FROM: CHIEF SECRETARY
DATE: 22 December 1983

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CHIEF SECRETARY TO THE TREASURY

PRIME MINISTER

PUBLIC EXPENDITURE REVIEWS

To maintain our firm grip on public expenditure it is important that we should use the time between the annual Surveys to tackle in depth the difficult areas where there are potentially large savings. The regional policy review is a good recent example. With your agreement I should now like to open up some more reviews, which we can consider before the next Survey, either in Cabinet Committee or, if you prefer, in a smaller group under your chairmanship.

The aim should be to look at the objectives of a spending programme afresh to see whether we should - or whether, politically, we can - devote substantially less resources to it. Radical reviews on these lines will need the agreement of colleagues concerned, and we should set firm guidelines for officials. In some cases you may want to hold a meeting of Ministers first, or to send a minute setting out the scope of the review.

We have already agreed, at your meeting on 21 December to a review of spending on agriculture. My other candidates are:

1. Urban programme. This has grown to a large total (£325m this year) with no clear definition of objectives or tests of success. The regional policy review failed to get to grips with it, and it may be giving the wrong signals to high-spending local authorities in urban areas.

The objectives and cost-effectiveness need to be set out in detail, with options for substantial savings, for us to consider before the next Survey. You may want a meeting with Patrick Jenkin and other colleagues to launch this. Alternatively, I would be glad to provide a draft minute for you to send him.

2. Defence equipment. Following the HARM/ALARM decision Cabinet commissioned an exercise to establish what technology it is militarily essential to have in this country. In my view it would help with future equipment procurement decisions to follow up this exercise now with a broader examination of the UK defence industrial and technological base so as to promote greater competitiveness in this area and maximise value for money in defence procurement. If you agree, the broader examination might be commissioned by OD when the Committee discusses the initial paper which I understand is with Michael Heseltine. It would be useful for the No. 10 Policy Unit and Cabinet Office Scientific staff to continue to take part in the work.

3. Family Practitioner Service. This expenditure is 'demand-led' and hard to forecast or control. Implementation of the Binder Hamlyn recommendations, and the current review of the drug purchasing scheme (PPRS), should help. But Binder Hamlyn's terms of reference did not cover the cost-plus contractual relationship between the NHS and family practitioners. This badly needs review: it tends to build up arrears of payments; it offers GPs no incentive to prescribe economically; and following legal action by some disgruntled pharmacists it now seems that its legal basis is unsound. If you agree - I do not think that Norman Fowler is likely to dissent - further work should be done in this area and a report made to Ministers for decisions by the middle of next year. It may also be necessary to look again at further options (eg. cost-related charges for drugs) before the next Survey.

4. Social Security benefits. Norman Fowler has already agreed in principle, during the Survey discussions, that all benefits should be reviewed to see if they are relevant to the 1980s. Pension issues are being considered by his Enquiry. Other priority areas are housing benefit and unemployment and supplementary benefits. I am concerned more widely about the inadequacies of forecasting, monitoring and control of benefits expenditure (where there has just been another large "demand-led" increase), and I shall insist in that context that officials do more work on this so that we can find ways of improving matters before the next Survey.

5. Territorial programmes. There is good prima facie evidence that the overall level of spending, in relation to "needs", in Scotland and Northern Ireland is substantially higher than in England and Wales. Our regional policy decisions have made only a very limited impact on this problem. This is a politically sensitive issue, and I would certainly not suggest that we could make any dramatic cuts in the short term. But I think we should ask officials to establish the facts as clearly as possible so that we can consider some adjustment at the margin, starting in the final year of the next Survey. If I may, I will let you have after Christmas a draft of the kind of minute you might send to colleagues concerned initiating this work.

If you agree with these proposals, I hope that my officials and the No. 10 Policy Unit can keep in close touch as the work proceeds.

J.S.L. Giers

for PETER REES

[Approved by the Chief Secretary]

LBS

File

CENTRE FOR ECONOMIC FORECASTING
262 - 5050
Ex. 385

EMBARGO: 00·30 HOURS MONDAY, 12 DEC. 1983

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THE AUTUMN STATEMENT

The Autumn Statement is notable for the optimistic tone of its economic forecasts. The fiscal projections are however disappointing since they confirm that the PSBR in 1983-4 could be some £2bn higher than originally planned. In this *Forecast Release* we examine the reasons for the Treasury's optimism about short-term prospects; analyse the causes of the PSBR overshoot; and discuss the implications of using asset sales rather than public expenditure cuts as a means of keeping public borrowing under control.

Our main conclusions are:

(1) If the authorities are correct in assuming stable oil prices and a stable exchange rate, then inflation could fall to 4½ per cent by the end of next year as they project.

(2) We believe it more likely that the exchange rate will drift downwards and hence inflation will be higher than officially forecast.

(3) A re-run of our October forecast on Treasury assumptions suggests that growth will be closer to 2½ per cent than 3 per cent next year, with exports, stockbuilding and consumption all lower than officially forecast.

(4) The PSBR overshoot in 1983-4 suggests that the cash limit system for controlling spending systematically leads to above-target borrowing whenever (as at present) inflation and thus tax revenues turn out lower than expected.

(5) Asset sales up to a reasonable amount are an acceptable substitute for spending cuts or tax increases if the purpose of the PSBR target is to control the size of the public sector; they are not a good substitute if the purpose of controlling public borrowing is to reduce inflationary pressure by limiting the public sector's claims on real incomes.

I The Forecast

Inflation

Many commentators, including ourselves, have forecast that (leaving aside short term movements in the RPI due to special factors) inflation will rise in the later stages of the cyclical upswing, and will be higher next year than this. The Treasury forecast challenges that view, and asserts that by the second half of next year inflation will once again be falling. Which of us is more likely to be correct? Is it realistic to forecast falling inflation next year, which will be the fourth year of the present recovery?

It should be stated at the outset that forecasting uncertainty is such that the difference between the Treasury and LBS inflation forecast is well within the margin of error attached to either. The average error for past Treasury forecasts made at this time of year for one-year-ahead inflation is 3 per cent. This figure, calculated for a period of much higher and more variable inflation, may overstate the uncertainty, but even if the likely error is only half as big, it still spans the difference between Treasury and LBS forecasts.

It is nevertheless instructive to examine the reasons why the two forecasts differ, since it serves to highlight some interesting differences in economic assumptions underlying the two forecasts.

Short-term forecasts of inflation in general strike a balance between two approaches: domestic prices can be determined either by domestic costs adjusting to world prices with little change in the exchange rate; or by world prices expressed in sterling terms adjusting to domestic costs via a change in the exchange rate. Monetary policy is an important factor in determining which of these effects dominates. Policy is especially important at present because there is a substantial gap between the prospective rates of increases of domestic costs and world prices, as Table 1 shows.

The gap between domestic costs and world prices

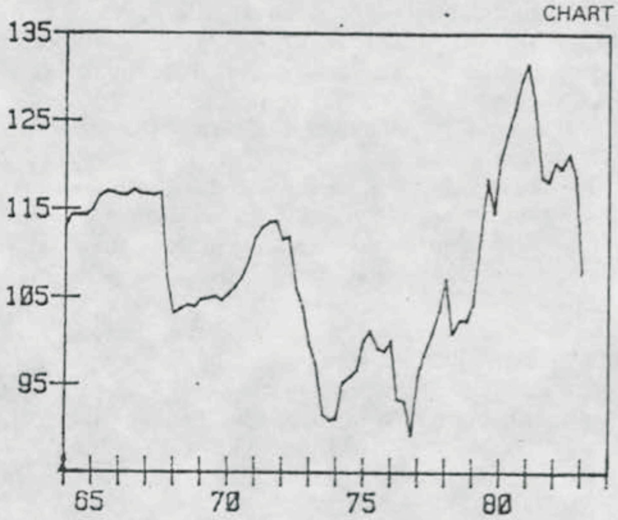
Table 1
Key Elements in LBS forecast of Inflation

	% changes, 1983Q4 to 1984Q4
World producer prices	6.8
Exchange rate	–6.2
World producer prices in sterling	13.1
Earnings per head (manufacturing)	6.3
Productivity (manufacturing)	4.1
Unit labour costs (manufacturing)	2.1
Producer prices	6.4

provides an opportunity to improve both competitiveness and profits. The opportunity is welcome because, as Chart 1 shows, we start from a position in which competitiveness, despite its improvement since 1981, is still weak, while Chart 2 shows that profits, though rising rapidly, are still low by historical standards. The problem is that improving competitiveness requires lower prices, while improving profits requires higher prices. One way of reconciling these conflicting claims is via a lower exchange rate. In our October forecast we forecast a modest fall in the exchange rate, but the Autumn Statement reveals that that is not what the Treasury is currently assuming.

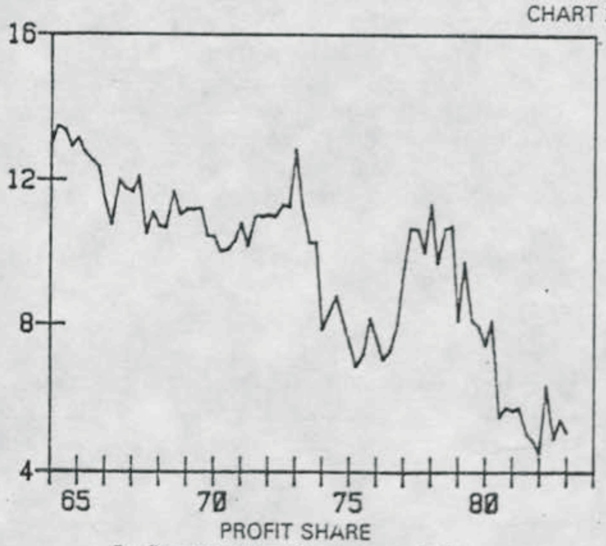
The authorities do not have an explicit policy for the exchange rate. They attempt to balance their long-term aim of stable prices (which is helped by a high exchange rate) against the short-term need to encourage export-led growth (which is helped by a lower exchange rate). The exchange rate was high in the summer months (following the Conservative election victory) and exports have been weak. The authorities seemed at that time content to see the exchange rate edge downwards.

CHART 1



COMPETITIVENESS
(Relative producer prices, 1975=100)

CHART 2



PROFIT SHARE
Profits excluding Stock Appreciation and North Sea Oil as % of GDP

However, the Autumn Statement assumes little further slippage from now on. If that implies that the authorities will be prepared to defend the exchange rate at its present level (if necessary by raising interest rates), then clearly the exchange rate projection underlying our October forecast was wrong.

What then would our forecast have looked like if we had assumed a broadly constant exchange rate, as the Treasury does? We have carried out some simulations to quantify this, and these are reported in detail on p3. The broad answer is that incorporating the Treasury assumption of a constant exchange rate into the LBS forecast would by itself bring our RPI forecast (1983Q4 to 1984Q4) down from 5.5 to 4.8 per cent. Further adjustments to bring our public spending and oil price assumptions into line with latest official plans and projections result in higher output and lower unit costs, which bring the LBS forecast for the RPI very close to the Treasury view.

The moral of the exercise is clear: inflation prospects depend crucially on the exchange rate. We remain of the view that unless there is official action to prevent it, the exchange rate will tend to weaken over the next year. The underlying reason for this is the large monetary overhang and weak competitive position, which could lead to persistent balance of payments weakness on capital and current account. However, if the exchange rate does hold up (and if the Treasury is right in its oil price assumptions), inflation next year could be lower than this year.

Output

If the difference between Treasury and LBS inflation forecasts turns out, on close inspection, to reflect mainly differing assumptions, the same cannot be said of the output forecasts. The official growth forecast for 1984 is 3 per cent on the average measure of GDP. In October we forecast 2.2 per cent on this measure. The difference between these growth rates, though within the average error of 1 per cent for the official GDP forecast, does imply a genuine difference of view which is worth exploring.

A key difference between the two sets of numbers is the forecast for personal consumption. Insufficient information is given in the Autumn Statement to pin down exactly why the Treasury and LBS forecasts differ. Qualitatively it appears that the two forecasts are similar – both forecasts expect the "saving ratio to stay below last year's level" and both predict a "rise in real after-tax incomes" (A.S. para 1.31). Each is "consistent with a rise in employment over the next year" (A.S. para 1.41). Even on earnings, where the Government Actuary's working assumption is a rise of 6½ per cent between 1983-4 and 1984-5 (A.S. para 3.04), there is little difference, once the LBS October forecast is adjusted for lower oil prices and higher exchange rates. However it is probable that real incomes are higher in the Treasury forecast at the end of 1983, reflecting recent information which suggests lower inflation and higher consumption in the current quarter. This, plus a slightly lower savings ratio throughout is probably sufficient to explain the difference in consumption.

Another reason why the official forecasts are higher than ours is that public consumption is projected to grow by 1 per cent next year, compared with the 0.3 per cent which we forecast in October. This stems from the lower inflation forecast which permits greater volume growth within an unchanged public expenditure Planning Total.

HMTs view of personal consumption has two important corollaries. Higher consumption reflects higher real income which is partly a consequence of a stronger exchange rate. The counterpart of the extra consumption, in the Treasury forecast, is a higher level of imports than in the LBS projection. But this is offset by higher exports which, given the exchange rate assumption, looks optimistic even against the background of expected world recovery. It seems unlikely that exports will be 4 per cent higher next year without any significant fall in the exchange rate.

The other corollary of higher real personal incomes (brought about by lower prices) is that profits rise by less. In the official projections, mainly because of the stronger exchange rate, persons are better off and companies are worse off than in the LBS forecast. But despite this the official forecast of stockbuilding is distinctly higher than ours which seems questionable.

Table 2 shows the main elements of the Treasury and LBS forecasts. Our overall assessment of the official projections is that, given their own assumptions about the exchange rate and oil prices, the price forecast looks reasonable, but the output forecast looks high. If the exchange rate remains close to present levels over the next year, then we would expect exports and stockbuilding to be distinctly lower than officially forecast, and output to be nearer 2½ per cent than 3 per cent.

Table 2
Comparison of Treasury and LBS Forecasts for 1984

Percentage changes	Treasury (Autumn Statement)	LBS (October forecast)	LBS (on Treasury assumptions)
GDP (average)	3	2.2	2.4
Consumers' expenditure	2½	2.0	2.0
Government consumption	1	0.3	1.1
Fixed investment	4	4.4	4.7
Stockbuilding (as % of GDP)	½	0.3	0.3
Exports	4	3.1	2.7
Imports	5	3.8	3.9
Current balance of payments (£bn)	0	0.3	0.5
RPI (4th quarter)	4½	5.5	4.4
PSBR(£bn fin. yr)	8	7.6	8.0

Re-running the October forecast on Treasury assumptions

In this section we examine in detail how the latest Treasury forecast differs from our most recent forecast. One reason why forecasts differ is that they are made on different exogenous assumptions. We have therefore re-run the LBS forecast using, as far as possible, the same assumptions as those underlying the Treasury forecast.

Assumptions

Table 3 sets out the principal assumptions/forecasts made by HMT and LBS on world prices and output, the exchange rate, taxes and public spending.

Table 3
Key Assumptions for 1984

	HMT	LBS
North Sea Oil price ($)	30*	31.5
World GNP (% change)	3½	3.3
Exchange rate (1975=100)	83*	81
Rooker-Wise indexation	5	5.1
National insurance surcharge (rate,%)	1	abolished
Government consumption (% change)	1	0.3
Fiscal adjustment (£bn, minus sign means increase in taxes)	-½	0.5

*HMT numbers are "interpreted" from the Autumn Statement

For 1983 the differences are unimportant. For 1984, the assumptions on world activity and the indexation of taxes and allowances in next year's Budget are very close. But on other items, there are important differences:-

1) Oil prices

The Treasury assumes that "North Sea Oil prices do not change very much from present levels" (A.S. para 1.47) whereas we forecast that, with the recovery in the world economy, there would be some upwards pressure on oil prices during 1984.

2) The Exchange Rate

The Treasury assumption is that "the effective exchange rate will not change very much from the average level for the first three quarters of 1983" (A.S. para 1.11). Our forecast was that, with UK interest rates following-US rates down and little or no surplus on the current account, the exchange rate would fall throughout 1984 to bring competitiveness back closer to its long-run average levels. Thus next year it would be 3½ per cent lower than in 1983 on average.

3) Taxes and Public Spending

Although the Planning Total in 1984-5 has been held at £126.4bn, the projection for total public expenditure in National Accounts terms has increased (since the Budget Statement) from £145bn to £146½ bn, reflecting among other things higher debt interest payments. The forecast of public revenue increased by only £½ bn, with a significant underlying fall in the forecast of non-North Sea revenue. This decline probably reflects the effect of lower inflation only partly offset by higher activity. The fall in inflation also means that the Planning Total, although unchanged in cash terms, is consistent with a higher volume of public spending. On the other hand, the 1983-4 overshoot of the PSBR means that the tax cuts assumed for 1984-5 no longer appear likely.

The Forecasts compared

If we re-run the October forecast on the Treasury's assumptions, then we obtain the results set out in Table 4. Each line in Table 4 shows the effect of changing just one assumption while the last line shows the effect of bringing all the assumptions into line with the Treasury's.

The *first* simulation, holding the oil price constant, results in lower inflation in 1984 but at the cost of a higher PSBR as North Sea Oil tax revenues are reduced; output is slightly higher. The *second* simulation, wih a constant exchange rate (and oil prices rising as in our October forecast) again results in lower inflation. But, because of the effects on UK competitiveness, output is lower and this in turn has an adverse effect on the PSBR. The *third* simulation, with higher public spending has a beneficial effect in the short run, on output and, because unit costs are lower, inflation, but raises the PSBR. The *fourth* simulation, with an unchanged national insurance surcharge, lowers the PSBR but at a small cost to inflation and output.

The growth rate in 1984 is 2.3 per cent at 1975 prices compared with the official forecast of 3 per cent at 1980 prices. As we showed in the October Focus (Table 20 p 17), the growth rate in 1984 will be only very slightly affected by the move to 1980 prices. On the Treasury assumptions, therefore, we would expect GDP growth of up to 2½ per cent in 1984.

Table 4
Treasury and LBS Forecasts: Key Variables

	GDP 1984	RPI 84Q2	RPI 84Q4	PSBR 1983-4	PSBR 1984-5
HMT (Autumn Statement)	3	5½	4½	10	8
LBS (October forecast)	2.2	6.5	5.5	9.4	7.6
LBS simulations based on October forecast, with Treasury assumptions					
1. Constant oil price	2.3	6.4	5.2	9.5	8.2
2. Constant exchange rates	2.1	6.5	4.8	9.4	7.9
3. Higher government spending	2.4	6.4	5.3	10.0	8.4
4. National insurance surcharge retained	2.2	6.7	5.7	9.4	6.9
5. All of the above	2.4	6.2	4.4	10.0	8.5
6. All of the above with higher taxes ('fiscal adjustment')	2.3	6.2	4.4	10.0	8.0

II Fiscal Policy

The major disappointment in the Autumn Statement is what it reveals about public borrowing. The PSBR forecast for 1983-4 has been revised upwards from just over £8bn to £10 bn. As Table 5 shows £1½ bn of this change is accounted for by increased spending and the remaining £½ bn by a fall in tax revenue. However, considering that North Sea tax revenue is £1bn higher than was expected at Budget time, there is clearly a rather larger shortfall in non-North Sea tax revenue.

Table 5
Fiscal Policy in 1983-4

	Budget Statement	Autumn Statement
General Government:		
expenditure	137½	139
receipts,	128½	128
of which North Sea oil	8	9
Public Sector Borrowing Requirement	8	10

The overshoot on public spending is especially disquieting since it has occurred against a background of inflationary undershooting. In the Budget Statement retail prices were forecast to rise by 6 per cent between the fourth quarter of 1982 and the fourth quarter of 1983. The estimate in the Autumn Statement is 5 per cent. All other things being equal the unanticipated fall in the rate of inflation should have helped to keep public spending within the cash limits, since it should have lowered the cost of public procurement. However, any tendency for public procurement to undershoot will have been more than offset by the overspending on wages and salaries. The public sector wage and salary bill in the first quarter of this year was nearly 12 per cent higher than a year earlier. This is already some 3¾ per cent higher than the average for 1982-3, and the cash limit for 1983-4 is only 3½ per cent. Even allowing for the incidence of back pay in the first quarter, these statistics imply that extremely tight control will have to be exerted over the public sector wage bill during the present financial year. When allowance is made for grade drift and other slippage, the control totals imply a virtual standstill in public sector wages this year.

The tendency for public spending to overshoot is also evident in the plans for 1984-5. Table 6 shows that the Planning Total has been adhered to, despite Departmental overspending, only by increasing asset sales and by reducing the external financing limits of the Nationalised Industries. This in turn has been achieved by allowing greater increases in Nationalised Industries' prices. Financing extra spending by putting up prices is little different from financing it by an increase in indirect taxation. It is not exactly in the spirit of the Medium Term Financial Strategy.

Controlling public spending is always difficult; a more disturbing feature of the upward revision to the PSBR is the shortfall in taxes. For it underlines what could be a persistent problem with the present system of controlling public finance during a period of falling inflation. The problem can be briefly stated; public expenditure is subject to cash limits, but there are no cash limits for revenue.

Table 6
Public spending plans, 1984-5 (£bn)

	Planned at Budget time (Cmnd 8789)	Revised planning
Departmental spending	125.2	126.4
Nationalised industries	2.6	1.9
Asset sales	−1.5	−1.9
Total	126.4	126.4

What this means in practice is that if inflation turns out lower than expected, the cash limit system on the expenditure side will generate some extra expenditure volumes to offset the shortfall in prices. This is an entirely desirable result; at the micro level it provides a strong incentive to control costs, since those who are successful in doing so can spend more in real terms. At the macro level it has the result that when inflation is lower than expected, output is boosted by extra public spending. Again this is desirable: for a given level of nominal GDP (broadly determined by the monetary targets) lower inflation leaves room for more output. The cash limit system of public spending control is one mechanism whereby lower inflation can by itself *generate* extra output.

However there is a risk under the present system that below-target inflation will result not just in higher *spending*, but in higher borrowing as well. This is because variations in inflation, which are offset by volume changes on the expenditure side, leaving the cash limits intact, are not similarly offset on the income side. Hence if inflation turns out lower than expected, expenditure stays on target, but revenue is below target. This happens because lower prices will immediately reduce VAT revenue; if subsequently wages turn out lower than expected there will be some shortfall in income tax as well.

The consequence of this tax shortfall is that borrowing overshoots, which in turn means either higher monetary growth (which will eventually reverse the inflationary gains) or higher interest rates. Given the strong commitment of the present administration to its monetary targets, it seems likely that if lower-than-expected inflation leads to higher-than-planned borrowing the result will be higher interest rates. This suggests that the present system of public expenditure control may be partly responsible for the persistently high level of real interest rates.

III Should Asset Sales be in the PSBR?

Asset sales next year are planned to comprise some £2bn of equities, mainly in BT and Enterprise Oil, plus council house sales and sundry other disposals.

The current programme of equity sales is not a complete departure from previous practice. Government equity sales as a percentage of GDP have been significant on several occassions in the past, notably under the Healey Chancellorship.

In accounting terms, asset sales reduce the PSBR – they are treated as negative public expenditure. Similarly asset purchases – i.e. Nationalisation – count as positive spending and boost the PSBR. Some commentators have argued strongly that this is inappropriate, claiming that a better measure of Government borrowing needs and fiscal stance would be obtained by treating asset sales as items that help to *finance* the PSBR rather than as items that actually *reduce* it.

The issues are extremely complex. But the right place to start the discussion is surely to ask the purpose of having a fiscal target. If we can answer that question, then we should be in a better position to decide what should and what should not enter into the definition of that target. The problem is that those who advocate steering the economy by a set of fiscal guidelines do so from a mixture of motives which are not always very carefully distinguished. It is worth spelling them out in detail and then trying to decide how asset sales should be in the light of each of these arguments.

(1) Lower interest rates

The argument most often advanced in favour of fiscal stringency is that it leads to (or permits) lower interest rates. If the PSBR is reduced then, for a given rate of monetary growth, the government will have to sell less debt, which in practice usually means fewer gilt-edged securities. Fewer gilts sales usually mean higher gilts prices, i.e. lower long-term interest rates.

But if the reduction in the PSBR has been achieved through asset sales, then the boost to gilts prices from the fall in gilts sales may be rather limited. This is because the people and financial institutions who buy the assets will pay for them partly by reducing the money that they would otherwise have spent on gilts. Some commentators take an extreme view, arguing that all of the finance for asset sales comes from money diverted from the gilts market – so the asset sales have no effect at all on gilt prices. This extreme view is not supported by our econometric model, which sugests that only some of the fund spent on asset sales will be diverted from the gilts market. Thus we believe that asset sales do raise gilts prices and so reduce long-term interest rates, but the effect is not as large as if the government raised the money through taxes instead of asset sales.

(2) Crowding out

The reason why it is desirable to lower interest rates is, among other things, to encourage job-creating investment in the private sector. Public borrowing tends to 'crowd out' private investment by bidding away funds that might otherwise be available to finance it. The normal crowding out mechanism is via high long-term interest rates, which drag up short rates and inhibit corporate borrowing. To this extent any policy that lowers long-term interest rates reduces 'crowding out'. Against this, sales of equities by the government will tend to depress equity prices, making it less attractive for private companies to raise new equity finance. Thus there will be some 'crowding out' via this route to be set agains the 'crowding in' (i.e. increased private investment) caused by lower long-term interest rates. There is a possibility that the net effect of these two effects on private investment will be beneficial, because the adverse impact on equity prices of the asset sales will be mitigated by overseas purchases, to the extent that they are permitted.

If the aim is merely to lower long-term interest rates, then it is appropriate to count asset sales as a reduction in public borrowing. If the aim is to reduce total crowding out, then it looks as though asset sales are, at best, only a little better than giltss sales.

(3) Efficiency and control

Let us now push the argument back a stage further. Why is 'crowding out' believed to be a bad thing? Isn't the state just as capable of carrying out job-creating investment as the private sector? Those who condemn crowding out usually have two lines of argument. The first is that public investment is more wasteful than private investment, so that crowding out leads to inefficient allocation of resources. The second is to assert that even if the public investment were efficient, it would constitute an undesirable concentration of economic power in the hands of the state.

This is not the place to discuss the merits of either argument. The point to note is that the debate has shifted ground. The issue is no longer the level of interest rates and of private investment. Instead it is the relative size of the public sector. If the purpose of PSBR targets is to hold down the size of the public sector, then it is perfectly valid to score asset sales as a reduction in the PSBR (and nationalisation as an increase in the PSBR).

Suppose for example that public spending is fixed and the choice is to hit the PSBR target either by asset sales or by tax increases. It seems as though asset sales are preferable to tax increases since they will shift control of resources from public to private hands. Suppose on the other hand the level of taxation is fixed, so the choice lies between cutting public spending or selling assets to meet a given PSBR target. Once again if the aim is to transfer resources from public to private sector, asset sales seem at least as good as spending cuts. For the problem with spending cuts is that the resources may simply remain idle.

(4) The 'once-for-all' nature of asset sales

Another seemingly powerful argument against including asset sales in the PSBR is that they do not have a continuing impact – their effect occurs only once, in the year of sale. On top of this, some commentators argue, the future revenues from profitable assets sold off will be lost. This argument ignores two vital points:–

a) Future borrowing needs

One is that profitable businesses have capital needs for expansion and modernisation. In many years those capital needs may exceed distributed profits plus internal funds. If the company is part of the public sector, then all oof its net borrowing is counted as raising the PSBR (in the absence of 'Buzby bonds'). Thus British Telecom had a net borrowing need of some £¼ billion in 1981-2, made net repayments of the same order in 1982-3, and is scheduled to borrow around £100m this year. The government has suggested that BT would have preferred to borrow rather more to finance a bigger capital programme but was not allowed to do so because of the impact on the PSBR. Sale of assets in BT will thus have a continuing negative impact on the PSBR in most years, although of course the effect will only be a small fraction of the initial sales.

b) Capital accumulation

The public sector is in surplus on its current account and has been every year since the Second World War except 1946. Substantial spending on capital account – net of small capital tax receipts – turn this current surplus into a large borrowing requirement. This provides a counterargument to the suggestion that asset sales are a 'soft option' compared to spending cuts or tax increases, because they bring about no permanent change in the balance of income and expenditure. The asset sales are a disposal of some of the large public sector capital stock that the government adds to each year and that previous governments have built up as the counterpart to current debt liabilities. Of course, because of its nature and wastefulness and depreciation, the potential market value of that investment is way below its cost. Nevertheless public investment, even at its current low level, will ensure that next year's fall in the government's stock of saleable assets will be very much smaller than the figure of well over £3 billion raised from equity and house sales. There is an analogy with a private sector company selling off one part of its business in order to provide finance for other activities. To the extend that those sales are used to finance investment in the remaining part of the business, this is a reasonable practice employed by many companies. To the extent that asset sales go beyond this – as they will do next year – they have to be justified as a short-term measure, to tide the company over a difficult period that is partly caused by the excessive past borrowing to pay for the assets now being sold. Thus sale of assets equal to the rate of accumulation, valued at market prices, of saleable assets, is acceptable and can be sustained indefinitely. Sales above that are not sustainable and can be justified only as a short-term unwinding of earlier rates of rapid investment.

(5) Counter-inflationary policy

a) Pressure of Demand

Any argument in favour of keeping asset sales in the PSBR could be rather dangerous if it was used to justify public spending at a time when the overall pressure of demand was high. One purpose of having PSBR targets is to regulate public sector demands on resources. If public borrowing is above target this suggests that public sector claims are running ahead of available resources, and indicates a risk of inflationary pressure. The traditional response to excess pressure of demand is to cut public spending or to raise taxes. Are asset sales an equally good way of siphoning off demand from the private sector? The answer is probably that they are not because asset sales may have little effect on current spending. The total real wealth of the nation is unaffected by them (except to the extent they increase net capital inflows from abroad). The private sector's asset portfolio is redistributed but its net wealth is unchanged. There is no change in incomes. Under these circumstances it is probable that claims on resources by the private sector will be little changed.

b) Monetary policy

The above reasoning is underpinned by an essentially Keynesian view of the inflationary process, in which it is excess demand for real resources which puts upward pressure on prices. An alternative view is that inflation depends in the long term on monetary growth and nothing else. On this view asset sales are just as effective a method of controlling monetary inflation as tax increases or expenditure cuts since they reduce the money supply equally effectively. However, to the extent that inflation is a function not just of money but of the total stock of financial assets, it seems likely that asset sales are more effective as a device for hitting monetary targets than for reducing the underlying inflationary pressure due to excess stock of financial assets.

Conclusions

The one certain conclusion that can be drawn from these theological arguments is that there is no simple solution to the problem of how to treat asset sales. However it does seem fairly clear that if the PSBR target is intended as a guide to short-term demand management and a measure of public sector claims on current flows of real resources, then it is *not* appropriate to count asset sales as negative public spending. When the PSBR is used as a measure of public sector demands on the monetary system, then there is no clear case for taking asset sales out of the PSBR, although the arguments for leaving them within it are by no means conclusive. If on the other hand the PSBR target is intended to measure the authorities' success in limiting the size of the public sector, then it *is* appropriate to put asset sales inside the PSBR.

The risk that the government faces under present arrangements is that a successful privatisation program could lead to inflationary overheating, since the resulting asset sales will enable the authorities to increase the direct claims of the public sector on resources while remaining within their PSBR guidelines.

National Health Service (Pharmaceutical)

4.57 pm

The Minister for Health (Mr. Kenneth Clarke): With permission, Mr. Speaker, I should like to make a statement on the discussion that I and the Secretary of State have been having on behalf of all the United Kingdom health Ministers with representatives of the pharmaceutical industry on the scope for savings in the NHS drugs bill and other matters of mutual concern.

Prescription medicines cost the NHS in England about £1,250 million in 1982-83. Drugs account for about 40 per cent. of the total cost of the family practitioner service and about 10 per cent. of the cost of the NHS as a whole. The pharmaceutical industry's profits from NHS sales are governed by the non-statutory pharmaceutical price regulation scheme which was introduced in its present form in 1978. In the words of the published scheme, it is a key objective that

"safe and effective medicines should be available on reasonable terms to the NHS, but also that a strong, efficient and profitable pharmaceutical industry"

should exist in the United Kingdom. The industry's present target profit level was set by the Labour Government in 1978. Like our predecessors, we recognise that there is a major and successful industry providing 67,000 jobs and a net balance of exports over imports of around £600 million a year.

However, the present scheme has run unaltered for over five years. A review of the PPRS and its role in relation to the industry and the NHS was announced earlier this year. After extensive discussion with the industry's representatives and having taken account of the 10th report of the Public Accounts Committee published in April, we have decided to reduce the level of profit from NHS business and the level of sales promotion allowed as an expense under the scheme.

First, under the scheme each pharmaceutical company participating in it is assigned a target rate of profit, taking account of

"the circumstances of the individual company, the contribution which it makes or is likely to make to the economy, including foreign earnings, investment, employment or research".

We have decided that these targets should be reduced by an average of four percentage points, which will represent a saving to the NHS in the United Kingdom of about £40 million a year. We have also decided that the discretion, which our Department allows in certain circumstances when companies exceed their target profit rates, should be tightened and related more closely to a company's circumstances. Companies will be told what their new targets are soon.

Secondly, the industry will spend about £180 million this year on sales promotion. Some, but not all, of this amount is an allowable expense under the PPRS. Such promotion is funded largely from NHS sales, and we have concluded that the allowable level should be reduced. We propose that companies should be asked to repay to the Department a sum equivalent to a sales promotion expenditure, which exceeds the level allowed under the scheme; and that the industry limit should be reduced from the present level of 10 per cent. of turnover to 9 per cent. in 1985-86. We estimate that when fully implemented these measures should reduce actual expenditure on sales promotion by 25 per cent., but we will review this area again to see whether a further reduction can be made.

All the measures that I have announced will take effect from 1 April next year. In a full year they will produce savings on the NHS drug bill rising on present estimates from £65 million in 1984-85 to well over £100 million in later years. This compares with the industry's total profit from sales in the United Kingdom in 1983 of an estimated £200 million. The changes will mean that the price freeze on drugs — introduced in August as part of the £25 million savings agreed then — will continue, with few exceptions, through 1984-85 and beyond. Furthermore, the price freeze will be at the level established by the 2·5 per cent. cut that we settled in August.

We have also discussed with the industry the problem of parallel importing of medicines. This occurs when an importer takes advantage of exchange rates and low regulated prices of particular drugs in other countries to import or re-import those drugs into this country in competition with the identical or near-identical products already marketed here. At present, an exemption order under the Medicines Act 1968 is being used by parallel importers, in a way not envisaged when the order was made, to bring into Britain substantial quantities of medicines without a licence. Clearly, there are potential health hazards if a drug has not been properly manufactured or stored, if labels are in a foreign languge, or if there is difficulty in tracing a batch of drugs found to be faulty. We are not aware of any injury to patients so far, but we propose to guard against that possibility.

We are statutorily required to consult on these matters, and we will therefore shortly issue a consultative document on proposals which will ensure that medicines parallel imported for general dispensing must be licensed under the Medicines Act, either in the ordinary way, or in the case of medicines also licensed in the European Community, through a modified licence to cover such safety matters as storage, labelling and tracing.

There remains the question of generic substitution, which we have been considering in the context of the PPRS review, as announced earlier this year. The Greenfield committee proposed that a pharmacist should substitute an equivalent generic preparation for proprietary medicine unless the prescribing doctor had specifically said that this should not be done. The committee acknowledged tht it had not taken account of the wider implications, for example, on the pharmaceutical industry, of its recommendation. Consultation of the Greenfield report earlier this year showed professional opinion to be divided on this recommendation, which was only one of 14 recommendations.

It became clear that many general practitioners were concerned that their patients would be supplied with formulations of drugs that their doctors had not prescribed. General practitioners and pharmacists foresaw problems of divided responsibilities for the treatment of patients. The various procedures considered raise serious practical problems. We have therefore decided not to proceed with generic substitution. We do, however, intend to start a new campaign to encourage generic prescribing by doctors. As to the other recommendations of the Greenfield committee, we have already announced our acceptance of these or referred them to the appropriate educational bodies.

The motion draws attention to the disgraceful delay in the Government's implementation of the recommendations of the Home Affairs Select Committee regarding nationality fees. Related to that, can we have a debate upon the way in which visitors to this country are treated, because many visitors from the Asian Sub-Continent are treated with a lack of dignity and courtesy?

Mr. Biffen: I appreciate the hon. and learned Gentleman's point. It is likely that we could meet it by reference to the private Members' motions on Monday, the third one of which could easily cover the point. The best advice that I can offer is that he uses his well-established and recognised skills on the opportunities provided by the Consolidated Fund Bill.

Mr. Andrew MacKay (Berkshire, East): Bearing in mind last night's events in Brent, will my right hon. Friend find time for the House to debate a motion on free speech and local democracy which would give the Leader of the Opposition the opportunity to condemn wholeheartedly the Labour leaders in Brent who brought that council to a halt by mob rule last night?

Mr. Biffen: My hon. Friend resists the cloying spirit of Christmas and remains combatant on these matters, in which case I tell him that he has plenty of opportunities to exercise his initiatives as a private Member to ensure that the matter remains before Parliament.

Mr. Mark Fisher (Stoke-on-Trent, Central): Is there likely to be a statement on the British film industry before Christmas? If there is, can the right hon. Gentleman give the House an assurance similar to the one that he gave about regional policy, that it will not be smuggled in before Christmas without the House having a chance to consider it fully?

Mr. Biffen: The most helpful thing that I can do is to refer the hon. Gentleman's point to my right hon. Friend the Secretary of State for Trade and Industry.

Mr. Harry Greenway (Ealing, North): Bearing in mind the country's interest in the film "The Day After", will my right hon. Friend consider the facilities for showing such films and others in the House? This film pulls at all our emotions and looks at the possible post-holocaust position. I believe that it points to the need to increase efforts to achieve multilateral disarmament. The country is very interested in the film but only a limited number of hon. Members would have been able to see it in the House today if all had turned up.

Mr. Biffen: I do not believe that I have any responsibility for organising film shows in the House. If I had, I would try to shrug them off as quickly as I could. I take note of what my hon. Friend says. I believe that there will be plenty of other people in the House who would be able to organise such a showing.

Mr. Speaker: Does the hon. Member for Coventry, South-East (Mr. Nellist) wish to raise the point of order that I stopped him raising earlier or has it been overtaken?

Mr. Dave Nellist (Coventry, South-East): It has been overtaken, Mr. Speaker.

Consolidated Fund Bill

Mr. Speaker: I wish to make a short statement about the arrangements for the debate on the motion for the Adjournment which will follow the passing of the Consolidated Fund Bill on Monday 19 December.

Members should submit their subject to my office not later than 9 am on Wednesday 14 December. A list showing the subjects and the times will be published later that day. Normally the time allocated to each subject will not exceed one and a half hours, but I propose to exercise a discretion to allow one or two debates to continue for rather longer to a maximum of three hours. Where identical or similar subjects have been entered by different Members whose names are drawn in a ballot, only the first name will be shown on the list. As some debates may not last the full time allotted to them, it is the responsibility of Members to keep in touch with developments if they are not to miss their turn.

A number of other matters arising from the review of the PPRS must still be resolved in discussion with the industry. In particular, a study of transfer prices, which are the prices charged by a foreign-based company to its United Kingdom subsidiary, is being conducted by independent consultants, and our Department is undertaking a study of pharmaceutical wholesalers' profit margins.

In framing the proposals the Government have sought to achieve a balance between the interests of the NHS as customer and the interests of the industry. We recognise the research achievements of the industry and the cntribution that it makes to the United Kingdom economy, and we want it to continue to flourish. However, there is an urgent need to contain the drugs bill for the Health Service, which we are also determined to achieve. I hope that the industry will accept this position, as we wish to continue with the price regulation scheme on a non-statutory basis.

Mr. Michael Meacher (Oldham, West): Is the Minister aware that the measures, far from achieving a balance, are a completely inadequate response to a public scandal of enormous proportions—I use those words advisedly. Against a background of deepening cuts in the National Health Service, leading to accelerating hospital closures, redundancies of doctors and nurses, and worsening patient care, is it not outrageous that the drug companies have been permitted by the Government to make profits at the expense of the National Health Service of more than £300 million this year—my figure, rather than the Minister's, is correct—at a rate of return on capital of 25 per cent., thus making it the most profitable industry after oil and advertising?

Is the Minister further aware that 54 of the 65 companies that supply the NHS are foreign-based, and that the Public Accounts Committee estimated that their profits from the NHS were understated through transfer prices and creative accounting—the Committee's words, not mine—by up to a further £200 million this year? Is he aware that the Public Accounts Committee report of last April stated that nine companies had made £33 million in excess profits—the Committee's phrase, not mine—from the National Health Service in two years; that three or four of the largest companies had been allowed profits of up to a 35 per cent. return on capital employed; and that the smaller companies, which do not manufacture in Britain, were allowed profits of no less than 200 per cent?

Is the Minister further aware that the Comptroller and Auditor General, in a highly critical report issued earlier this year, complained that the DHSS had inadequate evidence to assess the industry's efficiency, and that the Department had failed in the administration of the profit control aspect of the price regulation scheme for drugs? In view of that scathing indictment by the official authorities, will the Minister tell the House how he intends to rectify those gross administrative deficiencies? Will he confirm that the new target rate of return, which he was careful not to mention, is still about 20 per cent., which is well above the maximum level recommended by the Public Accounts Committee of 17 per cent? Does he acknowledge that the £40 million that he proposes to save is less than the profit that one company might expect to make from only one successful drug?

In view of the Minister's frank acknowledgement of the excessive profits made by drug companies, will he consider reducing the consequential higher prescription charges, which have increased seven times under the Government?

Is the Minister aware that the *Daily Telegraph,* which is not a Socialist magazine, recorded a survey which found that £25 million could be saved by substituting unbranded versions of the branded drugs that cost the NHS £60 million a year? Does he agree that an enormous saving could be made in this area? Does not his rejection of generic substitution owe much more to the arm-twisting of the drug companies than it does to the real concerns of general practitioners, behind which he tries to hide?

Is not the Minister's statement still a licence to print money for the drug companies, while the Government are trying to drive down the appallingly low wages of some of the lowest paid workers in the National Health Service?

Mr. Clarke: I am sorry that the hon. Gentleman is following the practice of his predecessor the hon. Member for Crewe and Nantwich (Mrs. Dunwoody) by reacting with hysterical and exaggerated language to an announcement which is extremely good news for the National Health Service and which represents a substantial saving on the drugs bill.

What we have negotiated in the proposals that I outlined to the House is part of the Government's policy towards the Health Service. We are seeking to improve its cost-effectiveness in order to maximise the value for money that we obtain from the increasing resources that the Government devote to it, for the benefit of the patients, who will receive better care. Independent consultants have examined transfer prices, because the Government wish to ensure that the figures that we use in our dealings with the pharmaceutical industry are accurate, and that no amount of ingenuity in accounting has obscured the position from which we are negotiating. As is usual with his practice on social security matters as well as on health matters, some of the hon. Gentleman's figures come completely off the top of his head. I am afraid the hon. Gentleman's figures are far less reliable than Treasury figures, DHSS figures or those from the industry.

In considering the actual rates of return, those for individual companies have to be a matter of commercial confidence. It is known that the overall target rate of return under the system we inherited from the Labour Government was 25 per cent. and above that a so-called grey area with the discretion of a further 10 per cent. What I have just announced reduces the overall target to 21 per cent. and the grey area to one third of whatever is the company's target. The figures he quotes—and some he disapproves of are for the more successful companies—were set under rules laid down by the Government of which he was a member. What I have announced is a significant reduction.

What I have announced represents a saving in a full year of over £100 million on the drugs bill of the National Health Service. The actual profits made by the pharmaceutical industry this year appear to us to be about £200 million. We disallow various costs for the purposes of the scheme. If account were taken of those, the profits might be up to £250 million. Nevertheless, we are making substantial savings in the drugs bill. We expect that pharmaceutical companies will react by cutting costs to some extent, thereby protecting their profits, which is good—for investment and employment in this country.

[Mr. Clarke]

Against this, the savings we are making are a substantial and significant response to genuine fears. I think that this is a fair balance between on the one hand the interests of drug users, that is, the National Health Service, and on the other the interests of those who work and earn a great deal of money for the country in the pharmaceutical industry.

Dr. Brian Mawhinney (Peterborough): Does my hon. and learned Friend accept that the first part of his statement on price freezing and the reduction of profits is welcome and will be seen as a positive contribution to savings in the Health Service? Will he also accept, however, that what he has said on drug substitution is a great disappointment and regrettably will be seen as a triumph for vested interests in the medical and pharmaceutical professions over the needs of patients? Does he agree that there is no reason clinically why substitution should not take place, bearing in mind that hospital doctors already use it, and that until generic prescribing are firmly in place the real savings to the Health Service on the drugs bill cannot be fully manifested?

Mr. Clarke: I have great respect for my hon. Friend's views on these matters, but I would answer him with a rhetorical question; what is he seeking to achieve in what he advocates? If he is seeking further reductions in the drugs bill, he should bear in mind that the announcement I have made is estimated to save over £100 million per annum on the National Health Service drugs bill. The House must realise that to go beyond that at the expense of the pharmaceutical industry would jeopardise much research-based manufacture in this country.

On generic substitution, I would accept as the best estimate of what might be saved the figure given by the hon. Member for Oldham, West (Mr. Meacher), that is about £25 million, but we could not achieve that and also make the other savings I have described without causing damage to the industry. If, however, the intention is to improve the prescribing practice of doctors, the best way of doing that is, as we propose, to strengthen our guidance and give further assistance to enable doctors to make their own choices about generic prescribing when they deem it suitable for their patients. Again, I respect my hon. Friend's view on this, but many doctors, though not all, were seriously concerned about a suggestion that they should prescribe one formulation of a drug which they judged suitable and then a pharmacist unknown to them who might dispense the drug anywhere throughout the country would use his judgment to substitute what he thought to be an effective alternative formulation. In hospitals doctors know ther pharmacists and can have a hospital policy; I do not think it the analogy with general practitioners is altogether accurate.

Mr. Jack Ashley (Stoke-on-trent, South): Is the Minister aware that he has adopted a cowardly approach in running away from generic substitution? He cuts a very sorry figure, giving way to vested interests. He has heard neither hysterical language from my hon. Friend nor rhetorical questions. He has heard reasoned requests to change his mind. Will he recognise that the drug industry's demand for protection is a demand for excessive profits which are still far too high? Will he please think again on this important issue?

Mr. Clarke: If the right hon. Gentleman wishes to save money, then he should realise that by our announcement we are saving the maximum that can be saved. If he wishes to improve prescribing practices, we propose to campaign to do that. We will not be drawn into a vendetta against drug companies and their profits solely for what appear to be totally abstract reasons which some hon. Members feel are worth pursuing.

Mr. Robert McCrindle (Brentwood and Ongar): I welcome the Minister's statement indicating considerable savings in expenditure on the National Health Service, but will he disregard to a fair degree the continuing reference to the percentage of profits made by pharmaceutical companies? Will he confirm that a great deal of the so-called profits are reinvested in research and development and that sometimes the development of an effective drug takes many years, so that the percentages which are being bandied about are somewhat illusory?

Mr. Clarke: I am obliged to my hon. Friend. It is worth bearing in mind that the percentage profit we use for the purposes of the scheme is slightly notional. It is a long-standing convention that historic costs are taken as the basis for it and that is the basis of the figures I have given. When judging the profitability of the industry as a whole, he is right to draw attention to the fact that a great deal of it is necessary to provide an incentive for research and development. Moreover, much of the profits earned by the drugs industry are profits on exports which produce a substantial benefit to the economy of the country.

Mr. Willie W. Hamilton (Fife, Central): Is the Minister aware that there will be widespread condemnation of what will be regarded as an inadequate response to the recommendations of the all-party Public Accounts Committee with the guidance of the Comptroller and Auditor General? That, together with the complete ignoring of the main recommendations of the Greenfield report, will be seen clearly for what it is—a complete and utter sell-out to the drug companies which will still be laughing all the way to their respective banks.

Mr. Clarke: Before I rose to make the statement I knew perfectly well that whatever I said would be greeted with anger and disappointment by the hon. Gentleman, just as I know perfectly well that there will be a lot of resistance and anger in some parts of the pharmaceutical industry about what I have proposed. That is an inevitable part of the process. The fact is that the savings to the National Health Service drugs bill which I have announced go beyond some of the savings that were recently being urged upon us by some of our critics. They do not fall far short of even the wildest figures that were urged upon me by the hon. Member for Crewe and Nantwich (Mrs. Dunwoody) when she spoke for the Opposition.

Mrs. Jill Knight (Birmingham, Edgbaston): Can my hon. and learned Friend say anything about the position of pharmacists in chemists' shops as a result of his statement? Many people will be most anxious that there should not be the closure of chemists' shops which are badly needed in many areas. Does he recognise that, while he has much support for stopping the rate of increase in the drugs bill in the Health Service, he is perhaps shooting the wrong fox because many doctors prescribe drugs over and over again for patients without even bothering to examine them? The waste of drugs in that way is severe.

Mr. Clarke: The payments we make to pharmacists are on the basis of reimbursements for the cost of the drugs that they supply to patients. Our action on parallel importing will help to meet one of the complaints of the Public Accounts Committee that we sometimes reimburse chemists for more than the amount they have paid for the drugs they have dispensed. Nevertheless, there are problems between ourselves and the pharmacists, most of which were not intended by either side of that negotiating table. I look forward to more negotiations with the pharmaceutical services negotiating committee in the new year both about our present difficulties and about a better form of contract for them for the future. This should help to guard against the closure of rural pharmacies which my hon. Friend is right to be concerned about.

As to the prescribing practices of doctors, I endorse what my hon. Friend said. It is important that we should act on the other 13 recommendations of Greenfield, as we are already doing, and give further guidance and assistance to doctors in following proper and economical prescribing practices.

Several Hon. Members *rose*——

Mr. Speaker: Order. In fairness to the Northern Ireland debates, I intend to allow questions on this important subject to continue until half past four.

Mr. Clement Freud (Cambridgeshire, North-East): While we welcome the advertising cutback on allowable revenue, and the principle of the system, the alliance is bitterly disappointed about the Minister's failure to do anything about generic substitution, as he could have done without alienating the family practitioners, who would probably prefer some generic substitution to the cash limits being imposed. Does he accept that the pharmaceutical industry must remain independent because not one therapeutic substance has come out of the nationalised pharmaceutical industry in the Soviet Union?

Mr. Clarke: I note what the hon. Gentleman says about generic substitution, but we have reduced the target rate of return on capital by an average of 4 percentage points to bring it down to about 20 per cent. We have also made significant changes on promotional activity, about which there is strong feeling in the medical profession and among the general public. Given the savings that we can make from the package of measures that I have proposed, generic substitution would not have been a significant or worthwhile addition.

A number of GPs and pharmacists have raised problems about generic substitution. One is that of the responsibility to patients if anything goes wrong when neither the doctor, the pharmacist, nor the people who pay the pharmacist are clear about what drug has been dispensed to the patient, regardless of what it said on the doctor's prescription.

I endorse the hon. Gentleman's final comment. Those who attack the pharmaceutical industry simply because it is profit making ignore the fact that it is a highly successful industry, making valuable medical innovations and earning substantial profits overseas. The state-owned industries of the Eastern bloc have never produced any significant innovation, and if the Labour party came back into power a state-owned industry in this country would not make progress either.

Mr. David Crouch (Canterbury): It is not a convention of the House that I have to declare an interest when a Minister makes a statement, but I do so. As I think the House knows, I am a director of a pharmaceutical company. I am also involved in the Health Service, being a member of a regional health authority. I therefore have a double interest.

I was one in the pharmaceutical industry who had recommended to it that it should look again at its figures on sales promotion and profit to see whether they could be tempered down in a way similar to the Minister's proposals. I take that view from within the industry. however, I warn my hon. and learned Friend not to go too far. It is possible to go just over the limit in reducing not so much promotion costs but profits, with the result that the industry will find it not worthwhile to continue production of the valuable drugs in this country. *[Interruption.]* Those who know nothing about the industry can make sneering, jeering remarks, but we are talking about one of the most successful industries, not in making money but in innovating and breaking new ground. My hon. and learned Friend must not go too far in this direction because, although the earnings and profits may seem high at 21 per cent., in its first 10 years a drug does not earn a penny. It takes all of that time to pass the approved list.

Mr. Clarke: My hon. Friend was interrupted by hon. Members who have no knowledge of the pharmaceutical industry to set against his own. I agree that the companies will find the reduction in profit levels and the changes that we have announced on promotional costs significant. We have not only reduced the profit figures but are proposing to change the method by which we control the level of expenditure on sales promotions above the prescribed limit. That will produce a significant reduction in the level of sales promotion on drugs to the benefit of the best companies and the patients. We shall heed my hon. Friend's warnings, but I think that we have struck the right balance between preserving a successful industry and making sure that we use our bargaining influence as a customer to make savings for the NHS.

Mr. Laurie Pavitt (Brent, South): On the hon. and learned Gentleman's choice of exhortation and campaigning rather than action on generic prescribing, I remind him that every Minister since Iain Macleod has tried the same campaign. There have been three separate issues under both Labour and Conservative Governments on special ways in which prescribers' notes and bulletins can be used. Each year, 80 per cent. of the drugs prescribed in the NHS are brand names and the Pharmaceutical Society of Great Britain, formed of qualified dispensing chemists, reckoned that on 10 drugs alone there would be a saving of £25 million.

In his discussions on promotions, will the Minister pursue three things? First, is it necessary to have one commercial traveller for every nine GPs? Secondly, is it necessary to have 6,600,000 free journals issued every three months to promote drugs? Thirdly, will the hon. and learned Gentleman attempt to stop the racket whereby a commercial traveller pays a doctor £10 for every person he is prepared to have on a new drug, calling it clinical investigation, when it is really sales promotion?

Mr. Clarke: I realise that I follow an honourable succession of Ministers of Governments of both parties in continuing to campaign on generic substitution. When it comes to professional opinion on generic substitution, I

[Mr. Clarke]

have not claimed that it is in our favour—it is divided. The hon. Gentleman will know that the Pharmaceutical Society of Great Britain had a highly contentious debate on the subject and passed a resolution which it would admit was distinctly inconclusive about what is good professional practice.

As to the number of travellers or representatives, and the amount of advertising and journals, the hon. Gentleman will find on examination that we have made significant changes in the level of sales promotion allowed and, compared with the actual level of sales promotion, we shall start imposing penalties on future levels at 25 per cent. below that. That could lead to important changes and improvements.

Sir Kenneth Lewis (Stamford and Spalding): Is my hon. and learned Friend aware that there are tens of thousands of households in which the bathroom and bedroom cupboards are overloaded with NHS drugs that have never been used, and that this is caused by widespread over-subscribing by doctors? If he can convince the medical profession that it needs to do something about that, he will save the NHS a great deal of money.

Does my hon. and learned Friend accept that if he can stop doctors having loads of material through their posts, and callers from foreign drug companies trying to sell them all kinds of pills and what-have-you, he will also help the medical profession?

Mr. Clarke: I agree with all of my hon. Friend's points. For the reasons that I have given, I think that the measures that we have announced will have a beneficial effect on the profession. To put things in perspective, the prescribing of drugs in this country per head of population is lower than that of most Western European countries. One has to persuade the doctors and the patients that a sensible level of prescribing is required, but our doctors and patients are less inclined to look for a pill on every occasion and for every purpose than is the case in other countries of Western Europe.

Rev. Martin Smyth (Belfast, South): Does the Minister accept that not all who may be critical of his statement are just out to get at the industry, because we recognise its strength? However, will his attempts to control the promotion of drugs and costs include stricter supervision of the amount of money spent in catering both for doctors and pharmacists who may purchase the drugs? How soon will limits be set on the importing of medicine?

Mr. Clarke: The costs of so-called hospitality and gifts are not allowed under the scheme at present and have never been accepted as an allowable expense. That kind of activity will continue to be disallowed under the new arrangements that I have announced today.

Regarding the new proposals on the importation of drugs, we hope to issue the consultation document shortly. Indeed, I hope that the technical details will go out from the Department tomorrow.

Mr. Meacher: The Minister has not answered two key questions. The Comptroller and Auditor General said that the DHSS machinery for assessing the industry's efficiency was inadequate. What new supervisory mechanisms is the Minister proposing to prevent the profit control mechanism going out of control? Secondly, why has he rejected the Greenfield report on generic substitution when a compromise agreement had been reached informally, I understand, with the BMA whereby general practitioners who did not wish for generic substitution by a pharmacist would be able to show that on the prescription?

Mr. Clarke: On the first point, I do not think that the hon. Gentleman is correct to say that the assessment machinery that was introduced by his Government has got absolutely out of control. The only judgment of efficiency that has to be made in the scheme is that of assessing the target rate of return set for each company. It is a difficult task to assess each company in relation to its capital investment and its research base activity in this country, its export earnings and its efficiency. But I think that the job is done effectively and well within the limitations of what is practical. What the Government have announced is a sharp reduction in the resulting cost to the National Health Service.

On generic substitution the best estimate I have of the savings likely to come from the so-called halfway house that some of the BMA found acceptable is £5 million in a full year. In fact, it did not amount to much more than a re-jigging of the present form upon which the doctor prescribed. It still gave rise to all the problems about responsibility for patients if anything went wrong, as I have already indicated. Given that we are reducing our costs substantially, and that we can proceed to encourage better generic prescribing, I see no point in going in for that kind of compromise proposal worth little money but opening up a considerable amount of professional controversy.

Mr. Dennis Skinner (Bolsover): On a point of order, Mr. Speaker. As the Minister has given some very long answers and as several Conservative Members and several Opposition Members want to ask questions, I wonder whether you would take, say one question or a couple of questions from Conservative and Opposition Members bearing in mind that I am not anxious to be called but other hon. Members are ahead of me in the queue? In any case, I think it is a sell-out by the Tory party to the Government to finance the Tory party and the Tory Members of Parliament who are directors to line their pockets——

Mr Speaker: Order. I am sorry; I should like to be able to accede to the hon. Gentleman's request, butin fairness to the House I have to protect the Northern Ireland business. The House has had a good run on the statement. No doubt we shall return to the subject on other occasions.

Mr. D. N. Campbell-Savours (Workington): On a point of order, Mr. Speaker. You referred in your comments to protection of hon. Members. Would it not be proper of hon. Members to request that we be protected against Ministers who make their replies in a very elongated form, thereby denying the right not only of opposition Back Benchers but of Conservative Back Benchers to ask their questions? Should it not go on the record that many of us were precluded from asking questions by the Minister's long answers?

Mr. Speaker: Let us not get into a great argument about this. If the hon. Gentleman had been watching me, he would have seen that I was getting equally exasperated by the length of some questions from Back-Bench Members.

Mr. Harry Greenway (Ealing, North): A number of us represent several hundred people who work in this industry and we ought to be representing them in this matter. When you said at twenty minutes past four, Mr. Speaker, that you would allow the questions to run until half past four, according to my count about five questions were fitted in.

Mr. Speaker: I think that it would be totally unfair to the House if on every occasion I allowed the questions to run to the end; it would be impossible. I have to protect the subsequent business of the House.

Mr. Freud: On a point of order, Mr. Speaker. The hon. Member for Hertford and Stortford (Mr. Wells) asked you to give a ruling on the House Buyers Bill in respect of the eligibility of solicitors who are Members of the House and you said that you would give a ruling. Will you at the same time — and I ask this for the sake of convenience — give a ruling in respect of people intending to purchase houses who are Members of the House because they are equally affected by the Bill and, like solicitors, have a vested interest in it?

Mr. Andrew MacKay: On a point of order, Mr. Speaker. I would not wish ever to question a decision of yours, Mr. Speaker, but I believe that only four Members of the House still wish to ask questions of the Minister on the statement. I suspect that all of them have constituency interests. As you said earlier that Christmas is getting near, would you give us the benefit of the doubt on this occasion?

Mr. Speaker: I am afraid that Christmas is not as near as all that. In fairness to the hon. Gentleman, I fully understand his frustration, but this might be said on any day on any statement.

Mr. Derek Fatchett (Leeds, Central): On a point of order, Mr. Speaker. The statement on the drugs industry has taken so long because of the lengthy replies. Are you aware that thousands of people outside the House believe that the behaviour of the drugs industry has been a major contributor to the cuts in the Health Service and that they would think the less of——

Mr. Speaker: Order. I am not certain that that is a matter for me.

SCOTTISH AFFAIRS

Ordered,

That the matter of Electricity in Scotland—Generation and Capacity being a matter relating exclusively to Scotland be referred to the Scottish Grand Committee for its consideration —*[Mr. Biffen.]*

Northern Ireland (Appropriation)

The Minister of State, Northern Ireland Office (Mr. Adam Butler): I beg to move,

That the draft Appropriation (No. 3) (Northern Ireland) Order 1983, which was laid before this House on 23rd November, be approved.

Mr. Speaker: The hon. Member for Antrim, North (Rev. Ian Paisley) wishes to raise a point of order.

Rev. Ian Paisley (Antrim, North): Thank you, Mr. Speaker, for defending the rights of the Northern Ireland Members to have their say. We appreciate that.

On a point of order, Mr. Speaker. Could you confirm for our guidance that if the first order is debated, say, until eight or nine o'clock the remainder of the time until half past eleven will be available for debating the second order, but that another hour and a half will not be added?

Mr. Speaker: I confirm what the hon. Member has said, that the debate on the first order may go until half past eleven. If it goes until half past eleven, the second order will have an hour and a half. If the first order finishes earlier than that, the second order may go until half past eleven.

Mr. William Ross (Londonderry, East): On a point of order, Mr. Speaker. You kindly indicated to me that certain matters in the first order are substantial and justify wide debate. By inference, the remainder must be considered not to justify wide debate. One of the items that apparently do not justify wide debate is the question of control. That has caused considerable concern and debate not only in the House but in Northern Ireland. I seek your guidance as to what can be debated on the first order and at what length.

Mr. J. Enoch Powell (Down, South): Further to that point of order; I wish to make a submission, Mr. Speaker. Your were good enough to write to my hon. Friend the Member for Londonderry, East (Mr. Ross) and you may have written to other hon. Members likely to take part in the debate, intimating what might or might not be regarded by the Chair as in order in the debate upon the Appropriation Order. This has been the subject of observations from the Chair at the commencement of similar debates in the past.

Might it be helpful both to the Chair and to hon. Members, since these orders are available a considerable time before the debates—I believe, that this order was laid on 23 November—if an indication of the view of the Chair could be given at an earlier date? An indication is often given by hon. Members to the Government of subjects which they would hope to raise. If it was within their knowledge what would and would not be regarded as in order, it would be possible to give that indication to the Government with more accuracy and certainty. I hope, therefore, that it might become a practice, if only an informal practice, in future where the minor Appropriation orders—I am referring not to the annual Appropriation order, but to the other Appropriation orders — are for debate for an indication to be given by the Chair generally of its views upon order in the compass of that Appropriation Order.

Mr. Speaker: I am obliged to the right hon. Member for Down, South (Mr. Powell) and I will answer his point of order first. He will understand that it is my wish to be as helpful as possible to Back Benchers, and therefore I

[Mr. Speaker]

readily accede to his request to send the information earlier than it was sent today. In sending it today, I was seeking to be helpful to hon. Members in drawing their attention to what would be in order and what might be out of order, so saving time in the debate; if the Chair must constantly be interrupting hon. Members while they are speaking, that wastes time.

To clarify the matter, I will read from the letter:

"The scope of this order is relatively narrow and policy questions should be raised only in connection with three matters; agricultural support measures, assistance to the shipbuilding industry and the housing benefits scheme. Four of the sevenSupplementary Estimates are for relatively modest sums and only the reasons for the increases sought should be raised."

Is that clear?

Mr. J. Enoch Powell: Further to that point of order. I am grateful to you, Mr. Speaker, for the announcement that you have made, and I listened to it with great care, as, indeed, I read with great care what you said in your letter to my hon. Friend the Member for Londonderry, East (Mr. Ross). I wonder whether in future consideration might be given to the distinction implied in the use of the words "issues of policy", as issues of policy may be involved in increases sought for a particular purpose under a particular sub-head. There is, therefore, still a difficulty that hon. Members might confront in deciding whether the increase under a particular sub-head did or did not open up the whole of that service or open up no more than a particular decision of policy taken within that service by the Government.

Mr. Speaker: To save the time of the debate today, the simplest answer would be for me to give further consideration to what the right hon. Gentleman has said. It is my wish to be as helpful as possible in all these matters, and I shall certainly consider what he said so as to make the situation clearer in future.

Mr. William Ross: Further to the point of order that I raised earlier, Mr. Speaker. You said in your reply to me that some of the sums concerned were modest. May I draw your attention to the fact that, although an individual sum may be modest, it may nevertheless have a considerable impact on a matter of policy?

Mr. Speaker: I used the word "relatively"; and that is a relative word.

4.43 pm

Mr. Butler: The order is being made under paragraph 1 of schedule 1 to the Northern Ireland Act 1974. In view of some of the points that have just been made, it might be helpful if I said that I shall be taking the House through the order and will be referring to some of the smaller issues. Whether that will encourage hon. Members to comment on those points when they make their contributions remains to be seen.

The purpose of the draft order is to authorise the issue of £107 million out of the Consolidated Fund of Northern Ireland Departments and to appropriate this sum for the purposes shown in the schedule. Hon. Members will recall that sums on account were approved on 10 March and in respect of the autumn Supplementary Estimates of Northern Ireland that the balance of the 1983-84 main Estimates was approved by the House on 7 July; together these amounted to £2,622 million.

The present draft order will bring the total Estimates provision for the year to £2,729 million. Detailed information about the provision sought can be found in the autumn Supplementary Estimates volume, copies of which have been placed in the Vote Office.

The draft order covers only seven out of the 42 Votes of Northern Ireland Departments. Major provision is sought in respect of the housing benefits scheme, which is already in operation in Great Britain, and I hasten to say that this is not new money, since assistance with housing costs was formerly provided through supplementary benefit and rent and rate rebates. There are also significant additions to existing services, notably the special aid for agriculture announced to the House earlier in the year, and assistance for Harland and Wolff Ltd., for which only a token amount had been provided in the main Estimates. I shall revert to those matters shortly.

As I have said before on these occasions, we are endeavouring to keep Northern Ireland in the most favourable position to benefit, along with the rest of the United Kingdom, from the increase in world economic activity that is expected during the remainder of 1983 and 1984. When the United Kingdom experiences economic revival, there are spin-off benefits for Northern Ireland. The steady 3 per cent. growth rate in United Kingdom GDP and the expectations for controlled or declining inflation next year augur well for Northern Ireland industry. At the moment, some reports indicate that Northern Ireland manufacturing industry is now holding up in employment terms, and generally output and other trends are reported to have improved. However, it is absolutely essential that we continue to do as much as possible to encourage industrial investment in Northern Ireland and to reinforce the effects of the economic trend. The economicinitiative announced earlier this year, with its additional support measures and incentives, such as corporation tax relief grants and 100 per cent. industrial derating, is promising to be of great help in our efforts.

The combination of economic recovery, particularly in America, and the efforts of the Industrial Development Board and many others, such as the all-party and partnership missions, have brought about a greatly heightened intensity of industrial development inquiries and activity, and a measurement of that is in the number of visits being entertained in Northern Ireland at present, running at a rate five times that of last year.

In the social field, with the introduction of housing benefits, we are maintaining the common system of social benefits that applies throughout the United Kingdom. The special aid for agriculture, the assistance to Harland and Wolff and other provisions for industrial support are evidence of our willingness to take account of the special needs and circumstances of Northern Ireland, even at a time when public expenditure as a whole is under constraint. Taken together, they demonstrate yet again the Government's continuing commitment to Northern Ireland.

When I introduced the order for the main Estimates on 7 July, I reminded the House of the extent of the additional special aid to the Northern Ireland agriculture industry that would be made available in the 1983-84 financial year. I also made it clear that the necessary provision for these special measures would be taken in Supplementary Estimates. The additional provision required is now sought