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HER MAJESTY'S TREASURY
POLICY CO-ORDINATING COMMITTEE

Minutes of a meeting held in Room 80, 2nd Floor Treasury Chambers, on 20 January, 1981 at 9.30 am

PRESENT

Sir Douglas Wass (in the Chair)
Mr Burns
Sir Kenneth Couzens
Sir Anthony Rawlinson (item I)
Mr Ryrie
Mr Bailey
Mr Barratt
Mr Byatt
Mr Hancock (item II)
Mr Littler
Mr Middleton
Mr Unwin
Mrs Gilmore

SECRETARIES

Mr Folger
Mr J M G Taylor

ALSO PRESENT

Mr Battishill
Mr Britton
Mr Cassell

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I PUBLIC EXPENDITURE AND CASH LIMITS

1. Sir Anthony Rawlinson reported on Ministerial discussions the previous day. At a meeting with colleagues, to discuss the timing of an announcement of the revised 1981-82 cash limit factors of 7% for pay and 10% for non-pay, it had emerged that the Lord President and the Employment Secretary wanted to reverse previous Cabinet decisions about the place of cash limits in public service wage bargaining. Both had argued for announcing a pay factor of 6% in the first instance with 7% being revealed following negotiations for the groups concerned. This would allow the unions to consider they had achieved something in negotiation and, it was argued, should result in a lower final settlement and a smaller risk of industrial action. The Secretary of State for Social Services seemed to see some attraction in this aspect and foresaw that the NHS ancillaries pay settlement might be 7½%. The Chancellor was due to put a paper on these issues to Cabinet for 22 January.

2. In discussion the following were among the points made:

(i) if Cabinet adhered to a 10% non-pay factor then the economic assumptions for the PEWP would need to be adjusted, with the slightly perverse result that the volume planning total would increase.

(ii) the Secretary of State saw some difficulty in announcing only a 6% pay factor for the NHS in the first instance. Taken together with the 10% non-pay factor it could imply a volume squeeze inconsistent with his promises on health volume. Sir Anthony Rawlinson would be consulting DHSS urgently to learn their definitive views.

3. There was general agreement in the Committee that the idea of raising cash limits during negotiations would be completely inconsistent with the government's declared policy on requiring public service pay to be settled subject to the discipline of fixed limits. It would amount to accommodation of cash spending to the settlements - something CSD hankered for but which Cabinet had decided firmly against in 1979. Summing-up the discussion, Sir Douglas Wass said the Chancellor should be advised to press

strongly for adherence to the previously agreed policy of not allowing cash limits to be negotiable. In reporting contrary arguments to Cabinet the Chancellor should make it explicit that he did so only as chairman of the informal group of colleagues.

4. Sir Anthony Rawlinson said the Chancellor had also asked for advice on suggestions by the Chief Secretary for improvements in the system of expenditure control. These included paying more attention to current year out-turn in scrutinising Estimates for the following year, so as to press down on the volume figures decided in PESC. In addition both Ministers had asked whether even at this stage there might not be some way of making reductions in 1981-82 volume plans. There had been suggestions that in the course of the coming year there might be a need for crisis measures. But short of that it was doubtful whether Treasury Ministers could realistically approach Cabinet for, say, 1% off the volume of all cash-limited programmes (which would yield about £170m on non-pay spending and £120m on pay). If they tried and failed their longer run position could be damaged.

II THE BUSINESS SECTOR: FISCAL OPTIONS FOR THE BUDGET

5. Introducing the paper PCC(81)5, Mr Ryrie said that the case for relief for the company sector turned partly on the size of action that was envisaged and so on how far it had to be taken at the expense of the personal sector. Action taken on the personal sector side would itself have monetary consequences to be set alongside those resulting from assistance to companies.

6. Sir Douglas Wass saw the past year or so as having confirmed that companies had learned from the experience in 1974-75. They had acted quickly to reduce working capital and shed labour so that, although stocks had fallen and unemployment had risen sharply, the company sector deficit had held satisfactorily. On the basis of this and a good deal of anecdotal evidence he saw it as quite likely that companies would use fiscal relief not to improve their financial position, but to undertake investment plans and generally to maintain activity that they had been forced to halt over the last year. The table at page 13 of the paper seemed to support the view that

relatively little of an ex ante improvement in the icc financial deficit would be reflected ex post in an amelioration of companies' net financial asset position. If anything the table might over-estimate the size of the effect. His view was thus that there was no single quantum of relief that it would be "right" to give to companies. A judgement would be required, weighing not only the opportunity cost in terms of extra taxes on the personal sector but also the uses to which ex ante relief for companies might be put. Clearly the £8 billion shift required to restore the non-oil company share of national income to the 1978 level was not feasible and would risk a reversal of the pressure on companies that had helped restrain pay increases. But even £1½ billion would be of some help.

7. Mr Middleton agreed there was room for judgement about the scale of help for companies. But it would be illogical to say that the sectoral imbalance had contributed to problems on bank lending and the PSBR but at the same time to deny, in effect, that help for companies in present circumstances could have a particularly helpful effect on bank lending. Sir Kenneth Couzens suggested that this effect would arise in aggregate even if only the hardest-hit companies used relief to cut back their bank borrowings.

8. In further discussion the following were among the points made:-

(i) although anecdotal evidence suggested some companies would use relief largely to sustain activity, others - on the GEC model perhaps - might use it to improve their financial position. Bank lending had after all risen sharply at a time when stocks had been falling and there were indications that banks were growing nervous about the indebtedness of some companies.

(ii) if companies foresaw a period of several years of tight liquidity ahead this might lead them to reduce indebtedness. But it was not clear that they were expecting that.

(iii) although there might be no fixed quantum which it would be sensible to give to companies, there might be a policy barrier of a kind insofar as relief for companies had to be financed by increasing personal taxes. But Sir Douglas Wass pointed out that in opportunity cost terms all relief for the company sector

involved an extra burden for persons - even if in the form of less than full revalorisation of tax allowances.

(iv) recent Treasury work suggested that present poor industrial competitiveness and profitability could be overcome only very slowly by market-based solutions alone. It would take some years of low pay settlements to close the gap compared with our competitors and tax measures to relieve industrial costs and/or profits would help achieve part of the necessary adjustment more quickly. On the other hand, competitiveness would not be improved by companies using relief simply to improve their net financial position.

(v) the long run decline in industrial profitability was worrying and there was a case for fiscal action to help reverse this trend. But it was recognised that fiscal action alone could not hope to solve this deep-rooted problem. It could do little more than "cushion the bump".

(vi) if the income tax burden had to increase to finance relief for industry this could feed through to higher pay claims and settlements and leave companies little better off on a net basis. But, it was argued, failures to fully revalorise personal allowances might not be perceived as increases in taxation.

(vii) to the extent that the consequences of an improved company sector deficit allowed the government to run a higher PSBR, then relief for companies might not, in effect, have to be entirely at the expense of the personal sector. On the other hand, the Chancellor might see the tolerable PSBR figure as fixed ex ante by confidence and other factors. Moreover the April increase in NIC, already reflected in the economic forecasts, would itself be perceived as hitting the pay packet.

(viii) to the extent that the cost of relief for particular parts of the company sector could be met from new taxes on eg oil companies and banks it might not necessitate an increase in personal sector taxes. But there would be an opportunity cost nevertheless and in any case there was little likelihood of squeezing significantly more from these sources.

(ix) The ex ante squeeze on the company sector had been greater than originally expected, largely because of the strength of sterling, and help for industry might be a necessary political response to the large burden of adjustment forced on industry. (On the other hand the severity of that squeeze was a main reason for the good performance on inflation over the last year.) In economic terms, too, if there were a desire for a lower exchange rate consistency meant there was a good case for fiscal relief to industry as a surrogate.

(x) a full simulation of a particular tax package would be required to estimate the net effect on corporate finances of relief financed by higher taxes on persons. The net improvement could be quite small, taking account of the effect of lower activity on profits.

9. In a brief discussion of the best means of effecting fiscal relief for industry the following were among the points made:-

(i) Sir Kenneth Couzens, Mr Burns and Mr Middleton saw a NIS cut as the most attractive option. It would be the best surrogate for depreciation and lower the structure of industry's costs consistently with medium term strategy.

(ii) industrial derating was attractive not least because rates were currently such a source of protest from business. For the long term too industrial rates were not a very sensible tax. But derating would be very difficult to implement for 1981-82 and would cut across the Environment Secretary's desire to make further changes in the system of local authority finance in the slightly longer term. One of his aims would be to shift more of the rates burden onto local electors.

(iii) Mr Ryrie thought industrial derating a most attractive option. But in practical terms the choice for 1981-82 was probably between NIS and CT. The Chancellor was very worried about leakage of a NIS cut into pay and its non-selective nature, with banks and oil companies benefitting as well as manufacturing.

(iv) Mr Cassell noted that from the selectivity point of view a corporation tax cut would be even less attractive than NIS: only about one third of corporation tax receipts currently came from manufacturing. Mr Byatt said there were nevertheless

arguments for cutting corporation tax rates as a long term measure. Its narrow base and currently high rate were very distortionary from the microeconomic efficiency point of view.

10. Summing-up the discussion, Sir Douglas Wass said there clearly remained a wide variety of views on the case for a shift in favour of companies and the best means of effecting it. He was not himself convinced that major relief for companies would be appropriate. Of the various possibilities for delivering relief he saw industrial rates as the most attractive, though he recognised the practical problems over early implementation. He invited Mr Unwin to draft a minute which he could put to the Chancellor reflecting the wide range of views expressed.

HM Treasury
23 January 1981