high level at the think in the Green Paper, and certainly was stated in the Red Book,

was stated clearly at the time of the Budget and it was stated I (Mr Lawson) No. I do think, and this is something which

I have been doing.

Your commitment - that would be quite stupid, and that is not what at any rate to ask you what your present view is? Not of course

should be seized to bring down PSBR, surely it is legitimate peak of North Sea oil, this is a period in which every opportunity

Chancellor. When you have said so categorically that because of this 352. You are implying that those two are one and the same thing,

not considered using what is in fact a windfall - a windfall which you yourself were not expecting a few months ago - for reducing the PSBR rather than reducing taxes?

(Mr Lawson) All life is a windfall, Mr Wainwright.

354. That is not a statement with which you can expect a Yorkshireman to agree, Chancellor, and I don't!

(Mr Lawson) Sometimes the windfall can be a pleasant one, and sometimes an unpleasant one. The fact that things do not turn out as you would expect, which is what you are talking about, does not mean that there is something wrong with events. It means that it is your expectations that were wrong.

Chairman

355. It does not mean that you should not react to the change, Chancellor.

(Mr Lawson) No, well, of course we react to all these changes and all these factors. An element in determining the Budget is judgment, that is to say, what is the appropriate level of the PSBR for the coming year, and that is a judgment that I am not concealing from you now. I could only conceal something from you if I had already made it, and I have not made that judgment yet.

Mr Wainwright

356. I would like to move onto the question of sales of assets. You will recall, I am sure, a very vigorous and I think illuminating discussion in this Committee last year and also at Budget time this year on accounting treatment of sales of assets. You said clearly that you did take account of sales of assets when you are deciding the appropriate size of the PSBR. Well, now that it is now expected that the proceeds of sales of assets next year, 1985-86, are likely to be considerably greater than was originally expected, do you intend

to use those increased enhanced proceeds of sales of assets for further reducing the PSBR below your 7 billion?

(Mr Lawson) No. Everything I said in that discussion to which you allude still stands, and perhaps it would be tedious to go over all that discussion again, except to say that of course that is one of the factors which has to be taken into account. As I said earlier, the composition of the public expenditure total is one of the factors that has to be taken into account in deciding what is the appropriate borrowing requirement. Again, I am looking for guidance from this Committee and I shall certainly be very disappointed indeed - and I hope you will not accuse me of talking to you as if you were a child now - if you do not in your report recommend what the PSBR (after all this discussion) for 1985-86 ought to be.

357. We are not in the position of having full access to the books, Chancellor.

(Mr Lawson) I think that is a bit of a cop-out!

Mr Fisher

358. Can we just clarify this point, please? You have referred to the Red Book and actually quoted the relevant passage, which was your policy at the time of the Budget. Has there been a policy change, because now, in the Autumn Statement, you have re-forecast your oil revenues upwards by $2\frac{1}{2}$ billion, and yet you are also at the same time anticipating (and indeed the Financial Secretary in a speech last week seemed to confirm this) that you are going to use that upwards forecast as the prime reason why you can cut taxes. In the Red Book however, you say quite clearly that this peak of oil revenue should be used to reduce the PSBR. Can we assume there is a change of policy on your part?

(Mr Lawson) No, there is no change of policy.

359. Priority?

(Mr Lawson) A number of things now look as if they are going to turn out differently - that is always the case - in 1985-86 from what we thought at the time. One of them is the level for 1985-86 of oil revenues. Other things change (on the tax side they tend to change in differing directions). That is the biggest single change that has to be taken into account in taking the Budget judgment. I am sure you know this very well, Mr Fisher, but some people do not: the fiscal adjustment is a very mechanistic calculation. It should not be held to imply what the Budget is going to hold in the way of tax reductions. It is an indication, but it is certainly no promise or pledge. It is mechanistic in this sense: we do our best forecast which has a very very wide margin of uncertainty at this stage, very wide margin of uncertainty, of what the PSBR would be in 1985-86. You then deduct from that the figure for the PSBR in the most recent Budget Red Book, which was 7 billion, and if you deduct that 7 billion that leaves you with a fiscal adjustment of 1.5 billion, but it is purely a mechanical arithmetical calculation which gives an indication of the ball park on present estimates in which the Budget might be. Not only may estimates change as we move nearer the Budget in the light of later information, one way or the other, but of course the judgment that is exercised at that stage, and at this stage, is purely an arithmetical calculation.

360. I accept that, Chancellor, but your Financial Secretary, when speaking to the Sun Life Assurance Investment Seminar - a crucial event in the financial calendar - said, and it presumably was not a chance remark because it is actually printed in the Treasury's press release: "The Chancellor's Autumn Statement confirmed that there should

be room for further tax cuts in the next Budget". That sort of fiscal adjustment?

(Mr Lawson) Certainly. I think that is true. He did not say there should be room for $1\frac{1}{2}$ billion of further tax cuts. He was being appropriate cautious, as befits a responsible Treasury Minister.

361. As you say, this whole matter is subject to wide variations and indeed, Sir Terence Burns, when kindly giving evidence to us on Monday, volunteered the information to this Committee, and I am sure you have had a chance to read, that his estimate of a 1 percent. change in the sterling/dollar exchange rate would lead to a £150 million adjustment, so that from that we can estimate that a 10 per cent. change in the sterling/dollar exchange rate would actually wipe out or could wipe out this fiscal adjustment. Would you agree with that?

(Sir Terence Burns) Could I make one comment? I think I said "one per cent. change in the sterling oil price". Whether or not that one per cent. change in the pound/dollar exchange rate will actually lead to a one per cent. change in the sterling oil price depends of course upon what is happening to the oil price, and it does matter whether the bilateral change in the exchange rate is due to changes in sterling or in the dollar, because we know that changes in the dollar effective exchange rate can very well affect the price of oil. It is not quite as simple as all that.

362. I am sure, Chancellor, you would agree that how those two things are related and have been over the last year or so would suggest that over the last year's trends, one would lead to the other. Would you confirm that? If you do confirm that, would you say that that means that the whole policy towards fiscal adjustments or tax cuts is rather a chancy and variable thing, and a slight risk - a hazard?

(Mr Lawson) Yes. I have never attempted to deny that my job is a difficult one, and you have unerringly put your finger on one of the reasons why it is a difficult one, but so far what we have managed to secure is our objective of, despite all these difficulties, getting the PSBR steadily lower as a proportion of GDP, and that is the objective we have achieved and we have achieved it in recent years with a reduction in taxation and I hope that we shall be able to continue and I believe we shall. The Green Paper shows that with the sorts of policies on public expenditure which I was referring to earlier, we will be able to have increasing scope for reductions in taxation, even though it is posited that the oil revenue ^{is} on a declining trend. I feel that this is something which we have to live with, which anybody doing my job would have to live with, but there do tend in practice to be offsetting factors if there is a big change in one of these elements.

363. I think we all appreciate the difficulty of your job; it is only too apparent, and also the very chancy and variable tactics, but you are today being very cautious, appropriately cautious about it.

(Mr Lawson) So I was when I gave the oral statement to the House of Commons and, indeed, so is the document itself.

364. I have just read to you one sentence from your Finance Secretary's speech to the Sun Life Assurance seminar, but in the next one he actually specifies that we could reduce the burden of tax by about £1½ bn for the year 1985/86, so he, unlike you, is not being cautious?

(Mr Lawson) No, he was saying if events turn out as they look like doing at the present time but he would no more deny than I would the margin of uncertainty that there is.

365. I do not wish to get you into any further trouble so can we move on slightly. I think you would agree that one of the most variable and chancy elements is what is going to happen to the sterling-dollar exchange rate. Is it now still your policy, as you told us last year, that you do not have a target for that exchange rate?

(Mr Lawson) Yes.

366. And yet you recognise that it is actually crucial and fundamental to the whole fiscal adjustment you might want to make later in the year and you still do not have a target for it?

(Mr Lawson) That is really wishing would make it so. It would not be sensible to have a target for the sterling-dollar exchange rate. Almost certainly you would not be able to achieve the target if you did set yourself a target and in order to try and achieve it you would have to take all sorts of policy decisions

which would not make sense in economic policy terms in all probability. Therefore, we do not have a target but it does not follow from that that we are not affected by the sterling-dollar exchange rate. We do not have a target for the United States Federal Budget deficit but we are certainly affected by that.

367. And you have a view on the United States Federal Budget deficit?

(Mr Lawson) Yes, I would rather see it lower. I have made that clear on a number of occasions.

368. But if it was lower would that not actually lead to lower interest rates in the United States and would it not quite possibly lead to a stronger pound and lower oil revenues and, therefore, in your fiscal adjustment next year possibly your view of what is desirable in the States would actually completely limit your options for next year?

(Mr Lawson) No, I do not think so. I think what would be likely to happen would be that you would have a lower level of interest rates worldwide and I think that would be to the benefit of the world economy and of the debtor nations in particular, but it would also be beneficial to this country.

369. How would it be beneficial to this country because it would presumably lead to a stronger pound and lower oil revenues and, therefore, the upward forecast you have made of $\$2\frac{1}{2}$ bn of oil revenues would not take place and, therefore, you would not be in a position to make this fiscal adjustment or tax cuts of whatever proportions next year, so you have a very strong vested interest in the opposite view to the one you profess of the US Federal deficit?

(Mr Lawson) In the first place, Mr Fisher, it is difficult to predict what effect a given reduction in the American Budget deficit would have on the sterling-dollar exchange rate, and those people who have tried to predict the sterling-dollar exchange rate in the past, including, I think, all of us in this room, have not had a conspicuously successful track record, which is one of the reasons we do not do it in public; at least I do not; I think the "scribblers" do! So, it is extremely difficult to predict from a given reduction in the American Budget deficit and I must confess I do not see any early signs of that coming about. But it is not difficult to predict from that what would happen to the sterling-dollar exchange rate. You then have to take into account what would be the consequences in this new economic world for the dollar oil price and, as Sir Terence Burns was pointing out, you have also to take into account what other changes there would be and what effect they would have on the likely tax total. Tax revenues from oil taxation are only a minor part. So, I think it is extremely difficult to predict. I would not, therefore, accept your conclusion for a moment but, more importantly, I would dissent very strongly from the hypothesis that you appear either to imply or at least impute to me that it is the primary object of Government policy to have the highest possible sterling oil price. It is not.

370. Chancellor, I would not dispute that. It is not an exact science and I think everybody in the room would take Sir Terence's point that it is open to variation, but all I said was that it could lead and I would have thought most people would agree with me that that is on the margin of a more likely ~~sequence~~ of events running from a reduced deficit.

(Mr Lawson) What is a more likely event?

371. The one I suggested, of lower interest rates, therefore a stronger pound, therefore reduced oil revenues and, therefore, no fiscal adjustment for you next year?

(Mr Lawson) We will have to see whether there is a fiscal adjustment next year, and if it would not be improper, we could no doubt each write down a figure on a piece of paper and have a wager and whoever is closer to it would win.

372. I am not a betting man!

(Mr Lawson) One of the factors you have not taken into account is that in so far as the strength of the dollar is affected by interest rates, it is probably relative interest rates which are important and if interest rates in this country are also coming down as well as interest rates in the United States, those relative interest rates need not change at all.

373. You have made great play since you have been Chancellor of being a proponent of "sound money", as you call it, which I take it you would agree means a strong pound? Would you agree with that?

(Mr Lawson) No. What I mean by "sound money" is a low and declining level of inflation with the ultimate objective of having no inflation at all. That is what I mean by "sound money".

374. Can I ask a direct question. Do you actually want a strong pound?

(Mr Lawson) I believe that it is the market which will determine the level of a currency.

375. I am asking what you want rather than what is likely to happen?

(Mr Lawson) Having said that - and that is probably why we do not have targets - obviously, other things being equal I would certainly not want to see a depreciating currency in external terms any more than I want to see a depreciating currency in internal terms.

376. Even though, as I see it from this Autumn Statement - I may be totally misreading it - your whole prosperity and philosophy, your aspirations for a fiscal adjustment or tax cuts next year, depend on there being a continuing weak pound?

(Mr Lawson) No. You think the pound is weak at the moment, do you?

377. I think you would like it to be weaker.

(Mr Lawson) But do you think it is weak at the moment?

378. It is weakening; it is down to 1.20 today.

(Mr Lawson) The assumption on which the forecast is made is that the exchange rate will not be very different in 1985/86 from what it is now. That is a fairly conventional assumption. There is no assumption that the pound is going to weaken. But different people have different views. There are some people who think the pound is weak at the present time; there are some people who feel that the pound is quite strong at the present time. It depends a lot on whether you prefer looking at the dollar-sterling exchange rate or the deutschmark exchange rate.

(Sir Peter Middleton) But the fact is that most of the changes that have taken place in the exchange rate have been the result of US policy, not ours, and it is a bit much to think they are busily pushing up the dollar in order to reduce our budget deficit.

Chairman

379. What was the date of the forecast in the Autumn Statement, Chancellor? When was the forecast made?

(Sir Terence Burns) It was finalised just preceding publication.

(Mr Lawson) Shortly before. We try and get it as up to date as we can.

380. On what assumption, then, about the exchange rate?

(Mr Lawson) The assumption about exchange rate, if I remember rightly but Sir Terence Burns must give the detail, was that the exchange rate would not be greatly changed from its present level.

381. And in dollar terms roughly 1.20?

(Sir Peter Middleton) It is the effective rate.

382. And the same effective rate as it is at the moment, roughly?

(Mr Lawson) We did not assume or write in any dramatic change in the sterling-dollar exchange rate.

(Sir Terence Burns) To answer your question precisely, we cannot finalise the forecast until we have the results of the public expenditure exercise, so the correct answer to your question is something like the end of the week before the Autumn Statement.

Mr Freeman

383. Could I ask you about asset sales. We have forecast next year in 1985/86 through privatisation programmes an increase of $\text{£}\frac{1}{2}$ bn in receipts and in terms of council house sales, another $\text{£}430$ m in terms of receipts. To what extent in both categories is this increased amount of receipts the result of financing pressure or are both these genuinely windfalls?

(Mr Lawson) In terms of the privatisation programme they are certainly our best estimates of what we are going to get. I do not know what you mean by "financing pressure". We have a continuing programme which we are pushing ahead with as fast as we can and the privatisation programme seems to have had a good day today, as far as I can make out. I think by the close of business last night they had had $1\frac{1}{2}$ million applications for British Telecom shares and a lot more are coming in today and they are still counting. That, of course, is quite a key element in the years that we are talking about. Then there are other privatisation plans, of which you are well aware and which I know you fully support, and they are very important. As I say, we are pushing ahead with a steady programme as fast as we practically can and our best estimate is a higher estimate for 1985/86 than we made at the time of the White Paper. On council house sales, it is slightly more complicated there because there are three elements in that. There is, first of all, the number of houses which we think we can sell; secondly, there is the price we think they are going to fetch, and thirdly, there is the proportion that are financed privately through the building societies rather than through local authority mortgages, which has no public expenditure benefit. All the elements are in play but one of the elements here is that it now looks on the evidence as if the building societies are going to finance a higher proportion of council house sales than we had earlier envisaged, but these are our best estimates of what is going to happen.

384. But you are saying these figures, as it were, have been given to you, that the result of the privatisation programme will produce $\pounds 2\frac{1}{2}$ bn. It is not you saying, "I need $\pounds 2\frac{1}{2}$ bn next year not $\pounds 2$ bn. Accelerate the programme"?

(Mr Lawson) We have obviously discussed this with other departments, sponsor departments. There is always pressure from the Treasury on the sponsor departments to get ahead with the privatisation programme, pressure from the Treasury on the Department of the Environment to get ahead with the council house sales programme and provide the finance, but I would say by and large my colleagues do not need all that much prodding because they are enthusiastic supporters of these policies themselves.

385. Could I ask a question about the public sector pay increases next year because the Autumn Statement assumes 3 per cent. in aggregate in public sector pay. Is that a target or a forecast?

(Mr Lawson) It is the pay factor. It is the way we have operated for many years now and it has not changed. The provision is given. The departments are given provision for a 3 percent pay factor and they have to live within that.

386. So it is a target?

(Mr Lawson) That is their budget. There is scope within that provision in various ways (and Mr Scholar would be happy to go into the detail if you wish) for an average increase in excess of the percentage given by the pay factor.

387. It would be fair to say to the extent that settlements were higher than that civil servants were literally pricing themselves out of the job. That would be the practical effect because those are limits per department.

(Mr Lawson) Yes, it is a little bit more complicated than that but certainly, although we do have a separate policy for Civil Service numbers, there is on top of that an interaction between pay

and numbers. The problem that we face - and I do not know whether we have time to go into it now - is that we have had nothing like the same reduction in the very much larger number of local authority employees that we have been able to secure within the Civil Service which is within our own control.

388. How has this year turned out in comparison with the comparable forecast for last year? Was the provision adequate? Was the target correct?

(Mr Lawson) Do we yet have the figures?

(Mr Scholar) We have not got the figures yet but, as you will be aware, we had a pay factor of 3 percent built into the plans this year and there has been a Civil Service settlement somewhat above that figure.

Chairman

389. How much more?

(Mr Scholar) The settlement was $4\frac{1}{2}\%$.

390. Fifty percent up.

(Mr Scholar) It was indeed above that figure.

(Mr Lawson) One and a half percent, not fifty percent.

Mr Fisher

391. A hundred and fifty percent.

(Mr Lawson) The $1\frac{1}{2}$ is right because what is important is the public expenditure total, the total amount of pay for civil servants, not just the increase - the total amount of pay. The total amount of pay has gone up by an extra $1\frac{1}{2}$ percent.

Chairman: We are clear about the concept. Whether it is worrying or not we will have to consider.

Mr Freeman

392. I understand those figures. Let me come back to the basic question: taking into account the movement in numbers, what is your best estimate of the outturn this year on the increase in aggregate public sector pay in cash terms? Is it less than 4½ percent?

(Mr Scholar) No, we have not got an estimate at the moment of that element of the overall outturn. We are not yet at that stage in the year when we could sensibly produce an estimate of this element of the public expenditure planning total, but I can say that so far in the current year departments seem to be managing within the provision with which they began the year. There have not been, so far as I am aware, any Supplementary Estimates yet before the House in relation to the pay Votes.

393. Just to be clear about this, pay went up 4½ percent and the departments are staying within a 3 percent aggregate cash increase?

(Mr Scholar) So far.

394. My third and final question concerns local government current expenditure. Could you look at page 21 of the Autumn Statement? My question concerns the paragraph 2.27. The background is that each year in the Autumn Statement there is an acknowledgement that, through pressures we are well aware of in local government current expenditure, additional provision has to be made not only for the current year but also for the next year. How, therefore, should this Committee view the statement that, for 1984-85 compared with 1985-86, in 1985-86 there would be a real reduction of 3 percent in local government current expenditure when, as I say, history has indicated that each year over-provision or additional provision is necessary?

(Mr Lawson) I think we reckon that this is realistic

- much more realistic than in the past - but it is very difficult to be precisely certain about this for the reasons that have been given here, the reasons I gave in my introduction, that we have increased provision by a billion pounds or thereabouts and the shire counties, who had a particular problem, have been allowed an increase of something like $4\frac{1}{2}$ percent, roughly in line with inflation. The problem has been with a particular number of authorities and these are now subjected to rate-capping; that was not in place before. That is why the expectation is that we will be able to get that reduction in real terms. There is also the fact, of course, which relates to the earlier point I made, that of local authorities' expenditure something like two-thirds is on pay and that is an amalgam of the rates of pay and also numbers. Local authorities certainly have scope for reducing numbers as I indicated earlier. Finally there is the fact that the biggest element in the local authority expenditure is education and pupil numbers are on a declining trend.

395. So to a certain extent the additional provision made for 1985-86 of about a billion was the consequence of carefully reviewing the practical implications of rate-capping?

(Mr Lawson) And these other factors.

396. And these other factors, and when we come to look at the Autumn Statement 1985 we will have come to the end of these very significant additional provisions that have to be made?

(Mr Lawson) Well, in 1985 rate-capping will still be in force. I am not quite sure I understand the point you are making. Rate-capping will still be in force then too.

397. Yes, but you have made provision for 1985-86 in this Autumn Statement for approximately another billion for local authority current expenditure?

400. Chancellor, my question relates to page 9 of your statement, paragraph 1.32 and table 1.3 on retail prices. You say in paragraph 1.32 that "The annual increase in the RPI may stay near to its recent rate of around $\frac{4}{5}$ per cent through the first half of 1985 before falling in the fourth quarter." If we may then turn to the table below, 1.3, and the final two columns where you have set alongside each other the forecast for the last quarter of this current year and the forecast for the last quarter of 1985, if we go through the categories, the RPI food forecast for the last quarter of 1985 is not falling, it is in fact for a higher figure than the forecast increase for the present year. The same is true of nationalised industries; in fact, there is a rather larger rise of annual rate of inflation forecast for the end of 1985. Then if we drop to the bottom of the table, to other items, again there is a rise. So it is clear from the figures that the whole of the expected drop in the fourth quarter arises from your estimate of the very steep drop in the annual rate of inflation on housing. Could I ask, first of all,

Mr Lewson: Yes. The increase in provision here has some-
 thing of a special nature about it in order to adjust both to the
 new framework and also to the experience of the past.

399. We should believe these figures?
 (Mr Lewson) ——— a further increase in provision, yes.

398. You have said that with the benefit of rate-coupling and the
 other factors you talked about - falling school rolls - when we look
 at the Autumn statement next year we will not be looking at slippage,
 we will not be looking at ———

(Mr Lewson) Yes.

if that is, as you hint in your paragraph, almost entirely due to your estimate of what mortgage rates will be in the last quarter of 1985?

(Mr Lawson) That is certainly a major element in it, yes.

401. If you are anticipating no increase whatever in the mortgage rates from now, how does that square with your estimates in other public spending parts of the Autumn Statement of a very substantial increase in the cost of interest on public debt?

(Mr Lawson) That is quite a different matter.

402. They are both interest rates, Chancellor.

(Mr Lawson) We did have an exchange, I remember, across the floor of the House, Mr Wainwright, on this very point.

403. But I had not then the advantage of this very interesting table of yours.

(Mr Lawson) No, but you had the advantage of my answer, which really dealt with the matter! I think I have got it here. What has happened is that interest rates have gone higher this year and particularly interest rates generally are higher this year than we had expected. We also now think they will be higher next year than we previously expected, so that goes up and the debt interest burden goes up as a result. Starting from where we are now, however, we expected interest rates to be coming down. Is that clear? Because you see they have already gone up this year.

Mr Wainwright: Yes.

Chairman

404. Is there not an apparent inconsistency between the assumption you are making in the section on the mortgage/housing side, and the assumption you are making elsewhere in your Statement?

(Mr Lawson) No, I do not see it. What is the inconsistency?

Chairman: The reason Mr Wainwright mentioned . We may well be wrong, but it seems to us there was some inconsistency.

Mr Wainwright

405. There does seem to me to be an enormous drop - your forecast goes from a $10\frac{1}{2}$ per cent. annual rate of increase in this current quarter of this present year down to a mere 4 per cent. annual rate of increase next year, and I still find it difficult to reconcile that.

(Mr Lawson) Well, the RPI changes depending on which months - the mortgage impact on RPI changes can be very considerable. This is not the only factor but perhaps if you would like to go into details I am sure Sir Terence would be happy to enlighten you.

406. It would be helpful.

(Sir Terence Burns) I think the difficulty you are having in seeing the consistency of these figures is partly because of the way in which the mortgage rate affects the RPI. The fact that we have the $10\frac{1}{2}$ per cent. figure in the fourth quarter of 1984 reflects the relative position of the mortgage rate in the fourth quarter of 1984 relative to the fourth quarter of 1983. The figure for the 1985 fourth quarter reflects the expected level of the mortgage rate in the fourth quarter of 1985 relative to the fourth quarter of 1984. The fact that the "4" is a good deal less than the " $10\frac{1}{2}$ " has got much to do with the extent to which the mortgage rate in the fourth quarter of this year is higher than it was in the fourth quarter of 1983, and you cannot deduce from that any inconsistency with the levels of debt interest payments. I can assure you that they are totally consistent.

407. Well, it would be very interesting, without doubting your

assurance, if we could have the break down of the figures, so that there is something rather more concrete to go on.

(Mr Lawson) You would like a note on this point, would you?

408. Yes.

(Mr Lawson) We will let you have a note on this point.

(Sir Terence Burns) Also can I emphasise of course that we were discussing when I was here on Monday the comparison you were making between the expectations at the time of the Budget and the expectations now. That does not tell us anything about the level in 1985-86 compared to the level in 1984-85. The Chancellor has suggested the numbers here are quite consistent with a low level of interest rates in 1985-86 than with 1984-85.

409. At the very least then are we entitled to derive from these figures that you are assuming that there is to be no rise in the mortgage rate at all from now to and including the last quarter of 1985? There must have been an assumption made.

(Mr Lawson) That is right.

(Sir Terence Burns) Yes. We are not expecting the mortgage rate in the fourth quarter of 1985 to be higher than the average in the fourth quarter of 1984. In fact we would expect it to be lower.

Chairman: Thank you. I think it would be helpful if we could have a note on that particular point.

Mr Wainwright

410. During a recent debate on the floor of the House on unemployment you gave the House the very interesting and useful calculation that no doubt in approximate terms the 1 per cent. reduction in real wages would tend to raise employment by about 200,000. Because nobody questioned you at the time, can I ask you now whether you were speaking of 200,000

more full time jobs, or did your estimate include a lot of part time jobs?

(Mr Lawson) My estimate was about jobs based on our experience of the economy - it was not specifically about full time jobs.

411. Are you happy that when unemployment figures are so crucial, both for the Treasury itself and for the public at large, there is sufficient clear differentiation between increases in full time jobs and increases in part time jobs, some of which may be very part time indeed?

(Mr Lawson) No, I do not think some of them are "very part time indeed", but I think the point is really this: what I was seeking to show is that the relationship there is (and it builds up over time) between changes in real wages, average real wages, and changes in the level of employment, and there is a very clear connection and a very clear relationship. I think you discussed this with Sir Terence Burns on Monday, and as I indicated at the end of my opening remarks, I hope to publish some further work on this in due course, fairly soon. There is a very clear relationship and I felt it might be helpful to the House if I were to indicate in very general terms the order of magnitude and that is what I was doing. It is impossible to be absolutely precise, and to say how this was going to break down between full time jobs and part time, but if you accept (and I think most people do accept this) that there is this relationship between pay and jobs, then I do think that conclusions follow from that as to what is going to be necessary if we have to have a decisive change in the trend of unemployment.

Chairman

412. Chancellor, this is clearly a very important issue, not least for those who are unemployed. You said it in general terms, but the Statement as I recollect it was that a 1 per cent. reduction in real wages would tend to raise employment by about 200,000. There is clearly a tremendous difference in whether that 200,000 is full time jobs or half time. If it is all half time jobs, the full time equivalent is only 100. What we are saying is are you saying you have made an estimate of 200,000 full time or full time equivalents?

(Mr Lawson) It is based really on the mix of the economy as it is at the present time.

413. The proportions are the same as the present proportion between full and part time jobs.

(Mr Lawson) Broadly speaking.

414. We do not have any figures for that, do we?

(Mr Lawson) Well, you do, yes. We do have figures for that. I think it is an important subject. I think you are absolutely right, Mr Chairman, and that is why I shall be publishing this more detailed work on this subject in due course, which Sir Terence Burns and his economists have been working on, and I do not know whether you would like to ask him any further questions now, but this will be published, and it will be available for everybody to discuss. I think it is a very important point.

Mr Wainwright

415. Since Chancellor you make no secrets at all of attaching so much importance to the level of real wages, and you gave this calculation to the House not just as an academic nugget, how do you see this reduction in real wages coming about, or how would you like it to come about? By what mechanism?

(Mr Lawson) I would like to see it coming about by removing the impediments to the effect working of the labour market.

416. Could you enlarge on that? That in itself is a rather generalised reply.

(Mr Lawson) Well, there is a whole range of factors which put impediments in the way of the efficient working of the labour market at the present time. The trade union legislation is one of the ways in which we have changed things, but there are also the changes that we have made in the Employment Protection Act. There are other matters which are under examination at the present time.

There is also the abolition of the national insurance surcharge which I introduced in the Budget this year which, of course, only came into effect on 1st October, which is only a few weeks ago, and it has not really had its full effect yet on the labour market.

Mr Howell

417. Chancellor, you seem to be ignoring the fact that supplementary and social security levels affect this matter?

(Mr Lawson) Yes, I should not have ignored them.

The relationship between pay in work and pay out of work is very important, of course, and that is one of the main reasons why we introduced the liability to unemployment benefit supplementary being eligible for tax in the 1982 Budget. There was a further change in supplementary benefit, as you know, which was announced at the time of the Autumn Statement this year.

418. But there are still masses of people who are better off out of work than in work, which I am sure you will recognise?

(Mr Lawson) It is a little bit late, subject to the Chairman's views, to embark on that subject again this afternoon.

Chairman

419. I think this is one we have touched on previously.

(Mr Lawson) I seem to recall it.

Mr Budgen

420. Chancellor, you talk about the need to reduce real wages.

(Mr Lawson) I have not actually said that. I said the need to have a lower increase in real wages or even a zero increase in average real wages. I have never talked about an actual reduction in wage rates.

421. A reduction in the rate of increase?

(Mr Lawson) Yes.

Chairman

422. I thought the Statement with regard to the 200,000 was referring to a reduction of real wages. Was that wrong?

(Mr Lawson) No, compared with what would otherwise happen to real wages, that is to say, if they were going up by 3 per cent. If they only went up by 2 per cent. instead of 3 per cent. that would be the effect when it is fully worked through.

Mr Budgen

423. But are there not dangers in talking like that, particularly for a Tory, because our party has been the party of a most rigid and authoritarian control of wages by statute and does it not give the impression that we are preparing the ground for some form of statutory wage control?

(Mr Lawson) No, you know me well enough to know that nothing would be further from my mind. I do not know anybody who has thought this Government is laying the ground for that. The arguments against a statutory pay policy are so many and so powerful that we have no intention whatever of going along that route and, indeed, I think experience shows the force of those arguments.

424. It certainly might be misunderstood by some employees, might it not, because they see powerful people like you saying how pleased the establishment is that company liquidity has risen greatly and that companies are in a good position to invest? Is not an employee going to say, "We have had a rotten time for a few years. We are hoping to do a bit better, and that is what we think one of the advantages of free markets is"?

(Mr Lawson) In a free economy an employee is entitled to say anything and different employees, different workers, will get different sorts of pay increases. That is perfectly sensible and right in a free economy, depending on the demand for the particular kind of work and the particular sorts of skills involved, but it is quite wrong to say to workers, that is to say, those in work, who might get a wage increase of X or Y that they have had a rough time. They have not. Real wages have been going up steadily. The people who have had a hard time are the people who have lost their jobs altogether and are unemployed. I fail to see the logic of compensating those who are in work for the suffering of the unemployed.

425. It might give the impression, though, that you were trying to talk wages down on behalf of the employers, might it not?

(Mr Lawson) No, I think my remarks are addressed to employers.

426. Are not employers entitled to say to you there are a number of things that you can do to increase the mobility of labour and you are very coy about it.

(Mr Lawson) Go on.

427. The Rent Act - you are coy about that, are you not, Chancellor?

(Mr Lawson) I do not know about being coy about that. It is perfectly true that we have not abolished rent control. I think we have increased mobility very considerably in another area of housing by the policy of council house sales, because obviously the man who owns his house is more mobile than the one who is a tenant. In the private rented sector I think there is a problem. So long as there is the fear in some people's minds -

and I agree it is a gradually receding one, but so long as the fear is still there that there may one day be a Labour government which would impose rigid rent control, then people are unlikely to invest their money in private rented property.

428. Chancellor, we all know the various things that can be done to increase the mobility of the labour market. There is no point in going down the checklist with you.

(Mr Lawson) We are doing these things, as I say.

429. Where have you made a speech in which you have said if the key priority of our society is rapidly to reduce unemployment without reflation, there are a number of specific areas of policy which ought to be adjusted, whether it is the Rent Act, the wages councils, the national insurance charges, the Redundancy Payments Act, all those things? Where have you made a speech in which you have tried to mobilise support against these various rigidities?

(Mr Lawson) Mr Budgen, let me say two things. First of all, there are a number of measures we have already taken, on the national insurance surcharge, on council house sales and so on and so forth, and they have improved mobility. I have made speeches saying that but they do not attract a great deal of attention because people are not particularly interested, I think, in that aspect of our economic policy, important though it is. Also, a lot of the measures to encourage business start-ups are an attempt to create a more flexible market by having a stronger new business, small business, sector. All those things I talk about. As for talking about things that we at the present time may be discussing among ourselves collectively but have not reached conclusions about, it is a little bit odd coming from you when you began this by giving me a lecture on Cabinet Government.

Mr Budgen: No, I will not be so impertinent as to reverse roles with you to answer your questions.

Chairman

430. Chancellor, I think you should not assume automatically that questions designed to find out your views are ones where we necessarily accept the implied assumptions or their base. I want to tie up two loose ends which still remain to be cleared before we finish. We did have some discussions with Sir Terence and Mr Scholar earlier in the week on the question of External Financing Limits for the nationalised industries and one of them was with regard to the water industry, where I think we were concerned at the speed with which you were proposing to raise the rate of return in that particular industry. We were not sure on which basis the capital was being calculated, whether on a replacement cost or an historic cost basis. We understand that it was, in fact, being calculated on a replacement cost basis. Could you, nonetheless, tell us what rate of return you intend to get from the water industry under the new policy calculated on the historic cost basis?

(Mr Lawson) I could not tell you. Maybe we could provide that but I do not think it is of the slightest interest. All that a historic cost tells you is how much inflation there has been over the period of the lifetime of the asset. That is all that tells you. It is interesting for some purposes but not for setting appropriate returns for the water industry or, indeed, for the price of water.

431. I thought it was worthwhile clarifying that particular point. We shall no doubt look forward to the Inland Revenue adopting a similar principle so far as replacement cost is concerned. Let us leave it on one side. Could I just clear one other point: you stressed throughout your Autumn Statement the fact that public expenditure has been held within the planned 1985-86 White Paper limit. Nonetheless, it would appear that the estimates for asset sales, which I think have been referred to earlier, have been raised by nearly a billion pounds.

(Mr Lawson) I am sorry, may I say on the Revenue point to make it clear that the Revenue is in a totally different business. The Revenue is in the business of collecting whatever tax it is necessary to collect on a basis that is certain. The only thing that is absolutely certain clearly is the historic cost, so it has to be based on that. But if you were to allow people to revalue their assets to whatever they felt like and base their tax bill on that, it would lead to a certain amount of arbitrariness in the system of tax collection which would not really be consistent with good government.

432. It is equally arbitrary to revalue the assets of the water authorities in calculating the rate of return they are getting on capital investment. I think we are probably going too broadly.

(Sir Peter Middleton) No.

433. I was just putting to you that you have maintained in your earlier statements that the planning total for 1985-86 has been held within the White Paper limit and I was going on to say, before you came in a moment or two ago, that nonetheless the estimates for asset sales have been raised by nearly a billion pounds and, of

course, additional council house sales and the removal of the national insurance surcharge have benefited the departments by about half a billion pounds and gross debt interest estimates have been increased by a billion pounds or so to 16½ billion. Would it not therefore be true to say that, if one looks at the picture broadly, there has been a significant increase in public expenditure over the original proposals?

(Mr Lawson) No. On the two main points, on the tax side it is perfectly true that departments have had less to pay by way of national insurance surcharge and this was docked off them, but one has to take into account also that as a result of Budget changes they have had more to pay in VAT and also Corporation Tax. So it seemed, taking all these together, that it was reasonable to stick to the White Paper figure which was 132.1 billion and have that as the sort of target within which we wanted to get. As for the asset sales, the privatisation sales as Mr Freeman pointed out, and council house sales, these are higher, yes, indeed; but the convention has not changed. It has been in operation for as long as I can remember, and certainly before this Government came into office, and just as acquisitions of assets add to the public expenditure, sales of assets reduce public expenditure. But it is, of course, equally true that in many ways the nature of this reduction in public expenditure in economic terms is different from the nature of a reduction in public expenditure in other ways. It could well be very different. This, as I said, is taken into account in setting the appropriate borrowing requirement when it comes to the time of the Budget. So we do take all this into account and I did this year. But, although it is not true to say that the impact of

asset sales is different from the impact of other expenditure accounts, to say, as it were, these asset sales have no economic effect, no monetary effect at all, would be wholly wrong and, therefore, it is wholly wrong just to disregard them.

Chairman: Chancellor, we would like to thank you and your colleagues very much indeed for the evidence you have given us. We obviously need to consider very carefully the various points which have been made and the answers you have given. We would be grateful for the notes which have been mentioned in the course of our discussion. As you know, we hope to produce a report within the next week or so. Thank you very much indeed for coming this afternoon.

FROM: A M W BATTISHILL
DATE: 30 November 1984

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Littler
Mr Cassell
Mr Monck
Mr Burgner
Mr Lavelle
Mr Odling-Smee
Mr Scholar
Mr Culpin
Mr Griffiths
Mrs Lomax
Mr Cropper
Mr Lord
Mr Ridley

C
Building Blocks for
A.S. debate. *P*
Two 30/11

AUTUMN STATEMENT DEBATE

You will want to see the report by the Treasury Committee (which I hope we may see on Monday) before deciding on the final shape of your speech for Thursday's debate.

2. Meanwhile, we have put together some building blocks on the areas you thought you might wish to cover anyway. We have not attempted at this stage to weld them into a continuous speech, since your office thought it would be most helpful to let you have as much material as possible for your return from Paris. The main building blocks (some of which are at present much too long) include:

- (a) a short introductory passage with the usual courtesies to the Treasury Committee;
- (b) a passage about the Autumn Statement and the main themes of policy: this is largely taken from your opening remarks to the Treasury Committee;
- (c) an international passage, dealing with the world economy, the US and international debt: this is rather on the long side but can easily be shortened;

- (d) a passage on the markets and interest rates;
- (e) NEDC and the return of the TUC;
- (f) a passage on supply side, picking out some of the points from the forthcoming EPR Supplement;
- (g) the success of the BT flotation and privatisation generally: this can be looked at again on Monday in the light of fuller information;
- (h) an all purpose piece on public expenditure.
- (i) a reprise of the real pay and jobs issue;

3. I understand that Mr Lilley is working on a passage on the Opposition fallacies which he plans to let you have after the weekend.

- See also his note in blue folder below

4. To cover possible interventions, I am also attaching the notes Mr Faulkner prepared on student grants for the Treasury Committee hearing. I have also commissioned defensive material for next week on the other issues you mentioned: Mr Walker's Macmillan lecture; root and branch substantiation of the comparisons with the last Labour Government which you used in the Queen's Speech debate; the pressure for lower employers' NICs; and (in case Mr Budgen returns to the charge) the milk super-levy.

5. As a separate matter, Mr Scholar is arranging for the preparation of the speaking notes and background briefs for the Chief Secretary which his office commissioned yesterday. (Mr Broadbent's minute of 29 November to Mr Scholar).

Choy
A M W BATTISHILL

CONFIDENTIAL

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A M W BATTISHILL

AUTUMN STATEMENT DEBATE: CHANCELLOR'S DRAFT OPENING SPEECH

I beg to move:

[That this House...]

Mr Speaker, this is the third occasion in the past six weeks on which the House has been able to debate the progress of the economy.

I make no complaint about that. Quite the contrary. I welcome the opportunity this provides for the House to consider the Statement I made on 12 November, and to acknowledge the undoubted success of this Government's economic strategy in bringing about firm economic recovery.

A success which is there for all to see in four years of steady economic growth, with continuing low inflation, and despite the still tragically high level of unemployment, an encouraging rise in new jobs over the last 18 months.

And a success which owes much to our resolution in tackling the problem of continually rising public expenditure, in reducing the share of national income absorbed by the public sector, and in freeing resources for more productive use by private enterprise. In a word, Mr Speaker, in providing private enterprise with the room to breathe.

This year's Autumn Statement provides further proof, if proof is needed, that those policies are working and will succeed.

Mr Speaker, I shall have more to say about these matters in a little while.

But, first, I should like to pay tribute to the Chairman of the Treasury and Civil Service Committee, my rt hon Friend, the Member for Worthing, and to the members of his Committee for the expedition with which they have conducted their enquiry into the Autumn Statement.

I know my rt hon Friend will not take it amiss if I say I do not find myself wholly in agreement with every word of the Committee's report. He would perhaps be surprised - and some members of his Committee might even be disappointed - if that were not so.

Nevertheless, I am sure the whole House is grateful to the rt hon Gentleman and to the Committee for managing to ensure that we have the benefit of their report in time for this debate.

AUTUMN STATEMENT

The Treasury Committee can, of course, justly claim something of a proprietary interest in the Autumn Statement. For it was in response to an earlier report from that Committee that my rt hon Friend, the Foreign Secretary, when he was Chancellor, presented the first Autumn Statement to the House in November 1982.

This year's Statement is then only the third of its kind. And as a relative newcomer it will no doubt evolve over time as further improvements are made to it. But already I believe the Autumn Statement has come to be regarded as a most worthwhile addition to our affairs, providing the House with the kind of information it requires if it is properly to discharge those responsibilities which it has in relation to the conduct of our economic and financial affairs.

This year's Autumn Statement, like its predecessors, brought together a number of announcements which fall to be made at this time of the year. Its particular value, as I know many hon Members recognise, is that it allows the public spending plans for the year ahead to be set in the context of a fresh economic forecast.

But as the House also understands it is not an occasion for a general re-statement or updating of economic strategy. That is primarily for the Budget. Let there be no misunderstanding over what that implies. The Government's overall objectives and strategy are unchanged. We are determined to continue to bring down inflation and create the conditions which enable progress to be made in also bringing down unemployment.

We continue to make better progress on inflation than most commentators have expected, and this downward pressure should continue over the coming year. Although the forecasts in the Autumn Statement do not foresee much of a change in the inflation rate over the twelve months, we would still have achieved a significant period when inflation has been below

5 per cent. This was scarcely imaginable 5 years ago. But now expectations are adjusting to this much lower rate of inflation, providing the basis for yet further progress on inflation that our policies are designed to achieve.

We continue to hear it said that the years since 1981 have been a period of weak recovery. But a closer examination of the figures shows that the pace of recovery of output has, indeed, been far from weak.

If growth in 1985 turns out as expected then the economy will have grown since 1981 by almost 12 per cent. This is very respectable by past standards.

It more than matches the growth of output during the previous recovery period from 1975 to 1979.

We shall no doubt hear from the rt hon Gentleman the Member for Sparkbrook that there has been no recovery, that it is simply a figment of our imagination, because unemployment remains high.

Of course unemployment is too high. Of course, every Member of this House wants to see it lower. But only the rt hon Gentleman could persuade himself that 4 years of recovery is a complete illusion. The House knows better than that.

Why then has unemployment turned out higher than expected?

As I told the Treasury and Civil Service Committee, the first reason is that on average the growth of output has been matched by equivalent growth in productivity - an improvement we have been seeking for years, and not something now to lament. The fact is that our productivity growth has been faster than expected, particularly after the disappointing performance in the 1970s. Second, the labour force has grown by more than anyone expected, particularly women in part-time employment. This is not a new trend but nor can it simply be ignored as a factor in explaining the unemployment figures.

The House has heard me say before that the level of unemployment would have been improved if real wages had grown less rapidly. There is no point in hon Members opposite closing their eyes to this. Real wages in this country have been growing at a rate similar to the overall growth in output. If real wages had grown less rapidly the level of output would have been higher. And the ratio of employment to output would also have been higher.

[See separate passage on pay and jobs if more is needed.]

I do not want to labour the point today. It is a simple enough truth. Those who choose to ignore it do no service to those who cannot find work because those who have a job are keeping wages too high.

Nor can we ignore the world background, and the fact that recovery in some parts of the world has been slow. However, the outlook is distinctly better. Let me remind the House of the opening sentence to the Autumn Statement

/World economy.

World Economy

[Even those Hon Members who, regrettably, did not read it all through at a sitting may have read the opening sentence of this year's Autumn Statement. This stated that:]

"1984 looks like being the best year since 1976 for growth in world output and trade".

We have been seeing output in the main industrial countries rising this year at 5% - faster than any year since the mid-Seventies. World trade has been rising by almost double that. But, in contrast to other periods of recovery, we are not experiencing a resurgence of inflationary pressures.

The growing interdependence of the international community, in an era of mixed exchange rates systems, has been accompanied by the development of a growing consensus on the stance of macro-economic policies. We are seeing some of the fruits of that joint approach this year. We now need to consolidate the position.

Fiscal deficits in most major countries, though still more than double the average of the 1970s, seem set to fall for the first time since 1979. At the London Summit, and at the subsequent Bank and Fund meetings in Washington this autumn, a recurrent further theme was the need for adaptability: domestically and externally. This was seen as a critical factor in achieving sustained growth.

In international terms this means above all restraining protectionism. At the IMF meeting, the Managing Director spoke of protectionist measures poisoning the trading climate and weakening the fabric of international economic and political co-operation as a whole. The challenge here is not just to resist protectionism but to push forward with negotiations for further liberalisation in the framework of the GATT.

I shall say something a little later about the measures we have been taking to restructure our own economy. But I make this general point now. The most important contribution we can make to the health of the world economy must be sound domestic policies. The sad history of concerted action programmes, locomotive theories and all the rest in the 1970s, shows how erroneous it can be to imagine that unsound domestic actions can help the world provided we all act irresponsibly together.

US policies

A further major element in sustained recovery, perhaps the most visible of all, is the level of interest rates. And here the economic prospect in the United States is of major relevance.

There has been much academic debate about factors contributing to the historically high level of real interest rates at the present time. Some believe that at least part of the explanation is persisting inflationary expectations and the degree of volatility in the financial markets. However undoubtedly the

predominant factor - and this view is widely held, not only in Europe but in the United States - is the size of the US Budget deficit in relation to US domestic savings. The resulting upward pressure on interest rates has inevitably, leaving aside any safe haven considerations, also led to a sharp rise in the value of the dollar. The counterpart to the capital inflows financing the US Budget deficit is a substantial US current account deficit - of the order of \$100 billion a year. The United States will soon become a net international debtor. It could fairly quickly become the world's largest debtor.

These sort of imbalances can continue in the United States for much longer than they could in any other country. But that the world's wealthiest economy should be a persistent large borrower of capital from the rest of the world is not a sustainable position. It is neither healthy for the international community nor for the US. US growth, and the large US trade deficit, has, it is often claimed, had positive effects. But we cannot be immune to US interest rates: and the traffic in financial transactions is increasingly extensive and can be undertaken more rapidly. So we have also had to contend with a protracted adverse effect on our interest rate levels and growth prospect quite apart from the underlying problem of sustainability.

Shortly before the Presidential election Congress reached agreement on a \$150bn downpayment reduction in the fiscal deficit. President Reagan has made clear that longer term plans to cut the deficit further will be announced when the 1986 budget is presented in January next year. Public debate and speculation

about the coverage of this package is already in full swing and I shall not add to it today.

If a significant reduction is achieved, the effect on demand, and slow down of inflationary expectations could be expected over time to lead to reinforcement of the recent modest cut in interest rates which the US authorities judged could responsibly be made. Alongside that one could expect some easing of dollar levels. There has been concern expressed in recent days about the US economy falling imminently into recession. I see little evidence to support such a view at this stage. But a soft landing would of course be an infinitely preferable outcome to either a precipitate or forced landing or indeed to a process of circling the landing strip in a mood of growing anxiety. And it would also make a major contribution to easing the problem of international debt.

[International debt

I would like to say a little more at this stage about the debt problem. I have no doubt that the strategy adopted has been broadly right. But there are elements in it which we need to develop further.

The origins of the problem can be put quite briefly. First, there was too much borrowing, with an over-reliance on bank finance. Second, a period of sharply reduced economic activity, with a high dollar and rising real interest rates, put great strains on the ability of many countries to service their current debt. Third, we saw a loss of confidence in borrowers' underlying

creditworthiness.

The strategy has responded to each factor. Developing countries have cut back their borrowing, typically on the basis of adjustment programmes devised by the IMF. Second, as I said earlier, there has been a strong resumption of growth. Thirdly we have seen the beginnings of a return in confidence - and with it a willingness, through debt rescheduling, to give adjusting countries a real breathing space.

More adjustment is still needed in some cases if debtor countries are fully to regain the confidence not only of the outside world but also of their own people. A huge volume of potential investment has been lost to the debtor countries by the flight of capital from their own residents. As my new Canadian colleague said in his first Fund statement, governments of debtor nations have this additional incentive to persist with their policies: if they are successful they will attract investment that will reinforce their efforts.

However the form of those flows is also important. Over-reliance on commercial bank finance in the past brought problems for borrowers and lenders. One of the legacies has been the need for banks to adopt a higher level of provisioning and add to capital resources.

There is another moral to be drawn. The need in the future must be to supplement or substitute for bank finance. Banking flows will remain important. But flows from outside the banking sector should gradually become more prominent.

In the decade after 1973, bank lending to debtor countries doubled as a proportion of total borrowing. But the rate of increase of direct investment grew at a much slower rate. There are indications that a number of debtor countries have asked themselves whether past inhibitions on such investment are really justified.

A resumption of direct investment, as traditionally understood, is not the only form of private financial flow which we need to encourage. Some debtors are beginning to contemplate returning to the bond market. We need to even out the hump in debt repayment ahead in a variety of ways: to devise new instruments to bring stable capital to countries whose underlying resources are often so abundant.

We need also to encourage further co-financing arrangements of the kind already undertaken by the World Bank. If some of the capital at present attracted to the United States does in due course move elsewhere it may need to be helped on its way in this and other ways. Some countries suffering emergency conditions will of course continue to rely on aid from overseas, including aid for famine relief or special adjustments.

At the London Summit we proposed that finance ministers should set up an intensive discussion of international financial issues of particular concern to developing countries within the framework of the established international institutions. As Hon Members will know, the Interim and Development Committees responded to this initiative by their decision to hold special meetings

in April of next year and I look forward to a wide ranging debate, covering amongst others some of the ideas I have touched on this afternoon, at that time.

But I come back to this point. Success in tackling international debt is closely linked with the pace of world economic recovery. The biggest single contribution to easing the debt problem which could be made over the next year or so would be developments of US policies which could lead to lower dollar and world interest rates.

I conclude these remarks on the external background to the Autumn Statement by a comment on the time scale of the several forms of adjustment I have mentioned.

In a recent lecture Alexandre Lamfalussy stressed the importance of carrying out monetary targeting in a medium term perspective. He linked this with the fact that the financial systems in many western industrial countries are "to varying degrees caught up in three interconnected evolutionary processes: one of innovation and deregulation; one of growing internationalisation; and lastly one of disinflation". I agree with that comment. But I would go further. More effective multilateral surveillance by the Fund also, I have argued, requires a medium term timescale. And so does the shift in financing arrangements for debtor countries, about which I spoke just now.]

correct

Market developments

Interest rates are now back on a downward trend. As I predicted at the time, July's sharp rise in rates was quickly reversed, as markets came to recognise the soundness of our monetary stance. This confidence helped to stabilise market interest rates in October, when a variety of other factors were all exerting upward pressure. When these pressures eased in early November, market and base rates fell to levels more in keeping with our stated monetary objectives. So recent experience has done nothing to shake my belief that maintaining sound monetary conditions is the only way to secure lower interest rates in the future.

2. Sterling continues to be affected by the strength of the dollar and by continuing uncertainty in the world oil market, but recent base rate reductions have been absorbed without difficulty, further evidence of market confidence in our monetary stance.

NEDC

As the House will know, the National Economic Development Council met yesterday. This was the first meeting since June and the first meeting since February to be attended by the TUC. I welcome their decision to return to the Council. Whatever the differences may be between the members, it must be right for us all to discuss together the economic issues facing the country. One benefit will be that we shall restart the work on new jobs. That was initiated a year ago when the TUC and I each contributed papers on this vital subject. It is one part of the Council's overall concern with improving the performance of the economy on a sustainable basis. But all members are agreed on its importance and the need to make progress on it.

I do not of course imagine that NEDC will have access to some quick acting remedy for unemployment denied to others. Nor do I see the aim of the exercise as agreeing on some old fashioned deal or dramatic action plan. But co-operation between all the members of NEDC can help in two main ways. First the Council needs to be alive and well if the vitality of the Economic Development Committees which do valuable work on improving the performance of individual industries is to be maintained. Secondly the members of NEDC, who of course all have their

policy priorities and separate responsibilities, can find areas where they can influence each other. This influence can affect actions taken outside the Council which in turn affect the economy and the prospects for jobs. [A notable example is the way in which businesses and employees adjust to the Government's macro-economic policies.] My conviction that the ability of the Government on its own to create durable jobs is limited is well known. It is precisely because of that conviction that I value the NEDC and the exchanges it makes possible.

[We discussed yesterday proposals from the CBI and TUC to making NEDC more effective. We did not agree on all points, but there was a useful amount of common ground and I expect improvement to follow. We also discussed the Autumn Statement and the contribution that tax policy can make to increasing employment. At later meetings we shall move on to other major policy questions relevant to employment and training. These have always been natural subjects for NEDC because they involve interaction between Government, business and unions. But they are even more important now.]]

AUTUMN STATEMENT DEBATE: SUPPLY SIDE

Mr. Speaker, we need an economy which is competitive and dynamic. Competitive so that we can sell our goods and services. Dynamic so that we can take advantages of new technology, create new products and market them properly. At the end of the day economic performance must depend on the competitiveness and dynamism of the private sector and on encouraging and nurturing a genuine spirit of enterprise.

This has required a major change in direction. And a new respect for the risk-taking in our society. But both are essential for the long term health of the economy.

This Government has done its part to free the private sector from unnecessary shackles. Let me remind the House of the controls we have abolished. Over pay and prices. Over foreign exchange, dividends, hire purchase and bank balance sheets. And physical controls on industry have been removed.

We have tackled distortions on economic choice.

Distortions imposed by the tax system. The changes in corporation tax, along with the abolition of the National Insurance Surcharge, have reduced the bias in favour of machines and against jobs.

Distortions imposed by industrial subsidies. Now much more selective and working with the grain of the market rather than against it.

And distortions which had hindered job changes, like housing and pensions. We have encouraged owner-occupation. Over 600,000 tenants have now become owner-occupiers.

We have strengthened competition policy. Monopolies in professional services are being removed.

And, in the labour market, we have encouraged more effective democracy and reduced the monopoly power of trade unions.

But, important though these are, they are not enough. On this side of the House we believe in the need for incentives, - at all times. Including lower taxation. And we have done something about that - by raising income tax thresholds, by reducing income tax rates, and in the tax treatment of share option schemes.

We believe in a society of owners as well as earners - with wider home ownership, wider share ownership, and much greater participation by workers in the rewards of their company's success.

And we believe in Small firms. They have a vital role to play in securing our future prospects as a nation. But their very size makes them particularly vulnerable to the weight of government intervention. So we have deliberately reduced the burdens placed upon them. We are encouraging the flow of investment finance to small firms through the imaginative Business Expansion Scheme. And through the Enterprise Allowance Scheme we are encouraging people to become self-employed.

We are transferring activities to the private sector. We have contracted out a wide range of services in central Government and the National Health Service. Others, which remain within the public sector, are subject to a rigorous search for better value for money.

But the key element is our policy of privatisation.

CONTRIBUTION TO AUTUMN STATEMENT DEBATE - PRIVATISATION

I am pleased to be able to say that the Autumn Statement shows that expected receipts from special sales of assets - privatisation - have been increased to £2½ billion in 1985-86. This does not represent a deliberate acceleration of the privatisation programme but updated forecasts of likely receipts. The programme is continuing on course and is proving extremely successful. Twelve major companies, a number of other enterprises, and over 400,000 jobs have been returned to the private sector. I stress jobs purposely. Enough companies have now been privatised to show that privatisation is a text-book demonstration of the benefits of free-market enterprise over collective state activity. The common theme among privatised companies is higher turnover leading to more profits, more investment, and in turn more jobs. That is why privatisation is and will continue to be a main element in our economic strategy.

We have just completed the most successful flotation of any company anywhere in the world.

[BT material to follow.]

AUTUMN STATEMENT DEBATE

PUBLIC EXPENDITURE

The Medium Term Financial Strategy assumed public expenditure would be held flat in real terms. The figures published in the Autumn Statement show that we have succeeded in that aim. Finance has determined expenditure.

Of course some Hon Members would like to see higher public spending. They turn a blind eye to the higher tax burden or increased indebtedness that necessarily entails. A case of willing the ends but not the means⁷. For our part we have set out the context within which policy operates in the Medium Term Financial Strategy. And we are sticking to that strategy.

Other Hon Members would like to see total spending lower but spending on particular programmes increased. Unfortunately one of the perennial tasks of Treasury Ministers is to remind Hon Members that the whole cannot be less than the sum of the parts.

I would support a third approach. Keeping spending within bounds, concentrating on the key priorities for Government and securing greater value for money by increasing efficiency and cutting out waste. I look forward to the support of the House on that basis.

While total spending has been kept to the level in the last public expenditure White Paper there have been changes within that total. Extra money has for example been made

available for health and personal social services. And, in view of present overspends, provision has had to be made for local authority spending. This higher provision, together with stiffer penalties and rate capping, remedies the major source of overspending on plans this year. Nonetheless the Reserve for next year is set at £3 billion, £250 million higher than the Reserve for 1984-85 set in the last public expenditure White Paper. Forecasts of receipts from sales of assets have also increased. Under existing conventions this reduces total public spending although, as I have consistently made clear, receipts cannot be regarded as having the same monetary effects as other reductions in public spending. This is one of the factors that will have to be kept in mind when the Budget decisions are taken, in a few month's time.

AUTUMN STATEMENT DEBATE

Passage on Pay and Jobs for Chancellor's Speech

[Linking passage]

Public discussion about the link between pay and jobs, and even some comments in this House, have suggested that there are many misconceptions about it. Surprisingly this confusion has not completely engulfed the front bench opposite. As I pointed out on an earlier occasion the RHM for Sparkbrook has said that rapid growth of pay will bring fewer jobs. I would like to try to clear some of these misconceptions up, and, in the process of doing so, explain why it is so important.

2. There are only two major routes through which slower growth of pay leads to faster growth of jobs: faster growth of output, and faster growth of employment for any given output growth.

3. It should be obvious that slower growth of pay leads to more output, provided that the financial framework is unchanged. At the simplest level lower pay and prices make room for more output within a given amount of money GDP - that is, total expenditure in the economy. What is happening is that firms want to expand production because it has become more profitable. To sell the extra output they have to reduce the rate at which they raise prices. This stimulates demand, and the final outcome is faster growth in output and slower growth in prices.

4. Now I come to the first misconception. People say: Yes, but you have overlooked the fact that demand has grown more slowly because of the initial slowdown in wages; this prevents firms from selling more output.

5. But the people who say this have themselves overlooked everything else that is going on. They have overlooked the additional demand from firms for investment goods and stocks; the additional demand from foreigners because British goods have become more competitive; and the increase in demand from households, tending to offset the effects of the slowdown in wages, from slower growth in prices, lower interest rates, higher growth in dividends, lower income tax, and faster employment growth. ~~The empirical evidence that will be summarised in next week's Economic Progress Report shows quite clearly that~~ The net effect of all these factors is an increase in output. Indeed it is likely that even consumers' expenditure will be higher than it would otherwise have been after a year or so.

6. A second misconception is that the additional output results from the "expansionary" fiscal and monetary policies that slower growth in pay makes possible rather than from the pay slowdown itself. People who say this have misunderstood the implications of the Medium-Term Financial Strategy. This provides a nominal framework for the economy. By keeping money supply growing within its target range even when wages and prices and hence money demand slow down, of course there will be a tendency for interest rates to fall and of course this will stimulate demand. And by aiming to keep the PSBR on track, of course this gives us scope for tax cuts to prevent it from falling; and of course these stimulate demand and activity. But all this is within an unchanged nominal framework.

7. This is a far cry from the proposals I sometimes hear for a big increase in the PSBR or an unsustainable reduction in interest rates and the exchange rate. That an unchanged MTFs framework presents

opportunities for faster non-inflationary growth of output when nominal wages grow more slowly should come as no surprise to those who have understood our policies.

8. As well as faster output growth, a slowdown in pay will also lead to faster growth of employment for any given output growth. This idea has also given rise to misconceptions. People construct colourful images of machines being broken up and men and women doing the work by hand. Or they talk of low paid, low status jobs in laundries and hotel kitchens. But that is not what will happen.

9. All the time men and women are being replaced by machines. Sometimes the rate of replacement has been faster, sometimes slower. It is influenced by the relative costs of labour and capital. A slowdown in pay will tend to slow down the rate of replacement of men by machines. It will not reverse it, and it will not make us less competitive than other countries - on the contrary, the gains from the reduction in costs will make us more competitive.

10. Perhaps more important, there will be shifts between industries, with labour-intensive industries growing more rapidly - because the relative price of their products will be slowing down - and capital-intensive industries growing more slowly. For the economy as a whole this means that the growth of jobs will be higher for a given growth of output.

SECRET AND PERSONAL
COVERING UNCLASSIFIED.

cc Mrs Lomax
Mr Wood.

Mr Wynn Owen.

✓

Autumn Statement Debate

We spoke last week about changing the "markets" section of the Autumn Statement speech in the light of the "first guess", and given the confidentiality of this information, I attach a suitably amended version of the 'markets' section, as agreed.

M NELSON

C. Revised passage for A'S' below, given that money numbers will still be secret (out next Tuesday).

Plus 3/12

Market developments

Interest rates have continued to come down. As I predicted at the time, July's sharp rise in rates was quickly followed by falls, when markets came to recognise the firmness of our commitment to ensuring sound monetary conditions. This confidence helped to stabilise market interest rates in October, when a variety of other factors were all exerting upward pressure. When these pressures eased in early November, market and base rates continued to fall to levels more in keeping with our stated monetary objectives.

2. Sterling continues to be affected by the strength of the dollar and by continuing uncertainty in the world oil market, but recent base rate reductions have been absorbed without difficulty, further evidence of market confidence in our monetary stance.

c
A preview of
the TCSE report.
MP

FROM: R PRATT
DATE: 3 DECEMBER 1984

MR SCHOLAR

cc PS/Chancellor
Mr Battishill
Mr Burgner
Mr Odling-Smee



AUTUMN STATEMENT DEBATE

Not seen
DWP

I sent you earlier today an advance, draft, copy of the Committee's report (not to copy addressees). We hope to see a final version tomorrow morning. But on the basis of the draft it would seem that the following public expenditure issues might need to be covered in the material prepared for the Chancellor (Mr Battishill's minute of 23 November to Mr Makeham):

- (i) how public expenditure priorities are determined *→ A state guide*
- (ii) the treatment of asset sales, debt interest and tax changes in public expenditure (this is the one specific recommendation that the report now contains);
- (iii) credibility of the public expenditure plans - particularly given the cut in local authority spending and the 3 per cent pay assumption.

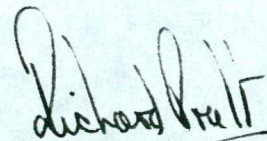
Although it is not a recommendation, and probably need not be specifically covered for the Chancellor's speech, in the report, the Committee "urge" the Chancellor to include a departmental split for the current year's estimated outturn in Autumn Statements.

2. I also attach, for Mr Burgner, the relevant paragraphs on nationalised industries' EFLs. The Committee specifically criticise the increase in the water industries' average rate of return on assets; the consistency of nationalised industries relative rates of return; and the "persistent cutting" of nationalised industries' EFLs -which particular reference to the effect on investment. I would be grateful if Mr Burgner would consider whether any briefing is required on this for the Chancellor.

3. The Committee repeat the charge that the prospective fiscal adjustment for next year is entirely dependent upon oil revenues. Again, there is no specific recommendation, but the draft report says that the Committee considers ^{it} to be "imprudent" to allocate temporary exchange rate related oil revenue benefits to

finance permanent tax cuts. The report goes on to conclude that the fiscal and monetary stance is actually more relaxed than intended last March. I should be grateful if Mr Odling-Smee would consider what additional material might be necessary for the Chancellor to cover this point.

4. We may have a clear ^{idea} what is necessary when we see the final version of the report tomorrow. But in the meantime, given that any necessary material will have to be submitted to the Chancellor by tomorrow (Tuesday) evening, it may be helpful to have some advance warning on the basis of the draft.

A handwritten signature in cursive script, appearing to read "Richard Pratt", written over a horizontal line.

R PRATT

amp

FROM: A M W BATTISHILL
DATE: 3 DECEMBER 1984

12/21

MR PERETZ ✓

cc Mr Broadbent
Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Scholar
Mr Folger
Mr Culpin
Mr Pratt

AUTUMN STATEMENT DEBATE: DRAFT MOTION

Last year I remember we were asked at quite short notice to suggest a draft Motion for the Autumn Statement debate. In case the same thing happens again this year, I thought it might be helpful if I circulated a draft. There is not a lot of scope for variation, and the draft follows fairly closely the lines of last year's text. However, I thought it worth adding in a reference to employment this year and to the Government's three year record in holding the planning total to White Paper figures.

2. If anyone has any comments perhaps they would let me know.

C
Thoughtful of M.B.
Looks OK to me.

amp
3/12

amp
A M W BAITTISHILL

amp

That this House approves the Autumn Statement presented by Mr Chancellor of the Exchequer on 12 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 keeping the public expenditure planning total for 1985-86 within the figure published in the 1984 Public Expenditure White Paper (Cmd 9143). ~~[the third successive year in which the planning total has been held to the level announced in previous White Papers.]~~

~~Philip~~
Can you pass this
wording to J Salveson
& Murdoch?
JLP

Note
Told John Salveson
+ asked him to ring Murdoch
with it immediately.
Puro 5/12

1. Dec
2. MP

FROM: MISS M O'MARA

DATE: 3 December 1984

cc PS/Chief Secretary
Sir P Middleton
Sir T Burns
Mr Bailey
Mr Cassell
Mr Burgner
Mr Battishill
Mr H P Evans
Mr Culpin
Mr Folger
Mr Pratt

MR SCHOLAR

TCSC: AUTUMN STATEMENT ENQUIRY

The Chancellor has seen the two notes by Mr Robinson and by Phillips & Drew attached to Mr Pratt's minute of 13 November. He has commented that these arguments are bound to feature in the TCSC's Report and will therefore need to be tackled in the Autumn Statement debate on Thursday.

MOM

MISS M O'MARA

pmg

FROM: R M PERFECT
DATE: 3 December 1984

cc Mr Perfect
Mr Battisill
self

Mus 3/12

- 1. MR SCHOLAR
- 2. CHIEF SECRETARY

cc Mr Gray *Mr Williams*
Miss Peirson
Mr Folger
Mr Makeham

✓ ✓

AUTUMN STATEMENT DEBATE

Mr Broadbents minute of 29 November commissioned a series of background notes.

- 2. Most fell to other expenditure divisions who will submit direct to the Chief Secretary with copies to GEP. Two full to GEP:
 - i. capital/current. I attach a note by Mr Davis and cleared with Mr Williams.
 - ii. the cost of the miners strikes - Mr Williams suggests using para 4 and 5 of the background to the TCSC - copy attached.

R.M. Perfect.
R M PERFECT

c
You may like to have this, too.
DM

CAPITAL/CURRENT AND INFRASTRUCTURE: BACKGROUND NOTE

- (i) Autumn Statement only provides outline expenditure plans for 1985-86. For detailed capital/current split, must wait for outline decisions to be translated into detailed programme figures in 1985 public expenditure White Paper. But note that document mentions "lower public investment, particularly by local authorities following the likely overspend in 1984-85.
- (ii) Last White Paper, Cmnd 9143, showed aggregate capital spending by public sector broadly maintained in real terms at 1978-79 level. In 1984-85, planned to be £24 billion or about one fifth of planning total.
- (iii) These figures exclude repair and maintenance expenditure which is very significant. DOE estimate that in 1983 R&M contracts for construction work alone represented additional expenditure by the public sector to the value of at least £5 billion.
- (iv) There is no "target" or "right" level of public capital expenditure. Each proposal must be considered on its merits in context of priorities for public expenditure as a whole. In some areas proper to cut back public sector investment to make room for private sector (eg, privatised corporations). In other areas Government recognises importance of public sector provision of infrastructure; and its decisions take proper account of relevant economic and social benefits. Little evidence to support widely held view that worthwhile projects, particularly in nationalised industries, not going ahead for lack of public funds.
- (v) Must remember Government's aim to reduce PSBR and hence interest rates and inflation, to provide framework for sustained growth. Jeopardising this objective (by higher total public expenditure, or wasting resources with non-cost effective expenditure) would be damaging in long run.
- (vi) If objective is to maximise the short-term employment impact of public expenditure, not clear that switch towards infrastructure would be sensible. Employment and training measures have a bigger and more direct impact per £ of expenditure. Spending on these measures has been steadily growing as a proportion of total public expenditure.

- (vii) Important thing is investment in the economy as a whole - particularly now that major enterprises such as BT have been/are being privatised. Across the whole economy, fixed investment in 1985 expected to be post-war record, as is 1984 figure.
- (viii) Do not believe that a genuinely viable project should need guarantees. They would only serve to undermine market disciplines. Such schemes often tantamount to higher public expenditure; with same potentially damaging impact on wider objectives, and private sector.
- (ix) Construction industry output for first half 1984 encouraging - up $5\frac{1}{4}$ per cent on same period of 1983; private industrial activity strong. Industry will benefit from marked rise in investment now taking place.
- (x) Reduction in net public sector housing provision in 1985-86 compared to last White Paper mainly reflects higher capital receipts from higher than previously expected level of council house sales. Government's policy is to transfer, where possible, new provision for housing to private sector. Number of private sector housing starts in 1983 was the highest since 1974.

PUBLIC EXPENDITURE IN 1984-85: PROSPECTIVE PLANNING TOTAL OUTTURN

(Note by HM Treasury)

The Committee have asked for a note on the prospective outturn for total public expenditure this year, the cost of the coal strike, and the claims upon the public expenditure Reserve. The Autumn Statement indicated (paragraph 1.58) that the prospective outturn on the planning total was nearly £128 billion, an excess of about £1½ billion over plans (shown in Table 2.1), and a figure which is broadly equivalent to the public expenditure cost of the coal strike continuing to Christmas. Since the Reserve was set at £2 ¾ billion, the implied aggregate potential excess on programmes is about £4¼ billion.

Firm Claims

2. The aggregate potential claim on the Reserve comprises a large number of items. Those already charged to the Reserve include increases in cash limited and demand-led programmes shown in Supplementary Estimates which have been presented to Parliament. The additional provision implied by Summer and Winter Supplementary Estimates is consistent with the estimated outturn for the planning total given in the Autumn Statement.

3. The main items in this category are summarised below:

	<u>£billion</u>
1. Carry forward of capital underspends in 1983-84 under the end-year flexibility schemes	0.3
2. Health service: pay of groups covered by review bodies, and of ancillaries; dentists and pharmacists expenses; FPS	0.4
3. Social Security (including National Insurance Fund)	0.3
4. Housing benefit (England)	0.3

5.	Export credit support	0.2
6.	Regional and selective assistance	0.1
7.	Other, net	0.2
	Total	<u>1.8</u>

The Coal Strike

4. As indicated by the Chancellor in his Autumn Statement, the public expenditure cost in 1984-85 of the coal strike continuing to Christmas, would be of the order of £1½ billion. This sum is a claim on the Reserve.

5. It should be emphasised that the projections of strike costs are subject to considerable uncertainty and it is only possible to give broad brush estimates. The impact on individual nationalised industries is affected by trading between them. After taking this into account, the aggregate impact on overall nationalised industry external financing is likely to account for about £1¼ billion of the total cost. The programme mainly affected, to a total of some £1 billion, is the Department of Energy's. Other industries affected fall elsewhere on the Trade, Industry, Energy and Employment programme and on the Transport and Scotland programmes. Aside from the impact on nationalised industry external finance, about £¼ billion will fall on other programmes, mainly Law and Order, in respect of the additional policing costs of the dispute, and also Social Security.

Other Potential Claims

6. The balance of the potential claims totals about £1 billion; this figure represents a net claim after taking into account some important offsets. The assessment of potential claims necessarily involves making forecasting judgments, on the basis of past experience and monitoring information as well as to reflect current developments, of the shortfall or longfall on particular categories of expenditure. Any detailed breakdown of this figure at this stage of the year would therefore be unreliable. It is, however, possible to indicate the main areas of divergence from plans:

- 1) Local authorities in GB are budgeting to overspend current expenditure plans by around £1.2 billion.
- 2) Local authorities' capital expenditure is also likely to exceed plans, although the authorities are in general heeding the Secretary of State's requests to exercise restraint and to maximise receipts.

- 3) There is a potential claim arising from an increase in our estimated net contribution to the EC.
- 4) Experience of recent years suggests that some departments will underspend their cash limits. In each of the last two years, such underspending has totalled £0.6 billion, although this margin will not necessarily be repeated.
- 5) It is also likely that receipts from the programme of asset sales in 1984-85, and other miscellaneous receipts that offset public expenditure, will exceed plans.

7. An up-to-date estimate of the prospective outturn on the planning total will be published in the Public Expenditure White Paper early in the New Year. Greater detail will also be given of the prospective outturn by programme, together with latest estimated external financing requirements for the nationalised industries. It will still probably be necessary, however, to include a unallocated estimate for additional shortfall or longfall, in line with the latest assessment at the time.



Handwritten signature

19

C
This is AWB's ^{draft} passage,
following yr discussion this
afternoon.

He is, in reflection, v.
reluctant to suggest saying
anything more specific
— either about the impact of
past cuts in tax or prospects for
the future.

It may, in any event,
have to take a rather different
form, depending how we end
up on Student Grants.

Handwritten signature

4/12

DRAFT PASSAGE ON STUDENT GRANTS/TAX

3/12/84 .

I entirely repudiate any charge that this Government is indifferent to the position of parents who are called upon to contribute towards the cost of their children's higher education. The proof of our concern - if proof is needed - lies in our record since 1979 in reducing the intolerably high burden of income tax imposed by Labour on families who hardly counted themselves as wealthy.

I have to remind my hon Friends of this. Those parents who will still face higher parental contributions next year are also among those who have benefitted from the real cuts in income tax we have made. The basic rate down from 33% to 30%; tax thresholds up 16% in real terms; and a start in producing a more reasonable scale of higher rates of tax.

Compared with merely indexing the income tax system we inherited five years ago, tax is down by almost £4 billion in 1984/5. And about a quarter of that reduction goes to those with incomes in the range of £15,000 to £30,000 a year.

Typically such families are now paying several hundred £s a year less in income tax this year as a result of the changes in this Parliament and the last. And

I hope to do still more to cut income tax in the Budgets that lie ahead. It is still too high. But so long as we keep firm control of public spending - as we mean to do - we can look forward to the prospect of still lower taxes for these families as for others.

3/12/84

We shall ask the House to reject the Opposition amendment. But there is one phrase in it - the allegation that our policies are calculated to sustain a high level of unemployment - which we reject with anger and disgust.

It is the very antithesis of the truth. All our policies are calculated to improve the prospects for generating jobs which can be sustained into the future.

No party in this House would deliberately foster an increase in unemployment as an objective of policy. We may, and do, differ at the best means of eradicating the scourge of unemployment. But all parties are united in pursuing that objective and so it should be.

The allegation in the Labour Party amendment dem^eans_h those who made it.

What is more it comes ill from a party:-

which knows that the miners' strike is destroying jobs, yet calculates that it is in Labour's interest to support this destructive conflict as long as it persists.

It comes ill from a party which knows that excessive pay destroys jobs yet calculates it is in their interest to support ^{militancy} wherever it ^{occurs} ~~manifests itself.~~

The allegation comes particularly ill from the RHG, who has admitted that his own Party's economic policy is "fatally flawed" because it ignores the link between excessive pay and fewer jobs. Yet with cynical calculation he remains the Spokesman for a policy which he has described as "incredible."

The Alliance, too, participate in this shabby, cynical calculation.

Their policy on jobs, such as it is, has shrunk to the proposal that we spend ~~one~~ ^{one} billion ^{pounds} on road building and other major construction projects.

Yet we all know that there isn't a major construction ^{or} road building project in this country which is not opposed at a local level by the Liberal party. When their calculations tell them where the votes lie, jobs go out of the window. Generous in theory, but selfish in practice.

The truth is that unemployment has been growing throughout Europe in every single year but one since 1973. It is absurd to say that ^{thus} remorseless and tragic increase has been the calculated consequence of ~~all~~ ^{diverse} the policies pursued by all the Labour, Conservative, Social Democratic, Socialist, Lib/Lab, and coalition governments that have been in power across Europe in the last decade.

In this country since the general election 300,000 extra people have found jobs. Not enough to absorb the unexpectedly large number of people seeking jobs. But a superior performance to the rest of Europe where the number of jobs appears to have continued to shrink. And where unemployment continues to increase at a more rapid rate than in this country.

Moreover, we now have in this country a higher proportion of our population in jobs than almost any major industrial country.

What is more, the countries which have been most successful in creating jobs have been those across the Atlantic and the Pacific who have relied more on free enterprise, low taxation, fewer controls, non-militant unions, and a flourishing enterprise culture. These are the very policies which the

Government is seeking to introduce to enable this country to generate the jobs and create the wealth which we all want to see.

But the real weakness of the opposition case lies not in what they do say but what they fail to say. In repeated debates in this House they have made virtually no attempt to spell out ^a credible and coherent explanation of how they would resolve the problems which this and every other major industrial country faces in the world today.

To them 3 million unemployed is not a problem to be solved but a tragedy to be exploited. They are like a doctor who offers his patients sympathy but refuses any diagnosis, any prognosis and any prescription.

Real compassion requires of us more than sympathy. It requires a willingness to face the tough choices, ~~it~~ requires a willingness to stand up to vested interests.

Unless the opposition parties are prepared to tell us what they would do - and why it would work now when it failed in the past and has been rejected by nearly every government in the free world - those parties will find themselves in the wilderness for a generation.

This Government has had the courage to make tough choices. It has had the resolution to stand up to vested interests. It has had the consistency to pursue a longterm strategy. And it offers the people of this country the vision of a free economy, which will harness their energies to the creation of jobs and ^{the} generation of the wealth, ^{we all} which we want as much for the welfare of the needy as to fulfil the legitimate aspirations of the majority.

(page)

FROM: DAVID PERETZ
DATE: 3 December 1984

PS/CHIEF SECRETARY

cc Mr Battishill
Mr Scholar

AUTUMN STATEMENT DEBATE

The Chancellor has seen your note of 29 November commissioning material for the Chief Secretary's wind up speech.

2. There is one point he would rather the Chief Secretary did not make - that is the suggestion, at paragraph 2(v) of your minute, that the fiscal adjustment could as in some past years turn out to be greater than is now being estimated.

A handwritten signature in cursive script, appearing to read 'DLCP'.

D L C PERETZ

mp

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mp

D L C PERETZ

David

He doesn't want to make the point. He wants to be in a position to deal with it if it is raised. I will make sure he is aware of the need for caution.

ps
etc

3/12/84

~~12/2~~

cc: McInerney; W Shields
PPS ✓

NNNN

031937 :REGAN STRESSES TAX REFORM, DEFICIT CUT SEPARATE
WASHINGTON, Dec 3 - Treasury Secretary Donald Regan stressed that his tax reform proposal would be dealt with separately and take second place to the administration's deficit reduction proposals.

In a speech to the National Press Club, Regan said the deficit problem did not diminish the need for a fairer tax system but added, "Deficit reduction is critically important but it is another matter completely. It will have first priority."

MORE

S

032010 :REGAN STRESSES =2 WASHINGTON

(Out of sequence)

Regan also acknowledged that the proposal could change as Congress, business groups and taxpayer organizations put forward their views.

"If it can be improved, we're willing to listen." He held out little chance of radical changes, however. "We are not backing away from the plan."

The Treasury Secretary also said he hoped that the plan would be considered by Congress early next year even though the president has not yet given his reaction to the proposals, presented to him just one week ago.

REUTER

031952 :REGAN STRESSES =3 WASHINGTON

Regan also ruled out using tax simplification as a vehicle for tax increases. He said "The President does not want to raise taxes."

Turning to the current deficit reduction talks at the White House, Regan once again emphasized that defense would have to be included in any package of spending cuts or freezes and could be brought "down quite a bit" through cost savings.

But with Defense Secretary Caspar Weinberger in Brussels for NATO talks, Regan thought it unlikely that defense would be discussed by the budget "core" group today.

REUTER

CONFIDENTIAL

pl. retypeFROM: DAVID PERETZ
DATE: 3 December 1984

MR PRATT

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Mr Bailey
Mr Anson
Mr Cassell
Mr Battishill
Mr Evans
Mr Odling-Smee
Mr Lankester
Mr Scholar
Mr Gray
Mr Riley**AUTUMN STATEMENT: 3 YEARS EXPENDITURE
AND REVENUE FIGURES**

The Chancellor was grateful for the illustration attached to your minute of 23 November.

2. Although we must now wait and see if the TCSC report makes any mention of this possibility, the Chancellor thinks that in any event ~~it should be included in~~ the post-mortem on this year's PES round, ^{should cover} ~~which should cover~~ presentation in general, *and this possibility in particular.*

D L C PERETZ

FROM: R M PERFECT
DATE: 3 December 1984

- 1. MR SCHOLAR
- 2. CHIEF SECRETARY

R. M. Perfect
 cc Mr Gray
R. Williams
 Miss Peirson
 Mr Folger
 Mr Makeham

AUTUMN STATEMENT DEBATE

Mr Broadbents minute of 29 November commissioned a series of short speaking notes.

- 2. I attach drafts - prepared in GEP. Miss Peirson has contributed note v.

R. M. Perfect.
 R M PERFECT

i. The importance of controlling public expenditure for achieving the Governments overall economic policies

Failure to control public spending would mean failure to reduce taxes on people and the firms they work for.

2. Over the last twenty years more and more people on lower incomes have been brought into tax while social security benefits have risen broadly in line with earnings. The result has been increasing numbers of people have come to be simultaneously subject to tax and entitled to means tested benefits. If their incomes rise they suffer an increase in tax and a withdrawal of benefits. The marginal rate of deduction for them both can be higher than the marginal tax rate at the top end of the scale. The resulting poverty trap means that many people have little incentive to find a job. We must reduce the tax burden on these people. And that necessitates tough decisions on public expenditure.

3. If we succeed, a reduction in the burden of taxation will allow a reversal of the trends of the last twenty years.

- we could tackle the poverty trap by taking more of the lower paid out of tax.
- we could reduce the proportion of income taken by income tax, increasing the incentive to work.
- and we could lessen the burden on industry, improving competitiveness and employment.

ii. Process by which expenditure decisions are reached.

The medium term financial strategy sets the framework within which policy operates.

2. That framework is based on holding public expenditure constant after allowing for inflation.
3. Having considered what can be afforded Government has to decide what bills have to be paid for and what the priorities should be. Expenditure decisions then reached in discussion between Treasury and spending departments. ~~Results reported to Cabinet and~~ ^{with final stages in Cabinet Committee} ~~and Cabinet.~~ ^{final stages of discussion may take place there too.}
4. Results reflect Governments priorities.
 - i. defence - the NATO commitment for growth of some 3 percent growth in real terms up to 1985-86 has been honoured. Provision for defence spending has increased 30 per cent in real terms (1978-79 to 1985-86).
 - ii. health - growth of nearly 1 per cent for hospital and community health services for the increasing number of old people. Health and personal social services provision has increased 19 per cent in real terms (1978-79 to 1985-86)
 - iii. social security - provision has been increased to provide for full uprating in November 1984 (in real terms this provision rises 31 per cent 1978-79 to 1985-86).
 - iv. spending on law and order is up-36 per cent in real terms 1978-79 to 1985-86.
5. In addition we have had to increase provision for local authority expenditure in view of their continued overspending. Tougher penalties for exceeding target or guidelines.
6. Given the stable total we must make savings in order to have room to spend more on those areas that only Government can deal with.
7. As we saidⁱⁿ the Green Paper on Public Expenditure in the longer term, controlling the whole calls for a rigorous application of priorities. We first decide what can be afforded, set our spending plans accordingly and then stick to those plans.

iii. Credibility of the 1985-86 total in light of 1984-85 overshoot

Additional claims on expenditure in 1984-85 mean that the prospective outturn is some £1.5 billion higher than planned. The major factors are the coal strike and local authority overspending.

Coal strike

2. Have assumed baseline for 1985-86 figures. So there will be some adjustments relating to NCB after the strike. They cannot be forecast with any certainty but would include minuses as well as pluses and the aggregate effect may not be very large - it depends on the outcome.

LA relevant current

4. Have made extra £900 million provision and increased penalties for exceeding target or guidelines. And rate capping has been introduced.

Other spending

5. Have taken steps to improve forecasting or demand led expenditure which has been major contribution to unplanned spending in past. As a result provision for ECGD, IBAP and Social Security have all increased. And we have solidly based estimates of European Community contributions now that negotiations over.

iv. Asset sales, cuts in Reserve and NIS adjustmentExtra receipts

special sales of assets	-500
housing	-430
Reserve	-750
	<hr/>
	-1680

Demand led increases

Social Security	+470
ECGD	+160
IBAP	+180
European Community	+200
LA current	+900
	<hr/>
Total (excludes £100m double counting)	+1810

Receipts

- figures for receipts are forecasts of what existing policies will produce. Privatisation right for wider issues - liberalises resources for most productive uses.
- forecasts of demand led expenditure have increased more than forecasts of receipts and the change in Reserve.

Reserve

- Wedge shape Reserve always reduced as plans rolled forwarded ^{each} a year.
- Reserve of £3 billion, £250 million higher than allowed for 1984-85 in last public expenditure white paper.

Planning total

- As well as abolition of NIS surcharge one has to take into account VAT and Corporation Tax changes which add to public expenditure. Taking all these together, reasonable to stick to Cmnd 9143 planning total .

(v) Fiscal Adjustment 1985-86.

1. Some have suggested that the fiscal adjustment next year may turn out to be greater than we estimated in the Autumn Statement. That is, the scope for tax reductions in the next Budget may have been understated. Others have suggested the opposite.
2. I should like to emphasise two points on this.
3. First, the projection in the MTF5 we published last March, for the PSBR in 1985-86, was illustrative only. My RHF will be reconsidering the appropriate path for the PSBR, in the run-up to the next Budget, in the light of all the latest factors.
4. There are those who say already that we should aim at a considerably lower figure, particularly because of the changes in the forecast paths of North Sea oil revenues and asset sales. Indeed, we pointed out in the Budget Report last March* that the pattern of these receipts in particular must be taken into account in determining the appropriate path of the PSBR. On the other hand, there are so many other changes happening that it is possible that the PSBR next year should be higher rather than lower. These considerations underline the fact that the estimates of the fiscal adjustment published hitherto rest on some very broad assumptions.
5. Secondly, it must be remembered that the forecast of the underlying fiscal picture is extremely uncertain, even at this stage. The public sector borrowing requirement is the net difference between flows of receipts and expenditure approaching £200 billion a year. With the best will in the world, we cannot expect to make precisely accurate forecasts of these flows. The margin of error in our present forecast

* Paragraph 2.17 of FSBR.

of the fiscal adjustment next year is certainly considerably bigger than the projected fiscal adjustment itself. One obvious possibility is that changes in both dollar oil prices and the sterling/dollar exchange rate could either reduce or increase our North Sea oil revenues significantly, compared with our present forecasts.

6. For both these reasons, therefore, it is impossible to say at this stage what the scope for tax changes in the next Budget will be. My RHF will be reaching a view on that in his Budget judgment, and I cannot anticipate his conclusion.

vi increased efficiency and reduced administrative costs.

We have concentrated on achieving savings by improving efficiency.

- the number of civil servants has fallen 115,000 since April 1979 (to 617,000 in October 1984): This saves around £1 billion a year on gross pay bill.
- we are contracting out work to the private sector where that can be done at a lower cost to the tax payer. Some substantial savings-£18m net per year- achieved from competition.
- the Financial Management Initiative was launched by Prime Minister to make Civil Service more business like - with clear objectives. As part of that initiative we are developing measures of output so value for money can be better assessed. Expect this to be reflected in the public expenditure White Paper to be published early next year.