

Jan 18
strategy

Amber... 1 11

cc. J. Verker.



The Chancellor will
be considering this matter
further over the weekend.

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

20 November 1980

It includes all
the points agreed
at the monetary
committee, including
the column of
framing bonds. I

T.P. Lankester, Esq.,
No.10, Downing Street

No - except - please don't announce
another M. ! we are
clearly having trouble with
M3.

don't see how it
can be made
shorter.

Dear Tim,

D. you know my
comments on this

END NOVEMBER ANNOUNCEMENT

The Chancellor thought the Prime Minister might like
to see the current draft of the complete statement
he will be making on 24 November. The text is, of
course, still very much subject to amendments of
presentation and style; but the material to be covered
has now broadly been settled. The Chancellor is
minuting separately about the public expenditure section,
with a view to clearing the detailed points with the
other Ministers concerned, in accordance with the
Cabinet conclusions on 19 November (CC(80)41st Conclusions,
Minute 5).

Yours

John

(A.J. WIGGINS)

why do we not announce
the RSC 2 ?

Frank
to
Frank
Mark
Bill

PL

END NOVEMBER STATEMENT (Draft of 20.11.80)

Monetary Policy

A1. At the time of the Budget I said I would consider this autumn the roll-over of the monetary target of 7% to 11% set for the period from February 1980 to next April. I have now done so in the light of monetary developments and developments in the economy generally. I am publishing the latest economic forecast today as required by the 1975 Industry Act.

A2. Although inflation is now falling rapidly monetary growth seems likely to overshoot the current monetary target. Recent statistics have, however, been bedevilled by distortions apparent since June when we abolished the corset imposed by the previous administration. The overshoot will certainly be less than the figures for the period so far might suggest. I expect growth to slow down in the rest of the target period, particularly in the New Year when the public sector moves into surplus. There are also signs that bank lending may now be starting to slow down.

A3. In these circumstances, I propose to maintain the present monetary target range for the rest of the target period. I shall take account of any excess monetary growth this year when I announce a new target in the Budget together with whatever further measures are necessary to ensure that the thrust of the medium-term financial strategy is maintained.

[A4. (A) The Treasury and Bank of England have now completed consultations on more effective methods of monetary control. The time between now and the Budget will be used to bring about a number of improvements in monetary control techniques.

A5. (A) First, consultations on new arrangements for prudential liquidity will be brought to a conclusion so that the reserve asset ratio, which impedes monetary control, can be phased out. Second, the Bank of England will open up discussions on the way it conducts its money market operations and lender of last resort facilities. Third, I am considering further steps which can be taken to put ourselves

in a position to evaluate the properties of base money and how it would fit in with our medium term objectives for wide monetary aggregates such as M_3 . These include [examining alternative sources of income for the Bank and] collecting and publishing a new monetary series for retail deposits (M_2). Fourth, we shall continue to take steps to sell more Government debt direct to persons. I shall therefore further extend the eligibility for index linked certificates so as to attract at least $\text{£}3$ bn next year. I shall explain these steps at greater length in the debate on Thursday.]

OR

[A4. (B) The Treasury and the Bank of England have now completed consultations on more effective methods of monetary control. I shall explain in my speech in the debate on Thursday how the time between now and the Budget will be used to make a number of improvements in monetary control techniques.]

A5. (B) I shall also continue to take steps to sell more Government debt direct to persons. I shall, therefore, extend the eligibility for index linked certificates so as to attract at least $\text{£}3$ bn next year.]

Is it necessary to answer M2?

Public Expenditure

*Significant impact on the
sector - needed to match
public expenditure.*

As hon members will know, the PSBR during the first half of 1980-81 is estimated to have been about £8½ bn. I expect the PSBR to be much lower in the second half of the financial year, but it could be around £11½ bn for the year as a whole. [Much] of this is due to the effect of the recession, particularly on public expenditure.

B2. We have reviewed public expenditure plans for 1981-82. In conditions of continuing recession in the UK, some increases in expenditure arising from the recession must be expected and planned for. However, the total increase in expenditure and in public borrowing must be consistent with the medium term strategy and with a continued reduction in inflation. That is essential for a resumption of sound sustainable growth.

B3. It is realistic to assume a higher level of spending on unemployment and other benefits this year than allowed for in the White Paper of last March. The changes in trading conditions are reflected in the external financing limits for the nationalised industries for 1981-82 which, excluding steel, are being announced separately [today]. These industries are being required to secure substantial economies.

B4. My right hon the Secretary of State for Employment announced last week extension of the special employment measures which will cost nearly £250 million next year. The Government have also decided to increase the provision for selective assistance for investment and support for industrial research and development at a cost of £50 million next year. These amounts, and the other public expenditure changes I shall mention, are in the 1980 survey prices at which the decisions have been taken - that is broadly the prices of a year ago.

B5. In view of these increases, we must now plan to cut the volume provision for the majority of spending programmes. We must also restrict the cost, and so the cash requirements, of the public sector. Our aim is to hold the planning total for the volume of public expenditure in 1981-82 below the outturn now expected for 1980-81. The ^{latter} is some £[1] billion higher in volume than envisaged at the time of the last White Paper. I am publishing in the Official Report [and making available in the Vote Office now] a summary of the effect

on expenditure programmes in 1981-82 of these decisions. Details of these changes, and of the changes in the provision for later years, will be set out in the public expenditure White Paper to be published at the time of the Budget.

B6. I should mention some of the main changes. We must, like some of our other NATO allies, adjust the rate of growth of our defence expenditure. Planned expenditure in 1981-82 will now be £200 million less than allowed for in the last White Paper. This will be nearly 8% higher than the level achieved in 1978-79.

B7. In broad terms, we shall be seeking a 3% reduction in the volume of local authority current spending compared with the level we planned for this year. We also propose to calculate the Rate Support Grant on the basis of providing a lower percentage of the reduced volume than the 61% (for England and Wales) in recent RSG settlements. My rhts the Secretaries of State for the Environment, Scotland and Wales will be consulting their local authority associations on these proposals before the RSG settlements next month.

B8. In 1980 prices have increased less than we allowed for when we decided on the uprating of social security benefits for this November. There will accordingly be some increase in real value of benefits. We intend that the increase in retirement pensions and other benefits in 1981 will be such that the excess adjustment over prices, estimated at one percentage point, is not carried forward into future years. This will maintain the real value of the retirement pension over time. Public service pensions will be treated in the same way. Any further action on index linked pensions will follow the report of the Scott Enquiry. A decision on child benefit uprating will be taken at the time of the Budget. We have also decided that the earnings rule limit will remain unchanged.

B9. But the cost of public expenditure programmes, especially pay, is as important as volume. It is essential to our fiscal policy, and fair, to look for a much lower growth in public service earnings in the coming year than in the recent past. It has already been announced that the Rate Support Grant limit will allow for a 6% annual increase in earnings from due settlement dates in the current pay round. It

SECRET

will provide for an increase in prices other than pay of 11% between the average levels for 1980-81 and 1981-82. Expenditure in other parts of the public services will be subject to broadly the same financial disciplines.

SECRET

Revenue

C1. I have also been giving consideration to the revenue requirements for financing next year's expenditure. I am determined that the size and composition of the PSBR in 1981-82 should be consistent with the Government's monetary strategy. The main fiscal decisions must await my Budget. But if we are to secure a full financial year's revenue, given the lead times involved, some decisions are necessary now.

C2. For that reason this is the time of year when we review and announce changes in National Insurance Contributions. We have concluded that an increase in employees' contributions would be appropriate.

C3. In the first place, we propose that the employees' contributions are increased next year by a quarter per cent to take account of prospective demands on the National Insurance Fund.

C4. Second, in order to maintain the planned level of health services, we propose that the health element of the national insurance contribution should be increased for employees by a further quarter per cent.

C5. Third, national insurance contributions do not pay for the whole of contributory benefits. Moreover, non-contributory benefits are financed entirely by the government outside the NI Fund and have been growing rapidly. We think those in work should directly shoulder a larger share of the cost of contributory benefits. We propose therefore to reduce the Treasury Supplement to the Fund from 18% to 14½%. This will be offset by a further increase in employees' rates of half a per cent.

C6. The combined effect of these changes will increase national insurance contributions from employees by around £1 billion in 1981-82 and increase the employees' rate, from 1 April 1981, from 6½% to 7½% on earnings between £27 pw and £200 pw. Other rates and levels will also change. Having regard, however, to the financial pressures on industry and the way the employer's share has grown in recent years, we shall not make any increase in employer's contribution rates. Full details are set out in the Government Actuary's Report and my RHF the Secretary of State for Social Services is introducing the necessary legislation.

C7. Since March there has been time to assess more fully the implications of the steep rise in the price of oil since 1973. This has been on a scale as important as that in 1973-74. The Government have concluded that there is scope for a further increase in oil taxation. The Inland Revenue are setting out further details of what I am about to announce in a press notice and will be inviting the industry to hold immediate consultations with them.

C8. Petroleum Revenue Tax - because of the way reliefs are structured - does not provide an adequate means of obtaining further revenue. I shall therefore introduce in the next Finance Bill a supplementary tax to be paid in addition to PRT, to take effect from 1 January 1981. The new tax will be charged at a rate of [20%] on gross revenue less an allowance. It will apply to fields which are in production whether or not they are yet liable to PRT. It will be deductible in calculating petroleum revenue tax and corporation tax.

C9. We are also examining the scheme of PRT reliefs and any changes, which will take effect from the same date, will be included in the next Finance Bill.

C10. I do not believe the changes will deprive companies of a fair return on their North Sea projects and exploration. They will together yield around £1 billion in 1981-82, mostly from the new tax.

(written notes for the
press note to
managing editor).

Interest Rates

D1. Until monetary growth has been brought back under firm control, it would be wrong to consider a substantial reduction in interest rates. But the changes which I have announced should leave no room for doubt about my determination to control the PSBR and to ensure that manufacturing companies are not unduly penalised. The growth in M_3 and the wider monetary aggregate is expected to decline in the new year. Inflation is already coming down and has fallen below the current level of short-term interest rates. And the narrower aggregates, which have particular relevance to short term interest rates are performing satisfactorily; I have therefore concluded that some reduction in MIR is possible. The Bank of England is, with my approval, announcing a reduction in MIR of 2 percentage points this afternoon.

Note

[This section copied only to:

Chancellor
 Chief Secretary
 Financial Secretary
 Sir Douglas Wass
 Sir Kenneth Couzens
 Mr Rylie
 Mr Middleton
 Mr Monck
 Mr Britton
 PS/Governor]



J B Unwin

20 November 1980