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Alex Lawson

PART A

**SECRET**

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PART A

1985

Begins: 19/3/85

Ends: 6/12/85

DD: 25 years

5/9/95

CHANCELLOR'S
MISCELLANEOUS PAPERS
FROM 1985

PO -CH /NL/ ~~00105~~ 0848
PART A

DM/A26

CONFIDENTIAL

bf 28/3 pl.
PP

SECRETARY OF STATE FOR EMPLOYMENT

✓ 21/3

CH/EXCHEQUER
REC. 21 MAR 1985
ACTION Mr Monck
COPIES TO CST, FST, MST, EST
Sir P. Middleton
Mr Bailey
Sir T. Burns
Mr Burgner
Mr Lovell
Mr Cropper
Mr H. Davies
Mr Lord

Caxton House Tothill Street London SW1H 9NF

Telephone Direct Line 01-213 6400

Switchboard 01-213 3000

Miss Margaret O'Mara
Private Secretary to the
Chancellor of the Exchequer
HM Treasury
Great George Street
LONDON SW1

19 March 1985

Dear Margaret,

**COMMUNITY PROGRAMME**

We expect to receive a number of Private Office cases for Ministerial reply following the changes to the Community Programme announced today. I am attaching a copy of a standard reply which we hope to use. I should be grateful for any comments you may have on this.

Yours sincerely,
Judith Rutherford.

JUDITH RUTHERFORD
Private Secretary

CONFIDENTIAL

DRAFT STANDARD REPLY FOR PRIVATE OFFICE CASES: COMMUNITY PROGRAME, after 19.3.85

You will have seen the Chancellor of the Exchequer's budget announcement that the Community Programme is to be increased in size by 100,000 places a year to 230,000 places a year. As you now, the Community Programme has been very successful with the original 130,000 place target exceeded in January 1985. In the light of this and the widespread support for the Programme Tom King and I made a very strong case to the Chancellor for an increase in the size of the Programme. As you can imagine I was very pleased to learn that the Chancellor had been able to agree this substantial major increase in the size of the Programme. I think you will agree that this reinforces the Government's continuing concern to help unemployed people in a cost-effective manner within our overall economic policy.

Following the Chancellor's announcement I have asked Bryan Nicholson, the Chairman of the Manpower Services Commission, who administer the Programme on behalf of the Secretary of State to consider how these additional resources can be allocated on a fair and equitable basis while at the same time ensuring that the extra resources are used as quickly as possible to help long-term unemployed people.

b/f [illegible]

CH/EXCHEQUER
REC. - 3 APR 1985
ACTION Mr Robson
COPIES TO Sir P. Middleton
Mr Cassell

✓ 3/4

PM/85/25

PRIME MINISTER

UK Continental Shelf: Production Controls

1. Peter Walker sent me a copy of his minute of 25 March about his discussions with Shaikh Yamani. I have also seen your Private Secretary's letter of 26 March.

2. It was to be expected that OPEC would respond to our decision to abolish BNOC by attempting to engage the UK in their efforts to prop up the oil market through production restraint. Yamani's comments expand on arguments which he and other OPEC Ministers have also made publicly.

3. I attach an assessment of our exposure to possible OPEC retaliation against UK interests. While the OPEC countries have considerable scope for acting against us, this does not in my view constitute in itself a reason to adopt any of the measures listed in the annex to Peter Walker's minute. For us to introduce controls now would inevitably be interpreted at home and abroad as a signal that we were prepared to collude with OPEC in keeping oil prices high. This would cause considerable problems in our relations with the US, the rest of the Community and in the International Energy Agency. I imagine it would also bring new criticism in Parliament. Moreover, once we had admitted our ability and readiness to use such powers, we would be under continual pressure from OPEC - and also from consuming countries - to use them.

/4.

4. The political and economic arguments for introducing restraints would have to be very strong to outweigh this. As to the economic arguments, they were well summed up in Peter Walker's letter of 20 January 1984 to me; namely that to attempt to influence the balance of supply and demand through the control of UK output would be very costly, could damage confidence in North Sea investment and would work only if it appeared likely to clinch an OPEC pricing agreement. On the political front, the major decisions to abolish BNOC and to move to market prices have been accepted by OPEC with remarkably little criticism so far. Having extracted ourselves from the front line over pricing, we would need strong reasons to re-enter it over production. The likelihood of OPEC action against our interests is no such reason, at least at this point. Our policies on production are sensible and we should stick to them.

5. As to royalties, I would favour a move to take them in cash rather than in kind if the practical and revenue considerations so permit, since to do so would distance us even further from the market.

6. I am copying this minute to the Chancellor of the Exchequer and the Secretary of State for Energy.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
3 April 1985

ANNEX

THREATS TO UK INTERESTS IN OPEC COUNTRIES

1. Should OPEC governments wish to take action against the UK, they have two options:

(a) to increase their own production in order to bring the price of oil down to an uneconomic level, thereby putting pressure on operations on the UKCS;

(b) to act against UK interests in their individual countries.

Increased oil production

2. The first course, to drive down the price of oil through increased production, would present OPEC with organisational problems. It would at the least put a heavy strain on its unity, and could well lead to its breaking up. It would also create immediate financial difficulties for the debtor countries, particularly Nigeria and Venezuela.

Direct action against British interests

3. Co-ordinated action against UK commercial interests would in principle be less difficult to organise. It is best to consider separately the possible scope and the likelihood of such action.

4. As regards the scope, UK exports to OPEC countries totalled around £6 billion in 1984. Saudi Arabia is the UK's biggest market outside North America and Western Europe; Nigeria is the biggest in black Africa. Principal interests in OPEC countries are set out in the attached table.

5. The key countries in terms of political sensitivity are again Saudi Arabia and Nigeria, although the diversity of our political and commercial relations with other OPEC states renders the UK vulnerable to some degree across the board.

6. Saudi Arabia, The Saudis, like others, have never fully accepted that HMG could not control production if it so wished. Were they to judge that our refusal, or failure, to control production was the main factor which undermined an OPEC agreement on production restraint and led to a further fall in prices, they might take action which would damage UK short term interests, for example by placing barriers to our exports to Saudi Arabia (about £1.3 billion a year); or (perhaps more likely) by rejecting our bids for important defence contracts (for example Tornado, Challenger). Total possible defence sales to Saudi Arabia at the moment amount to about £1.5 billion, and Saudi Arabia is the first target for UK defence sales over the coming decade.

/7.

7. Nigeria. The Nigerians have shown themselves less sensitive over production levels than they have been over pricing, but they keep a critical watch on the trade of UKCS oil, which is of a similar quality to their own. They might regard OPEC retaliation against the UK as an opportunity to divert attention away from their own maximising of production (at present about 1.6 mbd, as against their OPEC quota of 1.3 mbd). Nigerian retaliation could include nationalisation of some assets (for example Shell), repudiation of insured debts and action against British Caledonian, for whom the viability of the Lagos route is essential.

## Likelihood of Retaliation

8. While the scope for OPEC action against UK interests is considerable, there is no indication at this stage that the Organisation as a whole or individual members are considering retaliatory measures, nor is it ~~not~~ clear what any retaliation would be against: the United Kingdom has not declared that it intends to maximise production, or that it would never consider limits to production. When the decision to abolish BNOC was communicated to other oil producing governments, only the Venezuelan government made any reference to production restraint. Yamani's demarche to Mr. Walker was nevertheless clearly designed to exert pressure on HMG by warning of OPEC's concern at production levels (of which we are in any case aware).

9. Despite the urging of Yamani and OPEC as an organisation that HMG should cut production, they are probably as aware as we that the effect of any action the UK might take would have at most a marginal effect on the market. It is not therefore likely that they would force a political battle by acting directly against UK interests unless as a gesture of desperation - for example, if OPEC's own system of production controls or the Organisation itself were about to fall apart, or the market to collapse. This does not rule out the possibility of ad hoc discrimination against UK contractors by OPEC governments, for example, but in most cases decisions would probably be made on the objective merits of the contract in question. We have received no warnings or hints that such action is under consideration by any OPEC government at present.

10. The decision to abolish BNOC has got us off the hook of OPEC pressure on prices. As such, it is not to the advantage of OPEC. However, the market remains calm, and Yamani's comments should be seen as a tactical move rather than an ultimatum. There is no evidence that he has attempted to organise pressure by OPEC member countries generally.

# UK/OPEC TRADE RELATIONS*

**1984**

Exports to OPEC £6.4 bn

Imports from OPEC £2.4 bn

*(not including Gabon)

| Saudi Arabia | Visible Exports | Imports | Principal Business Sectors | British Subjects |
|---|---|---|---|---|
| | 1.3 bn | 507 m | Defence sales. Telecomms. Power generation. Agriculture. Health care products. | 35,000 |
| Iran | 703 m | 368 m | Machinery and transport equipment. Chemicals. Health care. Raw materials (iron and steel) | 70 |
| Iraq | 343 m | 69 m | Machinery and transport equipment. Textile and metal goods. Health care products. | 1,400 |
| Kuwait | 301 m | 141 m | Electricity generation. Desalination and Sewage Construction. Health care. | 5,800 |

| | Visible Exports | Imports | Principal Business Sectors | British Subjects |
|---|---|---|---|---|
| Qatar | 133 m | 28m | Power generation. Electrical Health Care. Sewerage Constuction. | 5,400 |
| UAE | 542 m | 87 m | Construction. Power generation. Agriculture. Health Care. | 7,100 |
| Nigeria | 614 m | 253 m (Jan-Oct) | Defence sales. Agriculture. Health Care. Raw materials. Chemicals. | 11,000 |
| Algeria | 287 m | 274 m | Machinery and transport. Telecomms. Dairy products. | 1,800 |
| Libya | 264 m | 155 m | Construction. Capital plant. Health Care. Motor vehicles. | 4 - 5,000 |
| Venezuela | 102 m | 249 m (petroleum products 94% of total) | Whisky. Chemicals. Machinery. Dairy products. | 2 - 4,000 |

| Ecuador | Visible Exports | Imports | Principal Business Sectors | British Subjects |
|---|---|---|---|---|
| | 34 m | 13 m | Defence Sales. Power generating. Transport. Textiles. | 550 |
| Indonesia | 186 m | 181 m | Power generating. Machinery. Chemicals. Road Vehicles | 5,000 |

c/ Draft to issue?

OK

MOM 24/4

FROM: S A ROBSON
DATE: 23 APRIL 1985

CHANCELLOR OF EXCHEQUER

c.c. Sir P Middleton
Mr Cassell
Mr Moore

NORTH SEA OIL : PRODUCTION CONTROLS AND ROYALTIES

This submission deals with Sir Geoffrey Howe's minute of 3 April to the Prime Minister and the letter of 10 April from Mr Walker's private secretary to No 10. It recommends you write to keep open the option of an early change from royalty in kind (RIK) to royalty in cash (RIC). The delay is making this submission has been caused by the need to discuss the position with people in the department who have been on holiday.

2. The correspondance arose from a discussion at No 10 on March 26 which considered Yamani's unattractive ideas for restricting UKCS oil supply. These ideas were set out in Mr Walker's minute of 25 March to the Prime Minister. I commented on them in my submission of 27 March. Miss O'Mara's minute of 29 March recorded your decision not to write at the time in view of the discussion at No 10.

3. The discussion at No 10 ended with the Prime Minister concluding there was agreement about the difficulties of restricting North Sea production. She asked Sir Geoffrey to prepare an assessment of the likelihood and possible scope of OPEC retaliation against British interests. She asked Mr Walker, in consultation with you, to consider the method and timing of a move to RIC.

4. Sir Geoffrey's response is entirely helpful. He notes that OPEC have considerable scope for retaliation but he does not consider this a reason to adopt production restrictions or delays. He believes that, if we did, this would attract criticism from other countries and from the House and would bring us under

continual OPEC pressure. He rightly points out that production restrictions are very costly, would damage confidence on the UKCS and take us back into the limelight which we so successfully got out of by abolishing BNOC.

5. Sir Geoffrey also says he would favour moving from RIK to RIC "if the practical and revenue considerations permit". He considers this would further distance us from the market.

6. The letter from Mr Walker's private secretary is not so helpful. Mr Walker apparently believes that the No 10 meeting agreed the switch to RIC should happen when the PSBR impact could be accommodated and in the longer term. He is opposed to an early move which he believes would call into question the case for the new Oil and Pipeline Agency and raise concerns about security of supply.

7. The letter quite misleadingly gives the impression that the statement on BNOC abolition linked security of supply to the taking of RIK. In fact it quite deliberately linked it to the power to take RIK (see attached copy of statement) and that power would be retained if we switch to RIC.

8. The letter concludes by saying Mr Walker will be ready to review royalty oil "once the new agency has been successfully established". It is not clear (even to his own officials) what Mr Walker has in mind here. The OPA will not be formally in place until Autumn 1985 so the formulation would rule out any change in 1985-86, particularly as notice of a change has to be given six months ahead of the start of a chargeable period.

9. Chargeable periods start in January and July. This means we have the opportunity to make a change from 1 January 1986 if notice were given before 30 June 1985. The change would involve a once and for all cost of some £350 million in the year of change and additional debt interest of some £50 million a year.

10. The obvious time to consider such a change would be when you have the next economic assessment. This will be available in June and so fits in nicely with the need to give notice. At that time you will wish to consider the PSBR cost in relation to the forecast PSBR outturn. It is also relevant that RIC is paid in two instalments a year - at end February and end August. RIK comes in pretty evenly throughout the year which means the change would make the public sector cash flow more lumpy and the PSBR more front end loaded.

11. I am pursuing with the department the question of spreading RIC payments. One possibility would be to offer the move to RIC to any licence group which wanted it on the condition that they made payments on some more attractive schedule than they are legally obliged to do e.g. quarterly. This would not reduce the once and for all cost but would reduce the lumpiness and the annual interest cost.

12. I recommend you write supporting Sir Geoffrey's assessment and saying you may want to return to the question of a move to RIC when you have the June economic assessment. A draft is attached.

SAR

S A ROBSON

## British National Oil Corporation

3.38 pm

**The Minister of State, Department of Energy (Mr. Alick Buchanan-Smith):** With permission, Mr. Speaker, I wish to make a statement about the British National Oil Corporation. I hope that it is for the convenience of the House that I make this statement now, in view of the debate arranged for tomorrow.

In the summer of last year, the Government reviewed the institutional arrangements and operations of BNOC. We then concluded that the balance of advantage lay in retaining the corporation in its present form, given the contribution that it was able to make to deriving full benefit from our oil resources.

Since then, the environment in which BNOC has to operate has undergone important changes. BNOC has traditionally operated by purchasing and selling oil under term contracts at prices fixed for a period of months ahead. Its purchases under participation contracts have been in this form which, as I explained to the Select Committee on Energy, has enabled BNOC to make a contribution to stability of markets in the short term.

There has, however, now been a major change in the structure of the oil market away from term contracts and towards spot and similar short-term transactions. This trend is unlikely to be reversed in the near future. In these circumstances, BNOC could avoid the risk of losses only by linking its prices for participation oil closely and continuously to movements in the spot market. Such a system would mean that BNOC could no longer contribute to stability in the market. The Government have concluded that this shifts the balance of advantage decisively against the retention of BNOC in its present form. I see no advantage in retaining a public sector body to operate on that basis.

The change in market structure that I have described has led me to the conclusion that BNOC should no longer purchase oil by exercising its options under participation agreements. Dealing in participation oil has been the dominant part of BNOC's activities.

The Government consider it essential to retain powers that would enhance security of supply if that proved to be necessary. We will therefore retain the participation agreements themselves so that we can activate them to have access to these oil supplies should the need arise. We will also retain the arrangements under which we have the power to receive oil from continental shelf licensees as royalty in kind. Those two factors together mean that security of supply will continue to be safeguarded.

I see a need in present circumstances to retain one other function of BNOC—the management, as agent for the Government, of the Government oil pipeline system. This system is important for both defence and civil purposes.

The retention of those three functions—custody of the participation agreements, disposal of oil received as royalty in kind and management of the Government pipeline system—requires the establishment of a small Government oil and pipelines agency as a successor body to BNOC. The abolition of BNOC and the establishment of the agency for the purposes that I have described will require legislation, and I intend to introduce this in the present Session of Parliament.

Finally, I wish to express the Government's thanks for the valuable work carried out by the chairman, board and staff of BNOC.

**Mr. Ted Rowlands** (Merthyr Tydfil and Rhymney): The Minister's statement is as disgraceful as it is incredible. As recently as 18 December he told the House of the important, vital and crucial role that BNOC could play and was playing in securing and controlling the nation's oil supplies. He now announces its abolition.

The notion that the Department of Energy can handle participation agreements and the complex problems of buying and selling oil is incredible. How many people with experience and professionalism in oil trading has the Department of Energy compared with Mr. Goskirk and the BNOC team? The statement is a disgraceful kick in the teeth for some of the most professional oil traders in the country?

The only lame excuse for abolishing BNOC is that it could no longer contribute to the Government's propping up of the oil price policy, but that was never its intention or original purpose. deliberate intervention by the Government in the past few months has created the corporation's problems.

Did not the Minister himself recently carry out a review of BNOC's role and totally reaffirm its vital part in the management of our oil affairs? We then heard that the Prime Minister's private policy unit had been further reviewing the corporation's role. Is it not absolutely clear that, on a major aspect of energy policy, the Department of Energy has now been taken over by the Prime Minister's policy unit? Given the very personal and honourable involvement of the Minister of State in supporting BNOC, should he not resign as a result of this decision?

The Minister's announcement is a final act of vandalism in the breaking up and dismantling of a highly successful and profitable corporation set up under the Oil and Gas (Enterprise) Act. BNOC belonged to this nation. It was the only corporation with 100 per cent. loyalty to the nation. We shall oppose this legislation tooth and nail. We commit ourselves to re-establishing BNOC, which will safeguard and develop our precious national oil resources.

**Mr. Buchanan-Smith:** I only wish that the hon. Gentleman had read the statement, or at least listened to me. There is no question of the Department of Energy taking over the participation agreement functions. We intend setting up the oil and pipelines agency to exercise the powers under the agreements.

I make it absolutely clear to the hon. Gentleman that this decision is my decision and that of my right hon. Friend the Secretary of State with the agreement of colleagues. I can assure the hon. Gentleman that the policy unit to which he referred advises my right hon. Friend the Prime Minister. I have received no advice or representations from that body.

The hon. Gentleman cannot sit like Canute and completely ignore market conditions. He cannot defend a body and its functions when that body is no longer appropriate.

**Mr. Peter Hannam** (Exeter): Will my right hon. Friend accept our thanks for making this statement today in advance of the debate that is due to take place tomorrow? Will he accept that those of us who have supported BNOC's role as a protective mechanism to

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Pl. type

✓ 7/4

DRAFT MINUTE TO THE PRIME MINISTER

UK CONTINENTAL SHELF : PRODUCTION CONTROLS AND ROYALTIES

Geoffrey Howe sent me a copy of his minute of 3 April. I have also seen [Peter Walker's private secretary's the letter of 10 April. from Peter Walker's office

2. I entirely agree with Geoffrey's assessment. OPEC countries have considerable scope for acting against us but, for all the reasons Geoffrey gives, I share his view that this should not lead us to adopt the sort of measures set out in the Annex to Peter's minute of 25 March.

3. [As regards] moving to royalty in cash, I accept Peter's point that this is dependent on our ability to accommodate the adverse impact on the PSBR. I will be considering this in June when I will have the next Treasury economic assessment. [It would be necessary] we should need to give notice of such a change by 30 June if it were to come into effect from 1 January 1986. In the meantime I have asked my officials to examine possible ways of ~~reducing~~ mitigating the adverse PSBR effects.

4. I do not see that such a change should create any concerns about security of supply. In his Statement on 13 March on the abolition of BNOC, Alick Buchanan-Smith linked our security of supply to the power to take royalty oil and this power would be perserved in any move to royalty in cash.

5. I am copyign his minute to Geoffrey Howe and Peter Walker.

[N L]

CHANCELLOR OF THE EXCHEQUER

19 vi 85

Chief Secretary

<u>OD(E)</u>

I attach a letter from my special adviser colleague at the N. Ireland Office putting their case on milk quotas.

They do not expect you to do other than resist any additional expenditure strongly. But it may be in our interest as well as theirs for you to support some reallocation of quotas in N. Ireland's favour.

Congratulations on your speech in the House today.

R

RODNEY LORD

CONFIDENTIAL

443/28

NORTHERN IRELAND OFFICE
WHITEHALL
LONDON SW1A 2AZ

Rodney Lord Esq
Special Adviser
The Treasury
Parliament Street
LONDON SW1

18 June 1985

Dear Rodney,

OD(E) MEETING ON MILK QUOTAS

I believe that Mr Rees will be attending Thursday's meeting of OD(E) which will be discussing the problems being encountered in Northern Ireland because of the operation of the milk quotas regime. This may not strike you as an immediately exciting or politically central topic, but in case you are considering making some input into the Chief Secretary's briefing I thought I should explain why we attach considerable importance to the outcome of the discussion. The basis of our case is the widespread belief in the Province that our producers and Northern Ireland as a whole are being treated inequitably. This is not an occasion for special pleading, I believe we have a very fair case on its merits, and all strands of constitutional opinion in Northern Ireland are united in believing that some redress is vital.

You will recall that at the time of the milk quotas agreement special concessions were agreed for the Republic of Ireland in recognition of the importance of the dairy industry to that country's economy and because conditions there make diversification out of milk rather more difficult than for most other parts of the European Community. The same considerations held good for Northern Ireland and in recognition of this the Council of Ministers allocated a special reserve of 65,000 tonnes to Northern Ireland.

However, as the main paper for discussion at OD(E) makes clear in Annex 1, because Northern Ireland producers had expanded production most in the two years leading up to the imposition of quotas Ministers decided to subsume the Northern Ireland allocation into the UK's national quota and then divide the total between the regions on the basis of each region's share of total UK milk sales in 1983. An indication of the standing of this arrangement is also perhaps given by the fact that it has not been possible to make the real methodology used for the allocation public.

The situation which Northern Ireland now faces is that all producers in the Republic of Ireland can expand by 4.6% more than their 1983 production; producers with 40 cows or less in England and Wales can maintain 1983 production, while the 5,200 producers in this category in the Province face a cut of 10%. These small family farms (some 60% of the total) are central to the Northern Ireland industry and they are set to do much worse than their British counterparts when at the time of the quotas agreement they were

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/supposed

supposed to receive special treatment. Literally hundreds of exceptional hardship cases in Northern Ireland face bankruptcy.

As Douglas Hurd's letter to colleagues of today's date makes clear if no easement can be agreed for Northern Ireland, then exceptional hardship cases will get only 36% of Tribunal determinations compared with 100% in Britain; expanders in Northern Ireland will get 49% of Tribunal determinations compared with 65% in England and Wales; and there will be surplus outgoers quota in England, Wales and Scotland further to enhance their expanders awards or to allocate to residual hardship cases which we all have.

You may wonder why there has been such a low uptake of the outgoers scheme in Northern Ireland and why we had such a high level of cases of 'exceptional hardship'. The first is primarily attributable to the preponderance of small family farms and the reluctance of many to forego dairying (the so-called birthright factor) coupled with very few viable alternative niches in agriculture - or indeed elsewhere. The second reflects the fact that Northern Ireland was some way behind the development of the agricultural industry in other parts of the United Kingdom at the time of the imposition of quotas and their impact has been consequently more severe.

What we are seeking is, in the most cost effective manner, equitable treatment for comparable dairy farmers throughout the UK without adversely affecting the current position of any individual producer in Britain and, hopefully, without committing any resources additional to those already set aside for the Outgoers Scheme. I appreciate that what we are asking for has some presentational difficulties for MAFF. Equally however the principle for which we are arguing, which is for equitable treatment of Northern Ireland as part of the United Kingdom, has some political importance.

Your help on this would be gratefully received. There is no reason (honest) why it should cost any extra money to get a lot of farmers back into the allocation of quota.

Yours ever,

EDWARD BICKHAM

Edward



te

FROM : S A ROBSON
DATE : 9 JULY 1985

CHANCELLOR OF EXCHEQUER

c.c. Sir P Middleton
Mr Monck
Mr Moore

ELECTRICITY PRICES : THIRD TRANCHE

This is a brief for your meeting with Mr Tebbit. It draws on some conversations I have had with Department of Energy officials in the past ten days. Mr Walker would be highly annoyed if he knew they had been talking to me and it is important to safeguard their position.

A. <u>Background</u>

2. The following can be drawn on.

3. The Chemicals EDC has recently revived its pressure for cheaper electricity for large industrial users. Their campaign is being led by Lord Gregson and is focusing on a "third tranche" of coal supplies from the NCB to the CEGB.

4. The essence of the scheme is that the NCB sells some coal to the CEGB at a price below the import related levels of the two existing tranches. The CEGB converts this coal into electricity and passes on the benefit to large users.

5. The proponents of the scheme argue that electricity prices in the UK are above levels in some competitor countries and, without aid of this sort, UK companies will suffer in terms of profits and, possibly, investment and jobs.

B. <u>Current Scheme</u>

6. The following is <u>confidential</u> and should not be used.

7. The Chemicals EDC has seen Mr Walker and provided him with papers

on their case. His officials have discussed the proposals with Mr Tebbit's officials. Mr Walker wants to get Mr Tebbit to support the case so that the two of them form a united front to approach Treasury Ministers, probably later this month.

8. The guts of the case is that the NCB should sell coal to the CEGB at long run marginal cost (LRMC). The Chemicals EDC assert that this figure is £32 a tonne at the pithead. This would be used to provide cheaper electricity for industrial users of over 100 million kilowatt hours a year.

8. The cost to the NCB - and so to public expenditure and deficit grant - is the subject of some debate. It looks like £50 million a year. The Chemicals EDC suggest it might become self-financing - this is pure fantasy.

10. The scheme is thought to be legal. The NCB have taken legal advice which says such a scheme would be legal as far as they are concerned. The CEGB believe it is legal for them too. The scheme is intended to have no affect on the CEGB's finances. They merely "process" some coal for the NCB for the benefit of certain customers identified by the NCB.

11. To my mind this looks pretty thin, but Energy lawyers are said to accept the scheme is legal.

C. Comment

12. The following can be drawn on.

13. You might make the following points :

(a) the scheme looks like poor economics - we set prices on LRMC for monopoly nationalised industries which are price makers. The NCB is not a price maker. It sells coal into a competitive international market. The price of its coal should be determined by this market place. The NCB's own costs determine how much coal it can sell profitably in this market (and so the size of the NCB), not the price it sells at;

(b) why should the NCB's marginal coal be cheap - marginal output is the output which would be the first to go if an industry reduces production. On that basis, the NCB's marginal coal, even when it reaches break even in 1987-88, will cost well above the price of the first and second tranches, not something well below.

(c) the scheme is a denial of everything we fought the coal strike for - we fought the strike to establish that the size of the coal industry should be determined by the market i.e. by what the NCB could profitably sell at the international market price. This marked a clear contrast with earlier policies under which the size of the NCB was production driven, not market driven. Using devices like this scheme to sell NCB coal would be a return to the days of the NCB being production driven;

(f) the scheme has no basis in energy policy - the case presented is one of industrial support and subsidisation. There is no energy case. This means that, if the scheme went ahead, the cost would have to come out of Mr Tebbit's budget;

(g) how far are our electricity prices higher

- such figures as we have from the Chemical Industries Association shows charges for large users in England and Wales are cheaper than in Holland, Germany and Belgium. We are cheaper than Italy excpet at load factor over 80%. France is cheaper but that reflects the cost of their high nuclear output.

(h) who benefits - it looks as though the bulk of the benefit would go to three users - BSC, ICI and British Oxygen. Presumably Mr Tebbit would agree that the BSC's EFL should be cut [not for use : his officials are said to accept this]. That means we are aiming to subsidise two highly profitable companies.

14. Mr Tebbit may come back with one argument. He may say its better to use surplus NCB coal in this way than to sell it at a loss on the export market. The answer is that the NCB has presently no surplus coal as every last tonne is being sold to the CEGB to rebuild stocks. Looking further ahead, the Government's strategy with the NCB is to bring its capacity in line with the market, so removing the endemic surpluses of the past. There may be some surplus coal after the CEGB stocks are rebuilt and before enough capacity is shut, but Mr Tebbit presumably is not suggesting a scheme of aid to large users of electricity can be quickly turned on and off. If we once accept it, we will find it very difficult to stop.

SAR

S A ROBSON

I shd be grateful if Mr Davies wd cultivate these people. I will continue to see Pepper & Congdon myself from time to time, & Davies & NMcD when their respective times invite of lunch.

FROM: H J DAVIES
DATE: 12 JULY 1985

C/ As requested. RO 12/7

CHANCELLOR

cc EST
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Lankester
Mr Peretz
Mr Wood
Mr Cropper
Mr Lord

Ch/ I really think it would be a ridiculous waste of your time to see people like Mike Osborne & Bootle. Most of these people lunch Treasury officials quite assiduously already & I should have thought you could have left it to Kerr & Howard. Even Pepper is only just worth the time you give him. (Anyhow didn't we have a dreadful lunch at Capel Cure quite recently?) RL. 12/7.

**BROKERS SCRIBBLERS**

You asked me to survey brokers circulars, and identify those to whom you might devote some attention.

2. I attach a list of the principal houses, together with the name of their lead person in the economic and/or monetary area. The list may not be entirely comprehensive, but it includes all those whose work has attracted my or HF's attention in recent months.

3. In the 'comment' column I have suggested some whom you might see. They need to be handled singly, I think. Perhaps you could indicate which of them interest you. We could either set up a series of calls by slotting them in over a period, or we could wait until a target name writes something of interest, and call him in specifically to discuss that.

4. For some of the less prominent names, where I do not think it is worth expense of your time, we could adopt the latter procedure at official level from time to time. I think that could help to make them feel that the Treasury was in touch with market opinion, which of course it is.

HJD

H J DAVIES

| BROKER | ANALYST | COMMENT |
|---|---|---|
| Greenwells | Gordon Pepper | You already see |
| Messels | Tim Congdon | " |
| Simon & Coates | Gavyn Davies | Worth seeing though has rather set views |
| Phillips & Drew | Paul Nield | " |
| Grieveson Grant | Michael Osborne | Worth seeing. Often hostile, but open to influence |
| Capel Cure Myers | Roger Bootle | Worth seeing |
| de Zoete & Bevan | Michael Hughes | Worth seeing. Also now writes in The Times |
| Rowe & Pitman | Ian Harwood/David Freud | Recently helpful on capital spendin |
| Hoare Govett | Roger Nightingale | Somewhat eccentric |
| Laing & Cruickshank | Malcolm Roberts | Possible |
| James Capel | Keith Jones | Possible |
| Fielding Newson-Smith | David Shaw | Marginal |
| Panmure Gordon | Roger Parsons | Marginal |
| Laurie Milbank | Tony Baron | Marginal |
| Pember & Boyle | John Wilmot | Marginal |

Absolutely not! (except as part of a larger lunch party, possibly)

FROM: H J DAVIES
DATE: 17 JULY 1985

CHANCELLOR

cc FST
EST
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Lankester
Mr Peretz
Mr Wood
Mr Grimstone
Mr Colman
Mr Cropper
Mr Lord

Many thanks. I take the ~~suggestion~~ ~~to~~ ~~companies~~ argument that the 1984 CT changes lead ~~produce~~ a front-loaded capital exp. profile, which should be matched by a front-loaded M3 profile. (I would like to discuss @ my next TB bilateral! Where is it?)

BROKERS' SCRIBBLERS

I had lunch today with Ian Harwood and David Freud of Rowe and Pitman.

2. They are strong bears of sterling M3 as an indicator.

3. They have one particular reason for this since for some time they have been arguing that capital expenditure this year will be very significantly higher than the Treasury or anyone else is predicting. They claim to have forecast the very high rise in investment last year also. Their analysis is essentially tax based, but they also have an optimistic view of the underlying economic situation.

4. Following this line of argument they believe that the recent very buoyant bank lending figures are not (in the corporate sector at least) a cause for concern. Furthermore, they believe that there will be an even more dramatic investment related bank lending boom in the first quarter of 1986. They think that for the Government to respond to this investment boom by raising interest rates could have very serious consequences for growth near the end of 1986-87. They argue, therefore, that we should now be conditioning the market to expect high sterling M3 numbers in X

the early stages of next year, so that we can avoid the need for a confidence related rise in interest rates.

5. They are slightly more concerned about lending to persons. They point to widespread reductions in effective interest rates for individual borrowing. They look at "gold cards" which can offer base plus 2. And to the growth of secured lending based on property equity. These factors are serving to push down the average cost of borrowing to individuals and therefore increasing the total. They diffidently advanced a case for a personal credit tax ( in terms rather similar to those I have heard from some people in the Bank of England ). But they found it hard to explain why there was inflationary danger in the current level of personal bank borrowing.

6. On privatisation Freud claims to have done a very major analysis of British Airways based on individual route profitability. He believes that the stock will (assuming we get round to selling it) be extremely difficult to price. He expects that we will get it wrong and that the market capitalisation will double quite quickly after sale. He promised to send me a copy of this analysis, which is as yet unpublished. Incidentally, he believes that the British Airways Finance Director, Gordon Dunlop, is incompetent, even when sober.

HJD

H J DAVIES

CENTRAL ELECTRICITY GENERATING BOARD

*Sudbury House, 15 Newgate Street, London EC1A 7AU. Telephone 01-634 5111*

*From the Chairman*
*Sir Walter Marshall, CBE, FRS*

18 July 1985

The Rt Hon Nigel Lawson PC MP
Chancellor of the Exchequer
Treasury Chambers
Great George Street
London SW1

Dear Chancellor

How kind of you to write with your congratulations. I am not at all sure the Honour is deserved but I am quite determined to enjoy it. I am very conscious of the fact that it is your foresight in appointing me to the CEGB that gave me the opportunity to do well. It is very kind of you and very flattering to say that it is the best appointment you have ever made. It simply gives me pleasure to know that I have not let you down. Thank you once again.

Yours sincerely

Walter

W Marshall

PPS

FROM R B BUTT
DATE 2 AUGUST 1985

cc EST
Mr Monck
Mr Burgner
Mr Edwards
Mr Bonney

**PROPOSED MILK MARKETING BOARD PRESENTATION TO PM**

The Chairman of the Milk Marketing Board has suggested that he makes a presentation of their work to the Prime Minister when she can find the time.

I suspect that Sir S Robert's letter is a pre-emptive strike. The activities of the MMBs including their relationship with Dairy Crest have been the subject of a good deal of outside criticism and the government commissioned a study by Touche Ross which is due later in the month and which Ministers collectively will consider in the autumn. It is questionable whether it would be a good use of the Prime Minister's time to have a presentation by the MMBs at any time - although we should leave No 10, with advice from MAFF, to decide that - but it would seem bad tactics to see them <u>before</u> the Touche Ross study has been received and examined. A meeting thereafter would be better focussed and could address any specific criticisms or recommendations arising from the report.

I attach a draft reply reflecting this point.

RB

R B BUTT

Pl type for

my' sig

DRAFT REPLY TO MR ~~POWELL~~ Turnbull, NO 10

No doubt the Ministry of Agriculture will advise on whether it would be a worthwhile use of the Prime Minister's time to have a presentation by Sir Stephen Roberts and his colleagues at the Milk Marketing Board. ~~The Chancellor considers that~~ If it were ~~it~~ decided to have a presentation ~~this~~ we think should not take place until the Touche Ross report on the operation of the Milk Marketing Board and Dairy Crest has been received and carefully examined. There is some danger otherwise of prejudicing the Ministerial discussions of this issue which are due to take place in the autumn.

[Copies as for Mr ~~Powell's~~ Turnbull's letter]. [See next page]

P. WYNN OWEN

~~A~~.L.

APS/~~ESS~~

RT4.69

PWP

FROM: A W KUCZYS

DATE: 15 August 1985

CHANCELLOR

Thanks.

**ELECTRICITY PRICES AND LARGE INDUSTRIAL CONSUMERS**

You may like to catch up on developments on third tranche coal since you minuted the Prime Minister.

2. The Scottish and Welsh secretaries have put in minutes which, while basically supporting Mr Walker, make some useful points. Mr Tebbit has sent a rather ambivalent minute; and Mr Walker has written again defending his scheme against your criticisms.

3. The Prime Minister has now kicked this into touch by asking officials to look at the details, with a view to a Ministerial discussion in due course. Although it would have been better if we could have killed this idea without further work, there are two useful points:-

(i) No.10 have copied the correspondence to the Law Officers, supporting ? thwarting Mr Walker's attempt to get approval in principle first; and

(ii) they have ensured that the Policy Unit will be involved in the further work.

4. We should be able to get the Policy Unit to support your line. I will have a word with David Willetts.*

AWK

A W KUCZYS

*I have now done so. The Policy Unit already take the view that this is a crazy scheme. They will continue to advise the PM against it.

AWK 16/8

SECRET

COPY No. 1

FROM: D J L MOORE
DATE: 27 SEPTEMBER 1985

CHANCELLOR

I will wait to see what Mr Brittan proposes. N

cc:
Chief Secretary
Sir Peter Middleton
Mr Monck
Mr Kemp

**CHAIRMANSHIP OF BSC**

The Prime Minister has asked what thought has been given to Sir Robert Haslam's successor at BSC, and has suggested Graham Day of British Shipbuilders as a possibility - Mr Norgrove's letter of 24 September to DTI. Mr Brittan will reply to this. In the meantime I do not think you need to intervene.

2. One possibility, which DTI are considering, is to appoint Bob Scholey, the present Chief Executive, as Chairman and to make an internal promotion in succession to Scholey as Chief Executive. Scholey, who is 64, might then be followed as Chairman by an outsider in, say, two years' time. By then the new Chief Executive would have some experience behind him and be well placed to support the outsider chairman.

3. DTI will also be looking at the alternative of an outside appointment now. But one worry is thatScholey would probably go if he were passed over again. We would then have an outsider chairman coupled with a new Chief Executive yet to make his mark with the other Executives - and the choice for Chief Executive is not obvious. Given that Ministers have now approved the strategy for BSC over the next 3 years, and taken the crucial capacity decisions, Scholey would probably make a good job of running the business in this period.

4. Graham Day is due to leave BS next year. DTI think well of him and will certainly consider him carefully. But BS is of course much smaller and there are some doubts as to whether his

personal management style, operating with just a few key people, would suit BSC.

5. The PM's point that the new Chairman's objectives will need in particular to cover those for privatisation to the maximum extent possible of parts of BSC is a bit puzzling. Haslam already has the published objective

> "to privatise BSC as quickly as practicable, with priority being given to those areas of business which overlap with the private sector and to activities outside the mainstream of BSC's steel businesses".

Some of the earlier Phoenix deals have not gone too well, and this may be what she has in mind. But Ministers approved in July the next Phoenix deal, with GKN; and beyond that the main possibilities for privatisation will have been taken up, short of selling the whole Corporation.

6. I will keep in touch with DTI on this and advise further when their thinking firms up.

DJLM.

D J L MOORE

The quality of the answers to these, and of course of X, will be of prime importance. But we will want to take first opportunity to make all the positive points, & not just in a defensive manner, & answer the points of opponents. We will draw up, & consider how to prepare the group to take the answers. I suspect the best way is for a synopsis by Peter to be the basis for a mtg & then the full answers & drafts. N

583/8 a A2

**10 DOWNING STREET**

*From the Private Secretary*

15 October 1985

Dear Rachel,

**ERM**

The Prime Minister has asked that the Treasury and Bank should give full written answers to the questions attached in preparation for the next meeting on sterling and the ERM. The meeting is scheduled for 13 November, and I should be grateful if the replies could reach me by 7 November.

The Prime Minister, as you know, wishes to invite a wider circle of Ministers to the meeting on 13 November. X/ They will need a suitable paper to give them an overview of the issues. I shall be in touch separately about the circulation of this and about the circulation of the questionnaire answers to the wider group.

I am copying this to Len Appleyard (Foreign and Commonwealth Office) and John Bartlett (Bank of England).

Yours ever

David

David Norgrove

Mrs Rachel Lomax
HM Treasury

| CH/EXCHEQUER | |
|---|---|
| REC. | 16 OCT 1985 |
| ACTION | SIR P MIDDLETON |
| COPIES TO | PS/EST, SIR T BURNS |
| | SIR G LITTLER, MR CASSELL, |
| | MR FITCHEW, MR PERETZ, |
| | MR SEDGWICK, MR H DAVIES |

16/10

I think it would be useful for Eddie to give B.G. a tutorial. N.

ERM Questions



## ERM QUESTIONS

### Why decide now?

1. What are the reasons for wanting to take a decision now - one way or the other?

### The policy framework and stance

2. Would joining the ERM amount solely to an evolution of the policy framework or would it also imply a change in the policy stance?

3. Are present monetary and fiscal policies tight enough to sustain a fixed parity against the DM, bearing in mind the strong performance of the German economy? For how long?

4. Would a decision on when to join be affected by the rate of sterling against the DM at that particular time? What do you see as the appropriate rate for sterling against the DM.?

5. How would the role of the monetary targets change if sterling were to join the ERM?

6. How much weight would in practice be given to them?

### Expectations and presentation

7. In what ways would joining the ERM have a helpful effect on expectations?

8. Would a tightening of policy (if that proved necessary) be more easily accepted within Government and by the Government's supporters if sterling were in the ERM rather than outside it? Why?

9. How would the decision to join the ERM be presented both to the markets and more widely?

Effects on the ERM and the markets

10. How would the admission of sterling change the ERM?

11. What turbulence would you expect if we were to join?

Managing Sterling within the ERM

12. To what extent would the present level of reserves provide a cushion against temporary downward pressure on the exchange rate, on the basis of past experience here and in other countries? Would you expect a net cost to the reserves over time?

13. In periods of upward pressure on the exchange rate what considerations would determine the extent of intervention before the decision to seek a realignment?

14. Is it envisaged that interest rates would change more often than they do now?

15. Is there a risk that the decision to abolish exchange controls would be seriously called in question?

16. What flexibility would be lost by sterling joining the ERM, in terms of (i) the policy stance
(ii) timing of decisions
(iii) presentation

Risks

17. What are the downside risks?

18. Does the UK's position as a major oil producer and exporter mean that it is too risky to join?

19. Are the objections to joining of a fundamental nature or are they questions of timing?

Alternative options

20. Could any benefits from joining the ERM be gained by instead setting a band (published or unpublished) as a non-member?

21. What are the implications, for the way we conduct and present policy, of sticking to the present arrangements?

22. Given that financial innovation is proceeding fast in the US and Germany why is it more difficult to interpret financial conditions in UK?

23. What can the Bank/Treasury do within the existing system to improve the reliability and usefulness of the financial indicators?

14 October 1985

MJ2BFD

This is all wrong. What we want is a ~~PS~~ PS letter to No.10. M.

Ch/ Draft letter below. I wonder if there is really any need to send a letter at all? I cd make these points - a bit more tactfully - by phone, & similarly tell No.10 you are content with the proposal. AWK 5/11

FROM: D J L MOORE
DATE: 5 NOVEMBER 1985
x3248

CHANCELLOR

cc:
Chief Secretary
Sir Peter Middleton
Mr Monck
Mr Kemp
Mr Grimstone
Mr Marr

BSC CHAIRMANSHIP

I understand that you are content with the proposals, in Mr Brittan's minute of 4 November to the Prime Minister, that Mr Scholey should become Chairman of BSC from April 1986 and that Sir Ronald Halstead, who is already a non-Executive member, should become non-Executive Deputy Chairman from the same date.

2. We had known that Mr Scholey was a front runner - my minute to you of 27 September. I agree throughout with the proposals. In addition to the points made by Mr Brittan, I think that if Scholey had been passed over he would probably have resigned and BSC would have had to cope with a new outside Chairman as well as a new Chief Executive. From my own contacts with them, I am in no doubt that this would have been a blow to morale. More positively, with the crucial capacity decisions already taken for the next 3 years, some of BSC's main problems are going to be with European competition, prices and quotas. This is a scene which Scholey knows very well.

below

3. The new Deputy Chief Executive, to be promoted Chief Executive from next October, is almost certainly going to be Martin Llowarch, their present Finance Director. He has Haslam's backing and, I think, that of the non-Executives.

4. DTI need to make proposals as soon as possible for Scholey's salary and for a modest increase for Halstead, and in due course for Llowarch. They also need to settle on the objectives for Scholey, and to agree them with us.

I attach a short draft letter to Mr Brittan, recording your agreement and making these points on salaries and on objectives.

DJM.

D J L MOORE

Enc:

003/

DRAFT LETTER FROM CHANCELLOR OF EXCHEQUER TO:

Secretary of State for Trade & Industry

copy to: Prime Minister

Your ref: JU505

APPOINTMENTS - IN CONFIDENCE

BSC CHAIRMANSHIP

I am content with the proposed BSC appointments set out in your minute of 4 November to the Prime Minister.

2. Before his terms of appointment are settled, you will no doubt consult the Chief Secretary in the usual way on your proposals for Mr Scholey's salary and for his objectives. We would also like to see your proposals for any increase in Sir Ronald Halstead's salary and, in due course, those for the new Deputy Chief Executive.

3. I am sending a copy of this to the Prime Minister.

[N.L.]

10 DOWNING STREET

*From the Private Secretary* 19 November 1985

Dear Tony

I enclose a copy of a letter which the Prime Minister has received from the Rt. Hon. James Callaghan, M.P.

I should be grateful if you would provide a draft reply which the Prime Minister might send to Mr. Callaghan as soon as possible.

Yours ever

Tim

DRAFT REPLY BY CLOSE 21/11

**TIM FLESHER**

| CH/EXCHEQUER | |
|---|---|
| REC. | 20 NOV 1985 20/11 |
| ACTION | MR H DAVIES |
| COPIES TO | PS/CST |
| | MISS O'MARA |
| | MISS PEIRSON |
| | MISS PAGE |

Tony Kuczys, Esq.,
HM Treasury.

cc Press

HOUSE OF COMMONS
LONDON SWIA OAA

01- 219 4166

From:

The Rt. Hon. James Callaghan, M.P.

20th November 1985

Dear Prime Minister,

You said in reply to my question in the House yesterday about devaluation of the currency under your Government that no-one in the House could exceed my own record in this respect.

I have looked at the figures. During my period as Prime Minister from March 1976 to May 1979, sterling rose in value by 5.8%. During your period as Prime Minister from May 1979 to November 1985, sterling has fallen in value by 30.3%.

As many people will have been misled by your inaccurate statement, I am releasing this letter to the press.

Yours sincerely

Jim Callaghan

The Rt Hon. Margaret Thatcher, MP

LR2.36

1. Philip - relevant to Callaghan letter, coming over. Spn.

FROM: MRS R LOMAX
DATE: 20 November 1985

MISS O'MARA

cc Miss Peirson
Mr Pickering
Mr Vernon
Mr H Davies

**LABOUR'S £33 BILLION PSBR**

At Prime Minister's Questions yesterday Mr James Callaghan asked -

> "As the Prime Minister says that the equivalent of the just over £10 billion PSBR in 1977 would now be £33 billion does not that illustrate how seriously our currency has been devalued under her management?"

2. The Chancellor would be grateful if you would work up a response to this line of argument, for use in Treasury Questions. The question as posed is of course factually inaccurate since the point of comparison is the PSBR ratio in 1975-76 not the nominal PSBR in 1977. Given that, how much of the change in the nominal PSBR is due to -

- inflation under Labour
- inflation under this Government
- real growth in GDP under both Governments?

RL

RACHEL LOMAX

**Mr. Hattersley:** Will the Prime Minister confirm that as the Government expect to receive £4·75 billion next year from the sale of British Gas and other public assets the tax cuts that she proposes for March will be wholly financed by those sales?

**The Prime Minister:** No. The right hon. Gentleman should wait for the Budget before talking about tax cuts. We will not be in a position to determine what will happen in the Budget until we have the latest economic forecast, which usually comes in February. That will depend upon many things, and it is thoroughly mischievous to try to say in advance what will happen.

**Mr. Hattersley:** I take it that the Prime Minister does not deny the Chancellor's estimate that £4·75 billion is to be obtained through asset sales. If that is the case, what other means of financing the tax cuts is possible? Is not the Prime Minister trying to set up a smokescreen to obscure the truth that, having increased taxes year after year when she promised to cut them, she now proposes to sell off national assets to buy a few squalid votes?

**The Prime Minister:** The privatisation programme stands in its own right because we believe in putting more companies into the hands of the people, with the possibility of enhanced share purchase. Even if the proceeds of privatisation are added to the public sector borrowing requirement that figure as a proportion of GDP is expected to be the lowest since 1971-72. Will the right hon. Gentleman contrast that with the record of the Labour Government in 1975-76 on which the equivalent PSBR now would be £33 billion?

**Mr. Hattersley:** The right hon. Lady flagrantly and pathetically avoids answering my question, so I shall repeat it. If she proposes to raise £4·75 billion next year from the sale of public assets, what possible alternative financing is there for the tax cuts that she proposes?

**The Prime Minister:** Public expenditure is projected to remain broadly stable in real terms over the survey period, whether those asset sales are included or excluded. I do not propose to make any statement about taxation cuts. My right hon. Friend the Chancellor particularly did not make any statement about fiscal adjustments. The right hon. Member for Birmingham, Sparkbrook (Mr. Hattersley) is intentionally being thoroughly mischievous.

**Mr. Beaumont-Dark:** Does my right hon. Friend agree that one of the tragedies of Ireland is that those who should take the lead in ending the maiming and killing of people in our land are the very people who talk of treachery where only courage and vision has been shown at this time? Is it not important that those fanatics, whether they be IRA or Protestant, should seek a way in which all peoples can live at peace and be united in this land?

**The Prime Minister:** I am very grateful to my hon. Friend. I believe that men and women of good will in Northern Ireland, in the whole of the United Kingdom and in the Republic should join in defeating the IRA.

**Mr. James Callaghan:** Reverting to the question asked by my right hon. Friend the Member for Birmingham, Sparkbrook (Mr. Hattersley), as the Prime Minister says that the equivalent of the just over £10 billion PSBR in 1977 would now be £33 billion does not that illustrate how seriously our currency has been devalued under her management?

**The Prime Minister:** No one in the House could exceed the right hon. Gentleman's own record on devaluation.

41/584

FROM: MISS M E PEIRSON
DATE: 21 November 1985

CHANCELLOR

cc Mr Cassell
Mr Evans
Miss O'Mara
Mr Ilett
Mr Powell
Miss Page
Mr H Davies

**LABOUR'S £33 bn PSBR**

1. You asked for a line to take on the argument by Mr Callaghan when he asked at Prime Minister's Questions on 19 November:

> "As the Prime Minister says that the equivalent of the just over £10 billion PSBR in 1977 would now be £33 billion does not that illustrate how seriously our currency has been devalued under her management?"

2. Mr Callaghan has followed that up with a letter about the devaluation of sterling in foreign exchange terms, claiming that under his government sterling rose while under the Prime Minister's it fell. (Separate action is being taken on that letter.)

3. This note gives the facts requested concerning the original statement by the Prime Minister, and a line to take on it.

Background

4. The Prime Minister had said:

> "....the PSBR....as a proportion of GDP is expected [in 1985-86] to be the lowest since 1971-72....contrast that with the record of the Labour Government in 1975-76 on which the equivalent PSBR now would be £33 bn".

5. That is, the comparison was with the PSBR ratio in 1975-76, not the nominal PSBR in 1977. The PSBR was £10¼ bn in 1975-76, ie 9¼% of the then GDP of £111 bn. In 1985-86 the Autumn Statement forecast of GDP is £357 bn, and 9¼% of that would be £33 bn.

6. Thus the translation from £10¼ billion to £33 bn comprises real growth in the GDP between 1975-76 and 1985-86 plus inflation over that period as measured by the GDP deflator.

7. The inflation element can be allocated between the two administrations by using the GDP deflator in 1979Q2 as the dividing line, which gives 54% inflation under Labour and 74% under Conservative. (The period between 1975-76 and 1979Q2 omits the worst of inflation under the Labour Government,

which occurred between 1973-74 and 1975-76; whilst the period between 1979Q2 and 1985-86 includes most of the re-acceleration of inflation which occurred between 1978-79 and 1980-81 before the subsequent deceleration. Also of course the latter period is significantly longer: the annual average change in the former period is 12½% and in the latter period 9%.)

8. The respective contributions to the increase from £10¼ bn to £33 bn vary considerably, depending whether one calculates the contribution from real growth first, ie on a low base, or last. (There are other possibilities somewhere between.) The range of calculations is as follows:-

| | £bn |
|---|---|
| real growth between 1975-76 and 1985-86 | 2- 5½ |
| inflation under Labour | 6¾-5½ |
| inflation under Conservatives | 14 -11¾ |
| | 22¾ |

9. The reason why inflation under the Conservatives produces more than twice the increase produced by inflation under Labour is not only that inflation is greater in percentage terms, but also it is of course applied to a higher nominal base.

10. The change of sterling in foreign currency terms under either administration is entirely irrelevant. (The Prime Minister did use the word "devaluation" in responding to Mr Callaghan's question, but that was because he had used the word "devalued".)

Line to take

11. I suggest that the line to take on this matter might be as follows:-

(i) The point made by the Prime Minister was that, if the PSBR in 1985-86 were the same proportion of GDP as it was in 1975-76, it would be about £33 bn.

(ii) The essential achievement of this Government is to have brought the PSBR down from 9¼% of GDP in 1975-76 to 2¼% (forecast) in 1985-86.

(iii) To talk about changes in sterling in relation to foreign currencies is quite irrelevant. It is domestic inflation, plus the real growth of over 20% in the GDP, which translates the actual PSBR in 1975-76 (£10¼ bn) into the equivalent figure of £33 bn.

(iv) The (appalling) record of domestic inflation under the last Labour government is second to none: the GDP deflator rose between 1974Q1 and 1979Q2 by an average of 16½% pa. And during the period in question (1975-76 to 1985-86) the GDP deflator rose by an average of 12½% pa under Labour and only 9% pa under the present administration.

nearly half the difference between the £10¼bn and £33bn is due to inflation under Labour & real growth in the economy.

MEP

MISS M E PEIRSON

FROM: H J DAVIES
DATE: 21 NOVEMBER 1985

Happy OK as amended.

CHANCELLOR

C/ The draft PM reply is very numerical but that helps to build a strong case. Content with two drafts attached?

RHO 21/11

cc PS/CST
Mr Cassell
Mr Evans
Miss O'Mara
Mr Culpin
Miss Peirson
Mr Ilett
Mr Powell
Mr Haache
Miss Page
Mr Cropper
Mr Lord

Ch/ PM/Callaghan exchange in the House are the back. No 10 asked for something "political". We have been asked for a reply tomorrow morning.

Rh. 21/11

**LABOUR'S £33 BILLION PSBR AND MR CALLAGHAN'S DEVALUATION**

Mr Callaghan wrote to the Prime Minister on 20 November to complain about her reply to his question in the House on Tuesday 19 November. No 10 have asked for a draft reply (Mr Flesher's letter, mysteriously dated 19 November).

2. A clear description of the question and the Prime Minister's answer, and the misunderstanding surrounding it, is in Miss Peirson's minute of today's date. She also answers the questions in Mrs Lomax's minute of 20 November to Miss O'Mara.

below

3. This minute takes Miss Peirson's as the starting point and attaches a draft reply to Mr Flesher and a draft letter from the Prime Minister to Mr Callaghan.

4. Mr Callaghan's letter focuses on the performance of sterling. He is no doubt sensitive to the charge of devaluation, as well he might be after his experience in 1967. The facts are these (courtesy of Mr Ilett). In dollar terms, as Mr Callaghan says, sterling rose 5.8 per cent during his term of office. It has fallen by a little over 30 per cent since May 1979. But if we look at the effective rate we see a fall of 6.4 per cent from March 1976 to May 1979 and 6.8 per cent from May 1979 to October of this year. The table attached gives details of these figures.

5. I understand that the Prime Minister wishes to refer to Labour's inflation high point of 26.9 per cent. That is now in the draft. She also wants to refer to the devaluation of 1967. I should have thought that was a mistake, since my recollection (though of course I was in short pants at the time) was that Mr Callaghan resisted devaluation and left the Treasury when it was imposed on him. The draft letter includes a square bracketed paragraph on exchange rates. But the covering letter suggests that it would be better omitted, since it is clear from the context that the point the Prime Minister was making concerned inflation, and there we are on stronger ground anyway.

[illegible] Callaghan [illegible] ER, there is quite a [illegible] come back.

HJD

H J DAVIES

EXCHANGE RATE PERFORMANCE BY GOVERNMENTS

| | | $/£ | £ERI | £ERI excluding dollar |
|---|---|---|---|---|
| | March 1976 | 1.9442 | 92.2 | 93.8 |
| 3.2 | May 1979 | 2.0579 | 86.3 | 84.3 |
| | % change | +5.8% | -6.4% | -10.1% |
| 6.5 | May 1979 | 2.0579 | 86.3 | 84.3 |
| average | October 1985 | 1.4220 | 80.4 | 86.6 |
| | | -30.9% | -6.8% | +2.7% |

RR3.55

1 Phylip

2 pm ?

cc PS/CST
Mr Cassell
Mr Evans
Miss O'Mara
Mr Culpin
Miss Peirson
~~Mr Ilett~~
Mr Powell
~~Mr Haache~~
Miss Page
Mr Cropper
Mr Lord
Mr Davies

Mr Scholar

Mr Dyer

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

22 November 1985

Tim Flesher Esq
10 Downing Street
LONDON
SW1

Dear Tim,

Thank you for your letter, dated 19 November, but covering a letter from Mr Callaghan to the Prime Minister dated 20 November. I attach a draft reply to that letter.

In concentrating on the performance of the exchange rate under two governments it seems that Mr Callaghan has got the wrong end of the stick. The sterling dollar rate, which is the basis of his calculations, has of course nothing to do with the real burden on the economy of the PSBR, which is the point the Prime Minister was making.

The draft reply therefore concentrates on the PSBR issue, and on the inflation record of both governments. The strong points are the far lower average rate, and the current rate and trend as opposed to that in May 1979. At the Prime Minister's request we have included a reference to the inflation high point of the Labour government, when, in August 1975, the year on year rate reached 26.9 per cent. But it is worth recalling that in May 1980 the year on year rate was 21.9 per cent.

On the exchange rate, Mr Callaghan's figures are broadly correct if we look only at the sterling dollar rate. Taking the effective rate, which is obviously a better measure, the record is somewhat different. Sterling fell by 6.4 per cent under his premiership and 6.8 per cent to October this year (monthy average).

The draft includes a paragraph on the exchange rate, which you said the Prime Minister was minded to include since Mr Callaghan raised it, though it is strictly speaking irrelevant to the main issue.

Yours ever
Rachel

RACHEL LOMAX
Principal Private Secretary

RR3.56

DRAFT LETTER FROM PRIME MINISTER TO:

The Rt. Hon. James Callaghan MP
House of Commons
LONDON SW1A 0AA

Thank you for your letter of 20 November. I am afraid that you have misunderstood my argument.

I said that the PSBR in 1975-76 (not 1977 as you claim) was, expressed as a proportion of GDP, equivalent to £33 billion today. That is correct. The PSBR in 1975-76 was £10¼ billion or 9¼ per cent of GDP - contrast that with the expected outturn for this year of £8 billion, or 2¼ per cent of GDP.

You seemed to argue in your question that the difference between £10¼ billion in 1975-76 and £33 billion today was attributable solely to inflation under this government. This is not so, for two reasons.

First, the point I made related to the proportion of <u>GDP</u> not the cash sum. 9¼ per cent remains 9¼ per cent, even ten years on. And, second, the increase in the equivalent cash sum reflects, of course, real growth over the period, as well as inflation under both the last Labour Governments between 1975 and 1979 and the Conservative Government since 1979.

As for inflation, the Labour Party's record on inflation is of course far worse than that of this government. Retail prices rose, on average, by 15.4 per cent a year from February 1974 to May 1979, reaching 26.9 per cent at one point, as you may recall. At the election the rate was over 10 per cent and rising. Since May 1979 the average annual rate has been 9.3 per cent. It is now 5.4 per cent and falling.

Your exchange rate claims, though not relevant to this issue, are also mistaken. The figures you quote refer only to the dollar rate. If we look at the effective rate, against a basket of currencies, which is clearly a better measure, we see that under your premiership sterling fell 6.4 per cent in just over three years. In the six and a half years since May 1979 it has fallen 6.8 per cent, or roughly half as fast - reflecting, amongst other things, our improved inflation performance.

As you did with yours, I am releasing this letter to the press.

MT

10 DOWNING STREET

THE PRIME MINISTER

25 November 1985

CH/EXCHEQUER
REC. 25 NOV 1985
~~ACTION~~ MR SCHOLAR
COPIES TO C ST
MR CASSELL
MR H.P. EVANS
MISS O'MARA
MR CULPIN
MISS PEIRSON
MR DYER
MR CROPPER
MR LORD
MR H. DAVIES
MISS PAGE

Dear Mr. Callaghan.

Thank you for your letter of 20 November. I am afraid that you have misunderstood my argument.

I said that the PSBR in 1975-76 was, expressed as a proportion of GDP, equivalent to £33 billion today. That is correct. The PSBR in 1975-76 was £$10^1/_4$ billion or $9^1/_4$ per cent of GDP - contrast that with the expected outturn for this year of £8 billion, or $2^1/_4$ per cent of GDP.

You seemed to argue in your question that the difference between £$10^1/_4$ billion in 1975-76 and £33 billion today was attributable solely to inflation under this Government. This is not so, for two reasons.

First, the point I made related to the proportion of <u>GDP</u> not the cash sum. $9^1/_4$ per cent remains $9^1/_4$ per cent, even ten years on. And, second, the increase in the equivalent cash sum reflects, of course, real growth over the period, as well as inflation under both the last Labour Government between 1975 and 1979 and the Conservative Government since 1979.

As for inflation, the Labour Party's record on inflation is of course far worse than that of this Government. Retail prices rose, on average, by 15.4 per cent a year from February 1974 to May 1979, reaching 26.9 per cent at one point, as you may recall. At the election the rate was over 10 per cent and rising. Since May 1979 the average annual rate has been 9.1 per cent. It is now 5.4 per cent and falling.

Your exchange rate claims, though not relevant to this issue, are also mistaken. The figures you quote refer only to the dollar rate. If we look at the effective rate, against a basket of currencies, which is clearly a better measure, we see that under your premiership sterling fell 6.4 per cent in just over three years. In the six and a half years since May 1979 it has fallen 6.8 per cent, or roughly half as fast - reflecting, amongst other things, our improved inflation performance.

As you did with yours, I am releasing this letter to the press.

Yours sincerely

Margaret Thatcher

The Rt. Hon. James Callaghan, M.P.

CHAIRMAN

BARCLAYS BANK PLC
54 LOMBARD STREET
LONDON, EC3P 3AH

4th December 1985

PERSONAL

The Right Hon. Nigel Lawson, PC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

Much to be said for this - at least we might reduce to one adviser per member* & sharply cut down on NEDO personnel. PS to ask Mr Monck to consider & advise. N.

*2 for the Chan (to enable Mr Culpin to be there). st.

Dear Nigel

It is probably foolhardy for anyone to suggest the possibility of a change in the format of a regular meeting which he has only attended a couple of times, but sometimes initial reactions can be valid, and I am, therefore, writing to you about the NEDC meetings.

It seems to me that the fact that the participants are comfortably outnumbered by advisers does inhibit discussion in that most people go on briefs prepared by their staff, and, since the staff are present, they cannot depart from them.

It therefore occurred to me that discussions would be less inhibited if the advisers were not present.

I did mention this very briefly to James Cleminson, and he said that before his time he had heard that there was such a meeting and that it produced a good discussion.

I apologise if I am inadvertently raising a topic which has been frequently considered and rejected in the past!

Yours ever

Tim

T. BEVAN

13/1207

**PERSONAL & CONFIDENTIAL**

FROM: B T GILMORE
6 December 1985

CHIEF SECRETARY

cc Chancellor
Sir P Middleton
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Kemp
Mr Lavelle
Mr Monck
Mr Peretz
Mr Scholar
Mr Spackman
Mr F K Jones

C./ To be aware this is hotting up. See this minute and Kingsley's one below. If it is true that the markets eventually prove unable or unwilling to produce the funds without some form of written gov't "endorsement" I should have thought that HMT would have to come out against the CFL.
Rw 6/12

**CHANNEL FIXED LINK (CFL)**

Mr Jones will be putting to you today (copy below) a progress report on the financial assessment of promoters' proposals. The cumulative process of assessment is now casting very serious doubt on whether EuroRoute could be financed without Government funds or guarantee, and some doubt even on whether the safest scheme, Channel Tunnel Group/France Manche, could. This is sensitive, and we shall not in any case have Schroders' considered advice until the week beginning 16 December. But it looks increasingly likely that this will lead to a very difficult political decision, with all the pressure for an expensive political or commercial "bounce" mentioned in my minute of 8 November.

There must be some guarantee of any kind. 2. I am particularly [illegible] for X.

B T G

B T GILMORE

47/1204

3. Flow 1

CONFIDENTIAL

FROM: B T GILMORE
8 November 1985

CHIEF SECRETARY

cc Chancellor
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Mr Bailey
Mr Anson
Mr Cassell
Mr Lavelle
Mr Monck
Mr Monger
Mr Moore
Mr Peretz
Mr Scholar
Mr Spackman
Mr F K Jones
Mr H. J. Davies
PS/C&E
PS/IR

**CHANNEL FIXED LINK**

Mr Jones's advice and draft below are on lines agreed with me.

2. There are high commercial stakes in the fixed link concession, as well as powerful political pressures. So the basic policy of avoiding government funding or guarantee (which includes not getting stuck with a white elephant) is easier said than done. But the April guidelines are clear and rigorous; the Department of Transport are on this issue robust; and a thorough assessment process has been put into place.

3. There remain risks of a political or commercial "bounce", whether at the Anglo-French summit or otherwise. It is perhaps more likely in favour of EuroRoute than of the other schemes. You will know that the City is still pretty sceptical, and at first sight the EuroRoute proposals fall rather short of shouldering the risks of their scheme. And however thorough the assessments, there remains the awkward prospect of having to agree a decision with the French between options which have all too little in common. It is for these reasons that we have suggested putting down a Treasury marker at this stage.

B T GILMORE