CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG

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28 November 1983

Dear Andrew

ATTRIBUTION E(A)(83)17

I attach an advance copy of the Chief Secretary's E(A) paper on "European Community Expenditure and the Control of UK Public Expenditure", for you to forward to the Prime Minister by tonight's bag. It will be circulated to the Committee tomorrow.

I understand that the Chancellor will want to have a word with the Prime Minister on Wednesday evening to tell her of the importance he attaches to those proposals.

Yours sincerely

J. Gieve

JOHN GIEVE
Private Secretary

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Briefing Note

No. 36
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THE CHANCELLOR'S AUTUMN STATEMENT

In his Autumn Statement, delivered to the House of Commons on 17th November 1983, the Chancellor of the Exchequer, Mr Nigel Lawson, gave an encouraging account of economic recovery:

> 'For the first time for many years we are now enjoying low inflation combined with steady growth. This is a winning combination. Our task is to keep that winning combination by sticking to - and indeed reinforcing - the policies which have brought it about' (Hansard, Col. 996).

Output is rising at a healthy three per cent per annum. Inflation is well down into single figures, and trending further downwards. Productivity is still improving fast. Investment is rising. New jobs are being created, although not yet rapidly enough to make significant inroads into the number of unemployed.

The one cloud on the horizon is public expenditure. The Chancellor foresees the Public Sector Borrowing Requirement (the budget deficit, in old-fashioned parlance) overrunning its target by nearly £2 billion this year. In July he introduced some corrective measures; more are now planned. But Mr Lawson has made clear that he will not flinch from raising taxes in the 1984 Budget if he thinks it necessary in the short run for the sake of keeping the economy on an upward path.

The Economic Background

The American economy is recovering from its recession - almost too fast, some experts would argue. This is good for world trade and therefore for British exports. Demand for British goods at home is buoyant, too, despite the severity of unemployment in many areas. The British economy is growing at the rate of three per cent per annum. That rate is expected to continue next year. In that event, UK growth during the three years 1982-4 will have exceeded that of our major competitors - an achievement without precedent for decades.

Inflation and Interest Rates; Investment, Productivity and Unemployment

As a result of the firm monetary policies pursued by Sir Geoffrey Howe, and continued by Mr Lawson, inflation is being brought under control. From a peak of 26.9 per cent under Labour in 1975, the year-on-year rate of price increases was brought down to below 5 per cent this summer. It has since risen slightly, but the Chancellor hopes for a further decline to 4½ per cent by the end of 1984. He went further in a recent speech:

> 'Only two decades ago an inflation rate of 5 per cent would have been considered too high. It is too high. The Government's ultimate objective is price stability' (Mansion House, 20th October 1983).

In company with inflation, interest rates are coming down. Bank base rates are now 7 per cent below their 1981 peak. This is good for investment, and for small and new businesses in particular. Contrary to general belief, investment in the British economy has been growing ever since the autumn of 1981. The 1984 estimate is 4 per cent.

In the ordinary way, all this would be reducing the unemployment figures as old jobs were revived and new ones created. The bitter-sweet truth is that productivity has risen so fast that unemployment has failed, so far, to fall. Since 1980 productivity in British manufacturing industry has risen by 15 per cent.

Public Spending

Against a target for the borrowing requirement of £8.2 billion for 1983-4, set at the time of this year's Budget, the forecast is for a figure of £10 billion. This is mainly a result of over-runs on public expenditure. The Chancellor is determined to prevent this prejudicing the general recovery of the economy. So he has announced measures which are designed to bring the 1984-5 borrowing figure back to £8 billion. Within the total figures, certain programmes are, nevertheless, going to receive extra public money in 1984-5. The changes now made are broadly as follows:

Expenditure up on education, social security, the Home Office, health and personal social services.
Expenditure down, compared with Budget time plans, on nationalised industries, housing benefit, defence.

Nationalised Industry Prices. A total of £666 million is to be deducted from the amount of taxpayers' money going to the nationalised industries in 1984-5. Part of this will be recouped by the electricity and gas industries in the form of higher prices to the consumer. Indications are that gas will go up by just less than five per cent and electricity by about three per cent. These increases would be below the expected rate of inflation and they would be justified by the facts:

* They would still leave gas and electricity prices at or below the level at which they would stand in a competitive market.
* They will not put British industry at an unfair disadvantage.
* They will mean that gas and electricity industries are still generating very low returns on their capital employed - 4½ per cent in gas and under 2 per cent in electricity.
* They will help to finance the future investment programmes of the electricity and gas industries.

This Government has taken numerous measures to help the less well-off with energy bills: the new disconnection codes; abatement of standing charges for small consumers; and very substantial increases in the assistance given to the needy through 'heating addition' and other Supplementary Benefits. Meanwhile, under this Government, the retirement pension has gone up faster than inflation.

Housing Benefit. The Housing Benefit scheme is administered by local authorities. There are at present seven million recipients, about one in three of British households; most people on supplementary benefit have their rent and rates met in full by housing benefit. The Government intends, from April 1984, to cut back some of the benefit going to relatively better-off households and those with non-dependants in work (usually young people) who will in future be expected to make a higher contribution towards housing costs. Also affected will be 18-20 year olds receiving supplementary benefit and living at home. About £180 million will be saved in a full year, together with about £50 million a year from lower rate rebates.

Tax Increases in the 1984 Budget?

The Chancellor electrified the commentators by saying that, if revenue and expenditure continued to move as now forecast, and if the borrowing requirement for 1984-5 were to be held on target, there could be a 'need for some net increase in taxes in next year's Budget'. He emphasised the uncertainties involved in a forecast made five months ahead of time, but was clearly determined that public expenditure should not put the inflation and growth targets at risk.

Conservative Research Department,
32 Smith Square, London S.W.1.

PJC/ACS

Public Expenditure file

WEEKEND WORLD

Sunday November 20, 1983

Lawson's Recovery Plan.

Fading from view.

Live interview with Nigel Lawson, Chancellor of Exchequer.

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PART ONE

BRIAN WALDEN:

Hello and good afternoon. Rarely can a newly-appointed and seemingly confident Chancellor have received such a buffeting, as did Nigel Lawson, following his announcement on Thursday of next year's plans for the economy. The burden of the attack he faced was that having raised expectations of tax cuts, he now warned that taxes in the next budget might rise. For the Chancellor, the criticism alone must have been painful enough. But, in the view of many, the episode has a much broader significance. It indicates they say that the whole strategy for economic recovery to which Mr Lawson is committed is being blown off course. And that's because more and more of his government colleagues seem unprepared to support the tough measures needed to make it work. It's all contributing to a growing suspicion that on the central issue of economic policy, the government is losing its way. So why has the Government apparently come unstuck ? And how do they intend to deal with the economy in the future ? The Chancellor of the Exchequer is here with us today, and shortly we'll be hearing his views. But first, let's hear the latest news headlines from ITN and Alistair Stewart.

ITN NEWS HEADLINES

BRIAN WALDEN:

Few people observing Nigel Lawson preparing his statement on the economy this week, would have imagined that he might have been sewing the seeds of serious political difficulties for himself. For the Chancellor was known to have grounds for optimism about the future. New treasury forecasts show that econimic growth, having picked up this year, would continue next. They showed also that employment was set to

start rising, and that inflation, already low by recent standards, was likely to edge down even further. And when the Chancellor delivered his statement to the Commons on Thursday, he made much of the good news.

NIGEL LAWSON (SPEAKING IN THE HOUSE OF COMMONS):

"The past year has seen falling inflation, renewed growth, and solid evidence of our continuing recovery from world recession".

BRIAN WALDEN:

Unfortunately for Nigel Lawson, however, those remarks lingered barely minutes in the memory. For they were promptly overshadowed by the bad news he'd brought.

NIGEL LAWSON:

"For the next year 1984-85, the forecast implies the need for some net increases in taxes in next year's budget".

BRIAN WALDEN:

The announcement that taxes may have to rise next year must have seemed extraordinary to anybody acquainted with Nigel Lawson's view of how the economy should be managed. And it was almost bound to lead to trouble. For, since he he was appointed Chancellor in June this year, Mr Lawson has made it quite plain that tax increases are precisely the opposite of the economic remedy he favours. The truth is that his statement to the Commons reflects the fact that almost from the moment he took up his job he's had a struggle on his hands. Both within the Cabinet, and within his own party, he's met resistance to the policies which he must have thought he'd been appointed to carry out.

Mr Lawson's always believed that sustained economic growth can only be achieved by creating conditions in which free enterprise can go unhampered about its business. And he's made very plain what he believes those conditions to be. The first condition he thinks free enterprise requires to produce growth is for inflation to be cut and ultimately eliminated. Only with stable unchanging prices, he argues, will businessmen take the vital decisions on which growth depends. And Nigel Lawson's second condition for growth is to cut taxation. Only this, he believes, creates sufficient incentive for employers to invest, and workers to become more productive. In view of that, Nigel Lawson must have found it a particularly bitter experience on Thursday, to have to warn of tax increases. The only consolation for him may be that he's known from the start that his strategy for permanent recovery was always going to be difficult to carry through. For to realise his twin aims of cutting inflation and taxes' required him to face a particularly daunting challenge. Curbing inflation, in Mr Lawson's view, is crucially a job for governments. The way they should do it is be controlling their borrowing. If governments borrow less, the overall amount of borrowing in the economy is reduced. The overall amount of money in the economy is then controlled, and when that happens, inflation falls. So in his view, to achieve his first aim, Nigel Lawson would have to reduce government borrowing. But reducing borrowing has other implications for him. For the purpose of borrowing is to help finance public spending. Public spending is paid for either by borrowing or by taxation. If a government reduces borrowing, then to make up the funds necessary to finance its spending, it has to increase taxation.

Similiarly, if a government reduces taxation, to cover its spending, it has to increase borrowing. But Mr Lawson wants to reduce both taxation and borrowing. So its only by cutting public spending that he can satisfy the conditions he's set for economic growth.

MALCOLM ROBERTS - SENIOR ECONOMIST, STOCKBROKERS, LAING AND CRUIKSHANK

Mr Lawson has to cut public spending in order to met two other objectives of his economic policy. Firstly, he wishes to reduce the level of taxation as a means of improving incentives, as a means of increasing the rewards for work effort. Secondly, he wishes to cut the level of public sector borrowing, because he thinks this is directly related to the rate of inflation. If he's cutting borrowing and tax, then he's obliged to cut expenditure.

BRIAN WALDEN:

Cutting public spending was always likely to be a formidable task. For since Mrs Thatcher first came to power, it's actually taken an even larger share of national income, under pressure from the defence budget and rising demand for social services. In 1979, it took just over a 40% share of total national income. This year, however, it's risen above a 43% share. That's a very considerable rise.
To pay for this, taxation over the same period has risen too. In 1979 it stood at 39% of national income. This year, taxation is taking more than 42%. That's a similiarly substantial increase. So, for Nigel Lawson, to bring taxes down merely to where they stood in 1979 would involve major cuts in spending. Public expenditure which this year totals 119 billion pounds, would have to come down to 107 billion pounds. That would mean cuts of 12 billion pounds. And that's something like 1 % of the

total. To make matters even harder, Nigel Lawson knew that public expenditure, far from falling, was under pressure to rise further still, requiring yet more borrowing and taxation. So, in early July, almost as soon as he was appointed, he's believed to have asked the Cabinet to agree to revise downwards the plans for future public spending. For he strongly suspected that the government's existing plans, announced at the previous Budget, were too high to permit major tax cuts.
But the Cabinet refused. A majority of his colleagues, it seemed, took the view that such a decision would be most unpopular, and would breach election pledges, like that to the Welfare State. And they feared that the danger of public opposition far outweighed the benefits that the cuts might eventually bring.

COLIN BROWN - POLITICAL JOURNALIST - 'THE GUARDIAN':

There is no doubt that when the Chancellor first took office a deep rift appeared between the Chancellor and his allies in the Cabinet on the one hand, who believed that deep and lasting cuts in the public expenditure were essential and their Cabinet colleagues on the other, who believed that to take such a course would be politically disastrous.
Those colleagues thought that, rather than cutting public expenditure they should be protecting it, and there was an ominous sign for the Chancellor at that point because he realised that to carry out his wishes, he would have to have a battle with his colleagues and win that battle.

BRIAN WALDEN:

The result of that clash was a compromise. Nigel Lawson was allowed to make cuts this year totalling 500 million pounds only to prevent expenditure from exceeding the total planned at thelast Budget. And he was given permission to start talks with spending ministers to find 2½ billion pounds worth of cuts next year,to offset anticipated over-spending then. But the protest that this year's cuts aroused caused further opposition within his party to his attempts to control next year's spending. Norman Fowler, the Health and Social Services Secretary, felt strengthened in resisting proposals that he introduce new health charges and reduce the value of unemployment and supplementary benefits. Patrick Jenkin, the Environment Secretary fought hard against the proposal to make savage cuts to grants to local authorities. And Michael Heseltine, the Defence Secretary,struggled against the Chancellor's attempts to make deep inroads into his budget. The result of this struggle was that by the time of the Conservative Party Conference in October, Nigel Lawson had failed to get agreement event to measures to keep spending in line with planned totals. And, in a blunt article in the Sunday Express, he showed his frustration, as he trenchantly re-argued the case for his strategy. He wrote: 'High growth will be achieved only by lower government spending. We need to look carefully at all our government programmes to see whether we can afford all that we are providing'. But, on that very same day, John Biffen, the Leader of the House Of Commons, delivered the heaviest blow yet to Nigel Lawson's aims. In a forthright statement, here on Weekend World, he attacked the notion that tax cuts were a high priority, and argued that the major areas of public expenditure should be preserved. He said: 'The Tory Party has a very well established tradition of the protective role of the State, and that very often means an expensive role. It is

consistent with Tory traditions, with realism and with a sense of responsibility.

JAMES NAUGHTIE - CHIEF POLITICAL CORRESPONDENT - 'THE SCOTSMAN':

The signifcance of the remarks made by John Biffen, was that here was in an intervention by someone on whom Nigel Lawson must have thought he could rely on spending matters. Someone who'd never been associated with the wets in Cabinet. Someone who didn't have an axe to grind as a spending minister, and above all, someone whose economic views had been very close to Mrs Thatcher's own in the past, a former Treasury chief secretary, after all. And so when John Biffen entered the debate, I think there was a sense that somehow the centre of gravity in the argument was moving away from Nigel Lawson. And when those remarks had been made and when they'd been absorbed by the ministers, I think Nigel Lawson, must have felt very isolated in the Cabinet.

BRIAN WALDEN:

It was Lord Whitelaw, the leader of the House of Lords, who was given the task of adjudicating between the Chancellor and his colleagues over next year's spending levels. Presiding over a committee of senior Cabinet Ministers earlier this month, Lord Whitelaw listened to the arguments between the Treasury and the spending departments. It's the agreements he forged in that committee that formed the basis for Nigel Lawson's autumn statement to the House of Commons on Thursday. At first sight, the Chancellor might seem to have done better out of Lord Whitelaw's committee than he may feared would be the case. For he told the Commons that he'd prevented any possible overspending, and that the balance between expenditure and revenue announced at the last budget would be maintained. A closer look at the figures,

however, suggests that the picture, from Nigel Lawson's point of view, was rather worse. Mr Lawson agreed to spending increases above next year's target, of about 2 billion pounds, mainly in social security, agriculture and education. To offset these, he managed to get cuts below the target of only 700 million pounds, mostly in defence and housing. So, he in fact allowed the overall planned total to be breached by 1.3 billion pounds. And that's not at all the sort of result he was looking for. So, Mr Lawson had to adjust revenue to be able to present his total package as staying on target. He announced the sale of an extra 400 million pounds worth of state assets - like parts of nationalised industries. He also said he would take additional revenue from the sale of council houses, to the tune of about 250 million pounds. And to make up the remainder of the spending excess, the Chancellor forced up the prices of gas and electricity to help raise 650 million pounds. The revenue changes totalled 1.3 billion pounds. So overall, the books balanced. But this wasn't, from Nigel Lawson's point of view, an ideal resolution of the Cabinet battle. For he knew well, that many would regard it as short-sighted to use the disposal of an asset that can be sold only once, to pay for public spending that's set to continue indefinitely. Worse still, for Nigel Lawson, was the fear that even existing tax levels wouldn't be sufficient to meet spending commitments. As a result, he had to announce increased national insurance contributions and give his hint of tax rises to come in the Spring. So, in the view of many commentators the autumn statement signalled another defeat for the Chancellor.

MALCOLM ROBERTS:

The Chancellor's statement must be regarded as a failure in the light of the objectives he set himself earlier this summer. At that time, he planned for reductions in the level of public expenditure. That's quite clear from his statement, that public expenditure is set to rise in the future. He

He also held out the hope of a reduction in the level of taxation,and yet now he's holding out the prospect of a small increase in the level of taxation. So judged against this objectives,this statement has to be considered a failure.

BRIAN WALDEN:

Friday's press bore out the assessment that Mr Lawson had failed. He came under heavy criticism even from papers that always have been his party's strongest supporters. The Daily Express, in a front page editorial, angrily told the Chancellor: 'This government was voted back to axe not to tax'. And Walter Goldsmith, Director General ofthe Institute of Directors, must have hurt Mr Lawson most of all when he said: 'The government's credibility as a tax-cutting administration is at an all time low'. So Nigel Lawson's predicament now looks grim. In essence the problem he faces is that his party seems to have committed itself in two opposing directions. They've said they'll protect the Welfare State, and other main areas of public spending. And many in the party believe it would be political suicide to go back on that. Their view is that tax cuts are to be welcomed, only if they are made possibly by any economic growth that may occur, to give the government more revenue. Alongside these people, however, the party has, in Nigel Lawson, a Chancellor who's committed to a plan for economic recovery that appears quite incompatible with the spending pledges. And who believes that sustained growth will only become possible tax cuts come first. What appears to have happened since the election is that the contradiction between the two camps has become ever more plainly exposed. In view of that, the Chancellor's options would seem limited.

He could of course, decide that the game's up, that he's fought hard, he's fought honestly, but he's lost. To bow to the wishes of a clear majority of his Cabinet colleagues would undoubtedly make the remainder of his period in office far more congenial. And, were he to do so, he need probably not despair of achieving some measure of control over public expenditure. Limited trimming to the huge social security and education budgets might be possible.

BRIAN WALDEN

And only on Thursday Michael Heseltine announced that he'd end, in 1986, the pledge that defence spending would increase by 3% a year above the rate of inflation. But the cost to Nigel Lawson of falling in line with his cautious colleagues is all too plain. Measures of this kind would be most unlikely to produce anything but the most limited tax cuts. And Mr Lawson would have to accept that the really large tax cuts that only deep inroads into public spending could produce would be beyond him. It would be tantamount to admitting that his whole strategy for economic recovery couldn't be implemented and that he was abandoning it. So that approach might well be impossible for Nigel Lawson to contemplate. Instead he might prefer to look for a way of breathing new life into the strategy he's always believed in. And to do that he might turn to the ideas of some of his most radical supporters. A number of prominent Conservative thinkers like Lord Harris of High Cross, director of the Institute of Economic Affairs, believe that there is a solution. The aim of the radicals is to bypass the politicians and make a direct appeal to the public. The public, they believe could be converted to an acceptance of expenditure cuts once the benefits of such a strategy are made plain to them. On this view, Nigel Lawson could hope to cut the ground from under the feet of his Cabinet opponents, who invoke public opinion in their cause, to do this he'd have to campaign to change the public mood.

LORD HARRIS OF HIGH CROSS - DIRECTOR, INSTITUTE OF ECONOMIC AFFAIRS

What is required is to take a fresh hard look at the whole range of Government activities, with a view to getting rid of a large number of them. Now politicians are naturally nervous because they think that the public is against them, and of course the public have been fed the illusion that they can have their government spending without paying the full cost in taxes and a variety of other ways. And what is therefore required is in my view a massive

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public, political educational campaign to persuade individuals of the reality that they can't have it both ways. And I believe that the great mass of individuals and voters are sensible surely enough to be prepared to accept large reductions in the range of Government activities to get the advantages of much lower taxes a much better performance of the economy and indeed a lower level of unemployment in the coming years.

BRIAN WALDEN

Ideas like this might well find favour with Nigel Lawson. For he himself has hinted in the past at something similar. And now, the opportunities for such a plan are starting to look favourable. It was announced only last Friday that the Government is likely to launch a national debate on the spending cuts needed to cut taxes. And the Government plans to publish a discussion paper - listing options early next year. If Nigel Lawson could use such a debate to change public opinion whole new opportunities might open up for him. His difficulties in Cabinet could disappear. And deep cuts might be possible in areas of public expenditure now closed to him. In the area of welfare for instance, the Government might privatise large parts of the Health Service, in other words require people to make their own provision. Similarly they might much reduce the role of state funded education. They might require people to make private arrangements for pensions, and other social benefits. And finally they might bring to an end certain major defence commitments such as the Trident missile programme, the British Army of the Rhine or the Falklands garrison. In short a revolution in public spending could take place. Cuts on this scale would produce massive financial savings. And beyond doubt they would permit the tax cuts that, in Nigel Lawson's view, would lay the basis for a sustained growth. So the radical approach would seem, from his point of view infinitely preferable to caution. But Nigel Lawson would have to be bold to try it. For he'd be arguing for nothing less than a

complete public rethink of people's expectations of what Government should provide. And there's no doubt that costs attach to this course of action also. On the most optimistic assumption there would have to follow a period of government disunity, during which the radicals campaigned openly against the advocates of caution. But worse than that, for Nigel Lawson, the campaign could fail, so that within the Cabinet the Chancellor could find himself utterly isolated. That in itself would be a bad thing for any government. And worse still, the disunity and strife might rage on until the next election, threatening the party's chances. So Nigel Lawson's got a choice. He could throw in the towel and admit that his strategy for recovery is over. Or he could keep faith with it, and bend every sinew, despite the risks to make it work. Well, he's with me here in the studio now, and we'll be back in a moment to hear what he has to say.

END OF PART ONE.

PART TWO

BRIAN WALDEN

Chancellor does it still remain your view that a sustained recovery vitally depends upon tax cuts, and that those cuts must come about through cuts in public spending.

NIGEL LAWSON - CHANCELLOR OF THE EXCHEQUER

Well certainly a sustained recovery depends on getting taxation down, that is vital. We have got a very good recovery going now, a recovery bolstered partly by the falling inflation, inflation is now down to 5% the lowest figure since the 1960's and our forecast suggests that it is going to go down further next year. And the economic recovery in this country is stronger than in any other country in the European comunity and again we see that continuing into next year. But to sustain that and to build on it and keep that going through a number of years, we're going to need to reduce taxation. But I would like to say this if I may - that although it is true that it depends entirely on public expenditure we'll come on to that, there isn't this great gulf in the Cabinet which you sought to portray. When I went to my Cabinet colleagues on the 21st of July, I don't know whether I should be telling you what happened in the Cabinet meeting or not.

BRIAN WALDEN

Do, do.

NIGEL LAWSON

But when I went to my Cabinet colleagues on the 21st July, I wasn't asking them at any time, to go lower than the figures for public expenditure set out by Geoffrey Howe in the public expenditure white papers set up earlier this year. Because we had campaigned during the General Election very clearly that that was the level of public expenditure that we consider appropriate

NIGEL LAWSON CONTD

and that was an election pledge which we said that we would keep Now it's quite true after the election a number of colleagues, thought it might be nice for their programmes to go up a little bit, but the Cabinet agreed - no we should stick to the figures that were published earlier this year, and that is what we have done, and not only stick to them for 84 - 85, the coming year, but of course we have a 3 year review as you know which covers 1985 - '86 and 1986 - '87. And that means that for 3 years, we had a satisfactory outcome of that review and that means now for the next 3 years public expenditure will be at this same level approximately in real terms. Now if public expenditure is staying at a steady level and the economy is growing which it is now, and I trust will continue to do, and our policies are designed to secure that, then that means that there is scope for progressive tax cuts.

BRIAN WALDEN

Well Chancellor, that was quite a long, and justifiably long statement, because it's only right that you should set these things out in your own terms. Let me however question you on some of it, for instance, let me quote you something, that you wrote in your own Sunday Express article, because you say public expenditure is now stablised at agreed levels for 3 years, but in the Sunday Express you wrote "indeed if Government continues to provide all the same services functions and benefits as it does at present state spending is likely to rise even higher in relation to the size of our economy." Now doesn't that reflect the voice of experience that one does not stabilise public expenditure by having deals with one's colleagues, there is an immense impetus all the time for it to rise, and how can you guarantee that for the next 3 years, now you know it will be stabilised.

NIGEL LAWSON

Well of course there is a constant tendency for it to rise. Constant pressure, pressures from pressure groups, from the ageing of the population, from the development of new technologies which are more expensive in many areas that are in the public sector and so on. But we can curb these as we have during this public expenditure curbed the consequences of these and find savings elsewhere to accomodate the consequences of these as we have done in this year's public expenditure review. Now the constant vigilance - constant vigilance is required. It is a constant struggle I don't pretend anything else but we can, there is no reason whatever why we should not succeed in holding these totals, and we have got to hold these totals. Now what I was talking about in that newspaper article was the longer perspective looking ahead way into the 1990's and if you project those trends there then I think you can see that there, you have probably got to do more, than simply these sort of things that we did in this particular public expenditure round. But looking to the next 3 years, which is what we did in this round, I'm satisfied that the totals we've got are totals which will enable, will give scope for reductions in taxation. Now that doesn't mean to say in every budget, we have reduced taxation, this is sometimes forgotten in the last two budgets in the 1982 budget, Geoffrey Howe reduced taxation, in the 1983 budget he did it again, and I can see on the future budgets a scope if we hold the public expenditure totals which we have to for further reductions in taxation. I have just said to the House of Commons that the prospect for the 1984 budget doesn't look too good.

BRIAN WALDEN

All right, now let's I want to come to what you have said about the long term, that what you said in the Sunday Express related to that and that there you think there must be some cuts,

BRIAN WALDEN CONTD.

but before we do that, let's get clear about these next 3 years. You see a lot of people say that you fudged this review anyway that in fact you did permit an overspend but that you balanced the books by pouring money back by taking of increase revenue, that's one point that ought to be considered, a lot of people say.

NIGEL LAWSON

Shall I answer that point?

BRIAN WALDEN

Well yes, I suppose we'll take that one first.

NIGEL LAWSON

Yes, yes, that's quite untrue, on the energy prices, these are economic prices, that's to say to give a reasonable rate of return a very, still a very low rate of return less than 2% on assets for the electricity industry economic prices and in gas indeed there was a report published only a few months ago, which showed that the British Gas Corporation was actually losing money on a lot of its sales, sales at the margin as the economists call it. And no sensible business does that, so it was a question of getting prices at realistic levels and what I, those who want them lower, are calling for, in something of an orchestrated campaign is energy subsidies, now that is a legitimate thing to ask for - and he's wrong but if people are asking for subsidies that is public expenditure and by ruling out those subsidies I am genuinely ruling out public expenditure, and on the other thing, the sales of assets, the government all the time, is acquiring new assets , new capital assets of one kind or another and it is reasonable to some extent to finance these by disposing of assets it doesn't need.

BRIAN WALDEN

Yes, I accept a good deal of that Chancellor actually, unlike many critics of your policy, but you see the trouble is it isn't that in fact all of this is going into savings, this is going for spending you are going to spend all this money away aren't you?

NIGEL LAWSON

No the, the, of course public expenditure is what it is, but the

BRIAN WALDEN

Which is going up.

NIGEL LAWSON

But, no it's not going up public expenditure in real terms this year will be very much, in the next year, will be very, very much the same as it turns out this year, even though this year it's turned out a little bit a little big higher than we'd anticipated for various reasons.

BRIAN WALDEN

Alright, let me bring you to what I regard as a much more fundamental case than that, though one, for some amazing reason that I don't understand very, very seldom put in the press or indeed put by commentators. What you're telling me about the next 3 years is this. If we get some growth and it's my belief as Chancellor that we shall, that I might be able to do something in respect to tax cuts, but you're whole theory has always been exactly the reverse of that. It's always been you have got to have the tax cuts in order to produce a sustained growth hasn't it?

NIGEL LAWSON

It's a question of what the rate of growth is. If we are to have the rate of growth of which I believe we as a country and as a economy is capable of, if we're going to have that and have the

NIGEL LAWSON CONTD

rise in living standards that we all want to see, and also looking further ahead and to have money to which we can afford to pay in the essential public services because there are essential public services but you've got to earn the money first before you can start spending it. If we're to have that sort of economic performance that sort of dynamic economy then we've got to have the incentives through tax cuts. However, even if we don't have the tax cuts we will have a rate of growth, what I am anxious to do is to get us the best rate of growth of which we are capable. Our record in the past has not been a very good one in this field, and may I say this too, I do think that it is really fundamentally wrong as well as being bad for the economy that poor people should have to pay such a high proportion of what they earn in taxation.

BRIAN WALDEN:

Well, I can well accept that, and a lot of poor people will agree with you, indeed a lot of people who aren't poor will think that they are paying too much. But you've said something very interesting there. What you have said is, and I am admittedly putting it in very crude terms, and you will tell me if I have misrepresented you, what it is that it is you are saying 'I Nigel Lawson would like a lot more tax cuts than are possible at this level of public expenditure. Sooner or later I shall be able to do something about that, and I will then get genuinely dynamic growth in the economy. For the moment, however, Mr Walden, be realistic. I must struggle along with what I can get at this level of public expenditure. Now is that an accurate representation of what you are saying?

NIGEL LAWSON: MP

Not quite. What I am saying is that if we can hold public expenditure in real terms, hold it, as a constant level in real terms, then with a growing economy that will give scope for tax cuts and the tax cuts in turn will enable the economy to grow faster. So you're into a virtuous circle. If I can take you back to 1979.....

BRIAN WALDEN;

Can I interrupt you there before you take me back to 1979. Let me ask you then, I suppose, I mean one puts these things in a way that one knows or hopes that the Chancellor will understand. Well let me ask you the blunt question then, that the Express put to you, and which no doubt is being asked in the pubs this morning. You say if one

contains the public expenditure at its given level, why don't you just cut public expenditure. Then you would get your tax cuts, wouldn't you?

NIGEL LAWSON:

Well, as I was suggesting to you we will get our tax cuts this way. And it is a question of a balance that always has to be struck. I don't think even you would suggest that the level of public expenditure should be zero. Clearly not. Clearly there is going to be a large bill for the old-age pension. Clearly there is going to be a large bill for defence. And clearly there is going to be a large bill for the National Health Service. So there are a whole lot of items of public expenditure which are there and it is a question of a balance - how high, how big does this burden have to be? And to prevent it from getting it so high...too high. Now what I am saying.....

BRIAN WALDEN:

So you are saying you are satisfied at the level of public expenditure at the the moment.....

NIGEL LAWSON:

Now I'll take you back to 1979 which I was trying to do a few moments ago.

BRIAN WALDEN:

Alright. Let's have 1979.

NIGEL LAWSON:

In 1979, what we said then, very clearly, is that what we

believed in was tax cuts, and we were going to achieve that by having public expenditure as a steadily smaller proportion of the total national wealth.

BRIAN WALDEN:

And you're nowhere near that, are you..

NIGEL LAWSON:

...And that is what is happening. It reached a peak in 1981, at I think 44%. It has been edging down since then; 1982 was less than 1981, this year less than 1982, and next year will be lower still. And clearly it follows that if public expenditure isn't rising - if it is staying constant in real terms - and the rest of the economy is growing, the whole of the economy is growing, then clearly it follows that we are achieving public expenditure as a steadily lower proportion of the total economy.

BRIAN WALDEN:

Chancellor, after all you brought 1979 up, I was going to spare you that unhappy reminiscence.....

NIGEL LAWSON:

.....Not unhappy at all.....

BRIAN WALDEN:

because think what you have told me this morning. You have told me this morning that for the next three years there is going to be, at real prices, a stabilization of public expenditure. That you think that eventually something has got to be done about that level and it would be done in the 1990's. That will mean that the

pledges that you gave in '79 on the then levels of taxation of getting them as a lower proportion of national income won't even have been met by the end of two periods of Conservative government. Even the levels that existed in 1979, and that one will expect another period of Conservative government to get taxation perhaps down back to, or lower than, the proportion of national income that it first was when you came to power with this brand new plan. Now Chancellor, that is not exactly a marvellous achievement.

NIGEL LAWSON:

I am all in favour of another period of Conservative government, but I don't share your exact confidences, particularly when we are going ...particularly what date we are going to get a particular percentage of taxation. Look at what we have done already. We have got the level of income tax down for everybody. But other taxes have had to go up - and why?... Because when we came in, again in '79, when we came in we inherited an absolutely appalling state of affairs, in which government borrowing was grossly excessive and set to rise still further. Government spending on a sharp upward path and it took time to correct that and one of the ways in which we had to correct the huge public borrowing, that is to say the dishonest financing of government spending, was to replace it by honest financing. The level of expenditure we kept it as tight as we could but it had to be financed more by taxation, less by borrowing. But they've bought borrowing down now. We have achieved that. And we are now in a period when we can look forward to the benefits of a tight control of public expenditure being reflected in lower taxation.

BRIAN WALDEN:

Alright Chancellor, let me conclude this section by putting back to you what I think it is that you have told me, and then move on to the other section of future spending cuts. What you've told me in respect to the next three years is this. That you are confident that you will infact be able to stabilize public expenditure in real terms. That you anticipate quite reasonable levels of growth, not as high as you would like or you believe you could indeed get if you could have all the tax cuts you wanted, but nevertheless in historic terms reasonable levels of growth, that out of that growth you think there in fact will be some tax cuts, but for a really dynamic turn around we must wait further than that. That is about what you have said, isn't it?

NIGEL LAWSON;

No, Not quite. On the last point let me just modify it in this way. There are fundamental trends in the economy and in society which if we are not careful are going to lead to a resurgence in public expenditure further ahead....

BRIAN WALDEN:

...I'll say....

NIGEL LAWSON:

And it is to prevent that resurgence that I believe more radical thinking is necessary.

BRIAN WALDEN:

Alright. Well now Chancellor you are not going to get any argument with me about that. The only thing I might have some doubts about is whether you are going to hold it

as easily as you think in the next three years.....

NIGEL LAWSON:

I said it would be a struggle....

BRIAN WALDEN:

I accept that you will win it.... Let us now move on, however, to as you say - not me - the vital need to come to terms with these pressures that keep forcing spending up. Let me ask you, now forget about this period of Conservative government. Let us anticipate a glorious Conservative victory in '87 or '88 and you're back to the Exchequer. What areas of public spending do you then want looked at for a long-term reduction?

NIGEL LAWSON:

We've got to look at all areas of public expenditure. But obviously the ones that we have got to look at hardest are those that are the biggest programmes. And if you take the...there are five areas of public expenditure which account for two thirds of the total - just those five. One of them is the interest on the national debt. That is not something which is controllable independently. But obviously the more we can get government borrowing down by cutting other forms of public expenditure the less the burden on the interest on the national debt - so there is a bonus there to be gained. The other four are Social Security, and I'm putting them in order of size (that is the biggest) Social Security, Defence, Health and Education. So clearly those are the areas that have to be looked at the hardest simply because they are the biggest programmes. But of

course there is the other one third and that will have to be looked at hard as well.

BRIAN WALDEN:

Sure. Let me take some of those then, Chancellor. No one expects , because this is a matter which as you say yourself has not even been discussed as yet in those terms-what has been discussed is a stabilization, when the Conservative government gets around to discussing actual cuts, what sort of options as Chancellor will you put up, and let's take the things you mentioned - the National Debt covers itself. Your option there is clear enough - don't borrow much. That will cover that one. What about Social Security. What will you suggest to your colleagues they might do there to cut the burden on the Treasury of having to pay for it?

NIGEL LAWSON:

I think that one of the general principles we have got to apply in all those areas, with the exception of Defence - in other words in the Social Security, health and in education - is this. Look at what we have done in housing. Housing is a basic need. And the need for housing will go up as the country gets wealthier, people's aspirations get higher. But the big question is who is to provide the housing. Is it to be provided by the State or the municipalities, by the public sector, or is it to be provided by the private sector. And it has been a cardinal policy of the Conservative party that more and more should be provided by the private sector. People like to own their own homes, and so on, and we have this big programme of council house sales which is making a big

shift of this kind. Now I think that what we need to do is to apply that sort of philosophy, that sort of agrument to these other areas and say how ... what is the scope for greater private provision in all these areas.

BRIAN WALDEN:

That's an interesting point, and not altogether a surprising one of course because one would have expected you to say that. What is it in regard to...by the way let's be clear what exactly what we're talking about... you are saying that the state share of Social Security, of health and of education shouldn't disappear but that far more should be taken off. People should provide more for themselves. OK. I can see how you might believe that in say 1990, why don't you believe it and do it now?

NIGEL LAWSON:

We have... What we have got to do is to take a hard look at these areas now. And maybe take some decisions now or fairly soon in order to effect what is going to be the pattern some years hence in the 1990's.

BRIAN WALDEN:-

... I understand ....

NIGEL LAWSON:

So we have got to start thinking about it now and we have got to start opening up the public debate on these issues now, in my opinion, and I think it is very helpful that someone like Ralph Harris of the Institute of Economic Affairs.Say they ought to, and other institutes of that kind, open up the public debate, because in many ways it is much easier

for them to do it. Because people find it very difficult to grasp the idea of the government having a public debate. As soon as a government says anything they assume that it is a firm, hard decision written in stone and set in concrete, and so on. And so I hope that they will do a lot toobut I accept that it would be desirable for us, who have done something already, for us to do more - to set out the likely trends, as we see them, we don't know for certain but as we see them, and what the sort of problems are , what the sort of choices are.

BRIAN WALDEN:

And you are going to do that, presumably, in the Green Paper that you are going to publish.

NIGEL LAWSON:

I am not committed to a Green Paper. I was asked in the House when we had it whether we would produce a Green Paper on this, and I said I would certainly consider the matter. I hope that we will be able to produce, after we have discussed it amongst ourselves first, obviously, that is the first stage, a document of some kind.

BRIAN WALDEN:

And I gathered from you rather to my surprise, I must be frank, that you regard these kind of discussions with your colleagues as something that has got to be got on with pretty urgently - certainly long before the next General Election.

NIGEL LAWSON:

Oh yes. Certainly. If we are going to effect the decisions in

The longer run we have got to start thinking hard about it and reaching the decisions of what we are going to do quite soon.

BRIAN WALDEN:

Alright. Make a huge leap in imagination, Chancellor, and assume that I was one of your colleagues and was sitting with you in that Cabinet. And I said well I've got a lot to do in my own department you know, Nigel, I don't entirely understand exactly what you are saying. What do you want us to do on the National Health Service? What do you want to have happen in regard to Health in terms of privatisation?

NIGEL LAWSON:

Well, you're not one of my colleagues. I regret that, Brian, I'm sure you'd be a great acquisition and an embellishment to a government which is already full of stars. But nevertheless, since you are not I don't think it would be right for me to discuss it with you now before I have discussed this fully with my colleagues.

BRIAN WALDEN:

Ah. So that you are going to put some pretty radical proposals on all of these areas - and let's repeat them - Social Security, Education and Health - and you are going to ask for a greater degree of what is called privatisation. That is that the citizen should pay for a lot of this himself, and not dump the burden on the State. But you aren't prepared to tell me what sort of suggestions you intend to make to you colleagues.

NIGEL LAWSON:

No because it doesn't begin with suggestions, anyway. What we've got to do first of all is to get an appreciation of the nature and scale of the problem. Once, we haven't really got that yet, there is a sort of lurking feeling that there is a problem, we have got to get a rather more precise appreciation of the nature and scale of the likely problem.

BRIAN WALDEN:

But Chancellor, you haven't got a lurking feeling that there's a problem have you..?

NIGEL LAWSON:

No. I'm talking about it more widely because, as you say, mu colleagues are busy-they have their problems in their own departments and we have not had a collective discussion on this except in the most general terms. We have got to get down now to more precise terms. Then when we have established the nature and scale of the problem then we can start suggesting what possible solutions there are.

BRIAN WALDEN:

Well, let's suppose.....

NIGEL LAWSON:

And incidentally, if I may add something. The shift from the public provision/State provision to private provision is one obvious route that we would want to go - that I would want to go, and I think the Conservative Party would want to go. Another is to say well even where things

are necessarily within the State sector, do they have to be entirely financed out of taxation. Are there other more desirable more sensible methods of financing.

BRIAN WALDEN:

Sure. Let us suppose, Chancellor, I mean this may not be the case but let us suppose that these somewhat monkish colleagues of yours who only have a lurking suspicion that there is a great problem about public expenditure, let us suppose that after you have bent their ears a bit they fully grasp that there is an appalling problem about public expenditure. Does that then mean that you will be able as Chancellor, to participate in the public debate that Lord Harris says we all need. Because that's what strikes me if you the most important man in the whole business are not going to give any details in the public debate I don't see how that public debate is going to be very effective. Is it?

NIGEL LAWSON;

When the time is right I shall take part in the public debate.

BRIAN WALDEN:

And when do you think that time will be right?

NIGEL LAWSON:

I don't know. I don't know. But I hope we can get down to it fairly soon. I think it is something certainly to be done in the early years of this parliament, even though what we are talking about is a problem which is going to emerge later on.

BRIAN WALDEN:

Chancellor, if I may say so, maybe a compliment from me is not something that you would look for, but what you've told me this morning I think is a courageous decision on your part. However, there are obvious costs to it. What about those members of the cabinet who will say to you well this is all very well, Nigel, But you're stirring up a hornets nest here. The last thing in the world we want to do is to start talking about cutting public expenditure or privatising Health, or any thing like that. For goodness sake forget about it. What would you say to them?

NIGEL LAWSON:

I don't think that is the way that this government has conducted itself ever since it came into office in 1979. What this government has been doing, and of course Margaret Thatcher is the supreme exponent of this, is telling people the truth. Saying one or two things that maybe don't sound very agreeable because they depart from the normal platitudes, but which have the ring of truth about them, and we have done a number of unpopular things and we have said why we have had to do them, why it has been necessary to do them. And what has happened is that the public have responded to this new approach. THey have responded to a government that tells them the truth, tells it warts and all and takes unpopular decisions when they have to be taken. And I think that that is the way we should continue.

BRIAN WALDEN:

Well. Let's take an example not of what is called a Cabinet Wet, and I won't even in fact name any, let us

take someone who has always been known as a very sound man on finance, but who plainly completely disagrees with you on the necessity for cuts in public expenditure to lead to tax cuts. What if Mr Biffen says to you I don't regard this as traditional Toryism at all. I believe what I told Brian Walden, that we have got to keep these spending programmes high and if they go higher that's alright, we must raise it in extra taxation. And you should keep quiet about it, Nigel, Because that is the safe Tory course. What would you say if Mr Biffen did say that.?

NIGEL LAWSON:

Well I didn't watch the programme so I don't know whether he said that or not .....

BRIAN WALDEN:

.... But you read the transcript, though, didn't you....

NIGEL LAWSON:

But you know the level of public expenditure which we are talking about, the level of the moment of something like £150 million, £150 billion, £150 thousand million, a massive sum in today's prices , that is not peanuts, that is a very substantial programme of public expenditure, and a Conservative government - which quite rightly does believe that there has to be public expenditure for Defence, for Law and Order, for looking after the needy - can still fulfil all those obligations and be true to the traditions of the Conservative party within a total of that size

BRIAN WALDEN:

Alright. Chancellor of the Exchequor, thank you very much indeed.