

PO-CH/NL/0021

PART A

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PART A

BUDGET 1987 TREASURY AND
CIVIL SERVICE COMMITTEE

NL/0021

-CH

PO

PART A

DD'S 25 years NABIZ 23-3-95

4-12-87
8-12-87

OPENING STATE-
MENT

From: J ODLING-SMEE

27th March 1987

12/2

CHANCELLOR OF THE EXCHEQUER

cc Sir Peter Middleton
Sir Terence Burns
Mr Peretz
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mr Culpin

OPENING STATEMENT TO TCSC

I attach a draft of this, following the outline in Mr Scholar's minute of 26th March.

2. A couple of points on the numbers:

a. the figure of 10 per cent for export growth in paragraph 2 refers to manufactures including erratics. It might be better to exclude erratics (ships, aircraft, precious stones, silver, etc), the relevant growth rate being 8 per cent.

b. paragraph 12 contains statements about our position in the league table for the growth of output per head since 1980. The EPR article and references based on it relate to the period since 1979. Since the league tables are the same for the two periods, it seemed better to start in 1980 so as to be consistent with the comparison in paragraph 11.

John Odling-Smee

J ODLING-SMEE

OPENING STATEMENT TO TCSC

Red

The economic background to this year's Budget was better than for many years. Output has now been growing at approaching 3 per cent a year for six years, and looks set to grow at the same rate for a seventh year. This growth has been well balanced. Investment has risen faster than consumption during the upswing as a whole. Of course there have been some years when the reverse was the case. 1986 was one, But the Red Book Forecast for 1987 shows consumer spending declerating slightly and both exports and investment growing faster than total output.

though the CSD's estimates for

2. On the external side the adjustment to the loss of our oil earnings has been proceeding rapidly. The volume of exports of manufactures in the three months to Febuary was 10 per cent above its level a year before. No other major country seems to have achieved export growth near to this. [The balance of payments in the first two months of this year was in surplus. This is rather better than I would have expected given the Red Book forecast of a small deficit for 1987 as a whole.]

premature?

3. An especially important part of the background to the Budget was the strong state of

the public finances. [The underlying factor here has been our firm control of public expenditure.]

We have kept public expenditure on a declining rate as a percentage of GDP - while still making important inroads in priority areas.

This has allowed us to reduce both borrowing and the tax burden since the early years of the decade. The PSBR is now at its lowest level since 1969-70. And with output growth continuing to be well above the growth of public expenditure I shall be able to take further steps to reduce the tax burden over the next few years.

I suggest adding new para here (as attached) flagged below

4. Those commentators who have been confounded by this good economic performance have put it down to luck. One would expect them to say that. I have always argued that the pursuit of steady and sound financial policies, backed up by measures to encourage enterprise and initiative and to improve markets, would produce better economic performance. Well, we've followed those policies and we're now seeing the results.

5. The centrepiece of our macro-economic policy since 1980 has been the MTFs. Naturally it has evolved in response to changes in the environment, especially the financial markets.

And pointing that evolution has naturally required the exercise of some judgement and discretion.

6. On the monetary side the behaviour of £M3 has become increasingly difficult to interpret. I have therefore concluded that in present circumstances it would be wiser not to set a

target for it next year. But I continue to monitor the growth of broad money and credit carefully.

7. The behaviour of M0 has, however, proved a useful guide to monetary conditions and decisions on interest rates. There has been an explicit target for M0 since the 1984 MTF [and I have set a target range for next year.] For 1987-88 I have set the target range at the level preshadowed in last year's Red Book.

The exchange rate continues to be one of the most important indicators of monetary conditions that has not changed. But what has changed recently has been that

8. [The exchange rate has been taken into account since the early years. Alongside the monetary aggregates it has been one of the most important factors affecting decisions on short-term interest rates.] The conditions for achieving a period of exchange rate stability - for other currencies as well as sterling - are better now than they have been for recent years.

9. That is why at the recent meeting in Paris the major countries agreed to co-operate closely to maintain exchange rate stability. [In the context of the agreement] I ^{have} made clear that I see no reason for [the exchange rate] ^{sterling} to move much from its present position. [Its value now is broadly consistent with the underlying economic fundamentals.] - and indeed I would not want it to do so.

Fiscal policy

10. [The MTF5 has also evolved on the fiscal side.] Fiscal policy has had to support monetary policy. This means that the budget deficit has to be set at a level which can be comfortably financed in a non-inflationary way. It also means that the PSBR should be set so as to reduce excessive upward pressure on interest rates. [The strong growth in private borrowing in recent years has therefore called for an offsetting reduction in public borrowing - shown very clearly in the new chart 2.4.] Over the medium and longer term, it means that public sector debt should not rise as a proportion of GDP. This implies a ~~maximum~~ PSBR of around 1 per cent of GDP when inflation is eliminated. Although we are not yet at price stability I took the opportunity of buoyant revenues to reach the 1 per cent objective this year.

I think this is a bit strong - and it provokes the question why we are now saying we shall not be reducing the PSBR any more - when private borrowing shows no sign of slowing down.

11. These sound financial policies explain the good performance of the economy. What surprises me is that some commentators are unable - or perhaps unwilling - to acknowledge how good the performance has been. They have barely recognised that our output growth, which was the lowest of all the major European countries in the 1960s and 1970s, has been the highest in the 1980s. [There seems to be some ambiguity about when the 1980s started. There should not be. The 1980s began in 1980 and the 1970s in 1970.

Indeed if we take on board the forecasts for 1987, our lead over the other countries is even more marked.

in the 1980s

12. During the 1980s manufacturing output per head has grown faster than in Japan, the US and Canada as well as the other major European countries. And the growth of output per head in the economy as a whole has been second only to that in Japan among the same group of countries (G7). This is a major transformation in our situation: from laggard to leader.

13. I am grateful to you, Mr Chairman, for allowing me to make these introductory remarks.



NEW
PARA

DRAFT PARAGRAPH ON BUOYANCY OF REVENUES

In the Budget this year I was able to cut borrowing by £3 billion and taxes by a little over £2½ billion. This was made possible by the growth of tax revenues, which was much stronger than I forecast in the Red Book last year. Some of this additional growth had become apparent by the time of the Autumn Statement, but later evidence has confirmed still further growth. The most important element has been increased CT receipts from an increasingly profitable company sector. We have provided business and industry with a sound framework and, thanks to the 1984 reforms, with a corporation tax rate which is lower than in any of our major competitors (except for the US which is now set to emulate us). The combination has proved highly successful, with increased profits and increased tax receipts.

I showed this to Robert & Michael's absence. He felt better to hold for Q & A's, with ref to judgement in opening remarks



Mr Schla

Passed on to Robert & Michael's absence.

I attach a Xerox of part of a speech given when I was subsequently

mentioned as a Pan-Am. The sign plane of it is that I made it in

January 1982 (I was in Warsaw @ the time), more

than 5 years ago.

~~Do you think there~~ might be some value in attaching it but in opening remarks to the TISC over

to release them of
their whole Nat is
frustrating them
in the conduct of
household policy
some hidden & visible
~~check~~ (of unachieved)

Change?

The attacks, of course,
with the help in
up in the sense of the
the high quality is
anxious (as in change
will be).

M.
P.S. You may find no
whole pamphlet work,
and v. 1

The Medium Term Financial Strategy: a return to financial discipline

The true nature of the worldwide economic problem, of which the current world recession is the most obvious symptom, is now widely recognised.

Throughout the world there is an increasing acceptance that we have to go back to basics. We have to restore and maintain financial discipline, monetary and fiscal alike. We have to restore and strengthen market forces throughout the economy. It is in this context that the British government has set its economic course.

In particular, the crucially important medium term financial strategy, with its commitment to declining monetary growth and government borrowing, represents a conscious return to that over-arching financial discipline which history has shown to be one of the two key preconditions of economic success and whose abandonment has led directly to the inflationary excesses of more recent years.

Just as the classical formula for financial discipline – the gold standard and the balanced budget – had both a monetary/exchange rate and a fiscal component, so does the medium term financial strategy.

Of course there is always scope for argument as to how severe that financial discipline should be. My own judgement is that we have got it roughly right – and I am reinforced in this by observing that, if you leave on one side those who believe that there should be no financial discipline at all, roughly a third of our critics complain that our financial policy is too tight, a third complain that it is too lax, and the other third contrive to complain on both counts at the same time.

Again, there is scope for differences of opinion as to how the necessary financial discipline is best applied. Looking around the world today there is a considerable measure of agreement on the desirability of having targets for monetary growth, and of reducing budget deficits. Even after the final collapse of the Bretton Woods system, there has been a continuing role in Europe for the exchange rate as a medium of financial discipline, first in the form of the European snake and since 1979 in the form of the European Monetary System (EMS).

Rules versus discretion

Yet again, there is scope for argument over the balance between rules and discretion in any system of financial discipline – and this applies in particular to the conduct of monetary policy.

It has always been a grotesque caricature of the present Government's economic policy to pretend that it consisted of leaving everything to an automatic pilot known as sterling M3. As far back as March 1980 we published our Green

Paper on Monetary Control, in which we explicitly stated that to assess underlying monetary conditions properly it is necessary to take account of the evidence of *all* the various monetary indicators.

It is clear, to take a topical example, that to the extent that the sharp increase in bank lending for housing has simply replaced lending by the building societies, the consequent inflation of recent sterling M3 growth figures has no necessary monetary significance whatever.

In general, as David Laidler has forcefully pointed out, in a world in which the monetary system is in a constant state of evolution, the exercise of judgement and discretion is inescapable. The important question is: who is exercising that judgement and that discretion?

If it is being exercised by those who do not really believe in the policy in the first place – and there are central bankers, as well as politicians, who fall within this category – then any departure from predetermined rules and guidelines will understandably be regarded with the gravest misgivings, since it will as likely as not represent a backsliding from financial discipline as such.

If, on the other hand, the discretion is being exercised by those whose commitment to the policy, and to the overriding need to maintain financial discipline, is beyond doubt, then there is no cause for such misgivings. On the contrary, the judgement that is being applied, fallible though it may be, is one calculated to minimise the risk of error in carrying through the complex task of sensible monetary control in a financially advanced and sophisticated modern economy.

After the best part of three years the present Government's commitment to the maintenance of financial discipline is indisputable, and the exercise of his judgement and discretion by the present Chancellor of the Exchequer falls fairly and squarely within the second of the two categories I have described.

The plain fact is that the true objective of those who urge the Government to abandon its medium term financial strategy is the abandonment of financial discipline altogether.

Unemployment and recovery

The road back from a high rate of inflation is, of course, a hard one. In particular, we are experiencing a distressingly high rate of unemployment.

Our critics sometimes argue that the present level of unemployment must either have been intended, in which case we are wicked, or else it must have taken us by surprise, in which case we are incompetent. The fallacy inherent in this latter-day version of Morton's Fork can best be illustrated by the analogy of warfare – and indeed it is a war against inflation that we are fighting.

In war, casualties are inescapable. They are neither intended, nor are they



FROM: CATHY RYDING
DATE: 27 March 1987

2

MR SCHOLAR

cc: Sir P Middleton
Sir T Burns
Mr Peretz
Mr Odling Smee
Mr Sedgwick
Mr Turnbull
Mr Culpin

OPENING STATEMENT TO TCSC

The Chancellor was most grateful for your minute of 26 March.

2. The Chancellor was content with the outline you suggested in your minute. On paragraph 2 (iii)-that the 1980s start in 1980 - the Chancellor suggests you look at Hansard for Treasury questions of 26 March.

CR

CATHY RYDING



- C/ Alex thought it would be a good idea for Michael to submit an outline opening statement tonight in order to be sure that when he produces a fuller version it covers the points you want.
2. In the folders behind are comments on growth league tribos and also a draft transcript of officials evidence
3. Content with Michael's suggestion? *Yes.*
- CE 26/3

FROM: M C SCHOLAR
DATE: 26 MARCH 1987

CHANCELLOR OF THE EXCHEQUER

cc Sir Peter Middleton
Sir Terence Burns
Mr Peretz
Mr Odling-Smee
Mr Sedgwick
Mr Turnbull
Mr Culpin

*Mr. A. ...
The books ...
with ...*

*PS. Re X, ...
8th ...
Hans ...
Tom ...
26/3.*

OPENING STATEMENT TO TCSC

You have asked for a brief outline of an opening statement for your appearance before the TCSC on Monday.

2. After discussion with Sir Peter Middleton and Mr Culpin I suggest the following:

- (i) Short preamble on the sunlit uplands
 - balanced growth
 - sound finances
 - sound external position
- (ii) This achieved not by luck but by steady policies.
 - here some highlights from Lombard speech - viz
 - objective and mechanisms of monetary policy
 - the role of the exchange rate
 - how fiscal policy supports this
 - the rationale of the 1 per cent PSBR

(iii) Quite extraordinary how some cannot/will not acknowledge success

X |

- the 1980s start in 1980

3. If you agree I will draft something on these lines for your weekend box.

4. If you want any supplementary briefing it would be helpful to know tomorrow, rather than on Monday, what we should prepare. I suggest you look at Mr Cayley's minute of 24 March on life assurance companies and capital gains tax: Mr Higgins seems likely to return

*(attached)
below*

1

o that. Mr Sedgwick is minuting you tomorrow on growth league tables, on which we have had a note from the Committee. The Revenue will tomorrow let you have a suggested line to take on Mr Wainwright's questions about gathering information on corporation tax from tax offices.

— A: see folder behind

MCS

M C SCHOLAR

19/3070

psw

FROM: DAVID PERETZ
30 March 1987

MR ALLAN

cc Sir P Middleton
Sir T Burns
Mr Odling Smee
Mr Scholar
Mr Sedgwick
Mr Culpin
Mr Kelly
Mr Brook

TCSC

I attach the various facts and figures I was asked for this morning (apart from the record of past statements on the exchange rate, which I have circulated separately):

- 6 and 12 month averages for the sterling three month inter bank rate over the last two years.
- Nominal and real short term interest rates in European Community countries and other G7 countries.
- The movements of the oil adjusted exchange rate.*
- The movement of MO (12 month and 3 month growth rates).
- Figures for the growth of personal sector financial liabilities and assets (and net wealth).

DL

D L C PERETZ

** To follow.*

** wrong!*

Public finance

The strength of the economy has been reflected in the public sector's finances. In 1986-87, public sector borrowing is lower, as a proportion of national income, than in any year since 1969-70. For 1987-88, the Chancellor has been able both to set borrowing substantially below the path envisaged in previous Budgets and to reduce taxes. The prospect is for continued low borrowing and further reductions in taxation.

The medium term financial strategy

The Budget continues the medium term financial strategy (MTFS) which has brought this about. The main points are:

- the Government will aim to keep the money supply in 1987-88, as measured by M0, growing within the range 2-6 per cent, as indicated in last year's Budget;
- the Government have agreed with other major countries to foster a period of exchange rate stability around current levels.
- there will be no target this time for £M3, which remains difficult to interpret (see *Economic Progress Report*, May-June 1986);
- short-term interest rates will continue to be held at the levels needed to keep downward pressure on inflation;
- the public sector borrowing requirement (PSBR) will be held to 1 per cent of gross domestic product (GDP), which—until this year—has been achieved only twice since 1950;
- the aim will be steadily to reduce, over the medium term, the growth of total spending power in the economy, as measured by the cash value of our national output (money GDP).

Table 2 sets out the Government's broad objective for money GDP in the medium term, and paths for the money supply and the PSBR consistent with that. Table 3 illustrates the possible split of money GDP between output growth and inflation.

Table 2
Money GDP, money supply, and the PSBR

	85-86	86-87	87-88	88-89	89-90	90-91
Money GDP ¹	9½	6	7½	6½	6	5½
M0 ²	4½	4	2-6	1-5	1-5	0-4
PSBR ³	5.8	4	4	4	5	5
PSBR as a per cent of GDP	1.6	1	1	1	1	1

¹ Percentage change on previous financial year. The figure for 1987-88 is a forecast; and in subsequent years the figures describe the Government's broad medium term objectives.

² 1985-86, 1986-87 percentage change on previous year, 1987-88 target range, 1988-89 onwards: illustrative ranges.

³ £ billion, cash.

Table 3 Output and inflation assumptions

	percentage change on previous financial year				
	86-87	87-88	88-89	89-90	90-91
Real GDP					
Non-North Sea	3	3	2½	2½	2½
Total	3	3	2½	2½	2½
Inflation					
GDP deflator	3	4½	4	3½	3

Budget measures

Tax proposals	yield(+)/cost(-)	£ million		
		1987-88 Changes from a non-indexed base	1987-88 Changes from an indexed base	1988-89 Changes from an indexed base
Income tax				
2p off basic rate		-2 200	-2 200	-2 820
increase in allowances		-705	-10	-10
changes in higher rate thresholds		-65	+40	+80
Excise duties				
petrol/derv		—	-240	-265
VED		+5	-90	-90
tobacco		—	-105	-110
alcohol		—	-105	-120
on-course betting duty		-20	-20	-20
gaming machine licence duty		+20	+20	+20
Profit related pay: new scheme		*	*	-50
Pensions package		*	*	-65
VAT				
small business measures		-115	-115	-60
tighter rules for certain traders		+300	+300	+400
Corporation tax				
small companies' rate cut to 27 per cent		*	*	-45
capital gains simplification		*	*	+60
tighter rules for companies resident in UK and abroad		*	*	+125
harmonisation of payment dates		*	*	+100
Inheritance tax: increase in thresholds etc		-90	-75	-170
Other changes		-25	-25	+95
Total		-2 895	-2 625	-2 945

— = nil

* = negligible

Forecast

On the basis of these policies and the measures in the Budget, the economy is expected to grow in 1987 by a further 3 per cent. Excluding North Sea oil, growth will be faster—about 3½ per cent. The balance of payments current account will continue in small deficit. Consumption is likely to grow a little less than in 1986, but exports and investment to grow more.

Inflation is expected to be about 4 per cent at the end of the year, after a slight rise to a shade over 4½ per cent in the summer. The tax reductions in the Budget mean that the tax and price index (TPI) will rise less, perhaps by about 2 per cent by the end of the year. The TPI measures the rise in gross pay which would compensate an average taxpayer for the increase in prices over the last year.

The forecast is summarised below.

The prospects: summary

	Forecast		Forecast	
	per cent changes 1986 to 1987	1986 Q4 to 1987 Q4	per cent changes on a year earlier	per cent changes on a year earlier
Output and expenditure at constant 1980 prices				
Domestic demand	3½	3	4	4
of which:				
Consumers' expenditure	4	3	4	3
General government consumption	1	1	3	3
Fixed investment	4	4	4½	4½
Change in stockbuilding (as per cent of level of GDP)	½	½	4	4
Exports of goods and services	4	4	6	6
Imports of goods and services	6	6	3	3
Gross domestic product: total	3	3	4	4
manufacturing	4	4	6	6
Balance of payments on current account				
1987	£ billion	-2½	6	7½
1988 first half (at an annual rate)		-2	7½	7½
Inflation				
Retail prices index			per cent changes	per cent changes
1986 Q4 to 1987 Q4			4	4
1987 Q2 to 1988 Q2			4	4
Deflator for GDP at market prices				
Financial year 1986-87			per cent changes	per cent changes
Financial year 1987-88			on a year earlier	on a year earlier
			3	4½
			4½	4½
Money GDP at market prices				
Financial year 1986-87			per cent changes	per cent changes
Financial year 1987-88			on a year earlier	on a year earlier
			6	6
			7½	7½
PSBR				
Financial year 1986-87			£ billion	£ billion
Financial year 1987-88			4 (1*)	4 (1*)
			4 (1*)	4 (1*)

* Per cent of GDP at market prices.

The reduction will benefit all 25 million income tax payers. It will:

- bring down the starting rate of income tax for practically everyone;
- bring down the marginal rate for the overwhelming majority—about 95 per cent of the total;
- benefit unincorporated businesses and the self-employed as well as wage and salary earners;
- be worth over £3 a week to a married man on average earnings.

The Budget raises the main personal allowances for income tax in line with inflation. This means that they remain 22 per cent higher in real terms (after allowing for inflation) than they were in 1978-79.

In this Budget:

- there is a new allowance for people aged 80 and over;
- the allowance for the blind is raised substantially;
- the benefit of the basic rate reduction to the higher paid is limited by restraints on the higher rate thresholds, so as to spread the benefits more evenly.

Table 4 shows the main allowances.

Table 4 Income tax allowances

	1986-87	1987-88
	£	£
Single person's allowance and the wife's maximum earned income relief	2 335	2 425
Married allowance	3 655	3 795
Age allowance for the single person	2 850	2 960 (over 80s 3 070)
Age allowance for the married person	4 505	4 675 (over 80s 4 845)
Allowance for blind	360	540

Profit related pay

After consultations following the last Budget, the Government have decided to introduce a new relief against income tax to encourage the spread of profit related pay (PRP). This is intended to promote greater flexibility in the labour market.

The Government see two main advantages in PRP:

- it gives employees a direct stake, and so a personal interest, in the success of the businesses for which they work;
- it enables pay to respond more flexibly to changing market conditions—and the more flexible is pay, the more secure are jobs.

The essence of the scheme in the Budget is that, on certain conditions, half of all PRP payments in the private sector will be entirely free of tax. This is double the relief proposed in the Government's Green Paper last July. The maximum amount of PRP eligible for tax relief will be £3,000 a year or 20 per cent of an employee's total pay, whichever is the lower. So for a married man on average earnings:

- if 5 per cent of pay is profit related, the tax relief will be worth about £1.50 a week, equivalent to a penny off the basic rate;
- if 20 per cent of pay is profit related, the tax relief could be worth about £6 a week, equivalent to 4p off the basic rate.

Pensions

The Budget also gives new reliefs against income tax to give people more control over their own pensions. It:

- allows people tax relief if they make their own personal pension arrangements, independently of their employers or of the State;
- allows tax relief on much simpler pension schemes than before, which will be easier for smaller employers to set up;
- allows people who are already in occupational pension schemes to top up their pensions from other sources and to enjoy full tax relief on the additional contributions they make.

These proposals will expand freedom of choice and make it easier for people to change jobs and take their pensions with them.

Indirect taxes

The Budget makes no change at all in the main indirect taxes. There is no change in the rate of VAT, or in the duties on drink and tobacco, or in the main rates of vehicle excise duty. And the only change on petrol taxes is a 5p a gallon reduction on unleaded fuel.

Small businesses

The Budget reduces the small companies' rate of corporation tax to 27 per cent, compared with 42 per cent in 1978-79.

It also makes VAT less of a burden on small and medium-sized businesses. In future, no trader with a turnover below £½ million—and that accounts for about half of all traders registered for VAT—need pay VAT until he or she is paid by the customer. This change has been long sought and is expected to save businesses about £100 million in 1987-88.

There are also measures in the Budget to offer small companies the option of reducing the number of VAT returns which they have to make.

Streamlining corporation tax

Business taxation was radically reformed in the 1984 Budget. This Budget builds on that reform by:

- simplifying the taxation of companies' capital gains;
- rationalising the timing of companies' tax payments;
- streamlining the arrangements for collection of corporation tax.

The Budget also includes two new tax reliefs for oil production companies. These are designed to encourage their research and development effort, and so help a sector hard hit by last year's oil price collapse.

Inheritance tax

The Budget eases the burden of inheritance tax, in particular on the smallest taxable estates. This will be of special help to those whose inheritance consists almost entirely of the family home.

Action against abuse and loopholes

The Budget contains a series of measures to prevent abuse and close loopholes. For example:

- it limits the amounts which the very highly paid can take tax free in pension lump sums;

- it makes the tax rules more effective for banks, for Lloyd's, and for companies resident both here and abroad;
- it reduces the over-generous VAT relief for traders who are only liable to VAT on part of their business.

Summary

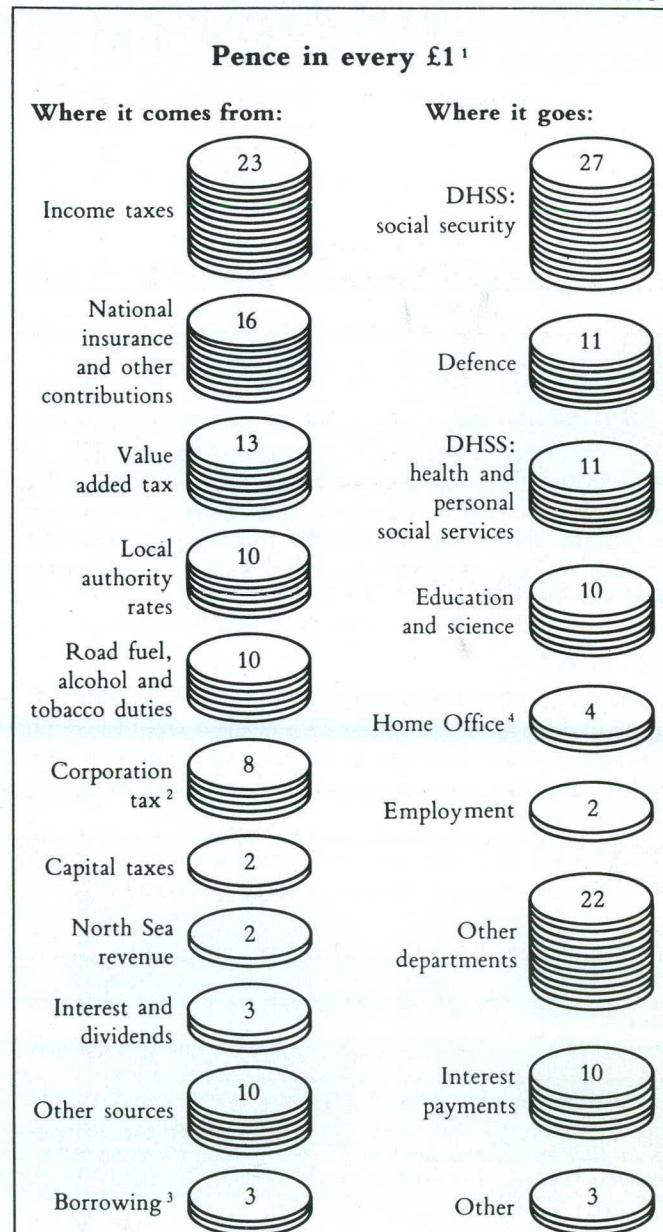
The measures on income tax, profit related pay and pensions will:

- leave people more of what they earn;
- encourage them to identify more with the businesses for which they work;
- allow them more control over their own pensions.

There will be no change in the main rates of indirect tax. The Budget will ease the tax burden on small businesses. And the measures will all be afforded within a reduced total for Government borrowing.

Public Money 1987-88

Chart 4



Cash totals of revenue and expenditure £173 billion

1 Rounded to the nearest penny
 2 Excluding North Sea
 3 By central and local government
 4 And Lord Chancellor's Department
 Source: Derived from *Financial Statement and Budget Report 1987-88*, table 1.2

The Budget

Throughout the last eight years, the Government's aim has been to defeat inflation and maintain a vigorous, enterprising economy which will generate sustained growth and increased employment. Monetary and fiscal policies have brought about lower inflation while providing for continued growth in output. They have been supported by policies to encourage enterprise, efficiency and flexibility. The Budget builds on these policies.

The economic record

Over the 1980s (see table 1) Britain has grown faster than any other major country in the European Community. This is in sharp contrast to the 1960s and 1970s, when Britain came bottom of the European growth league.

Table 1 Growth league table

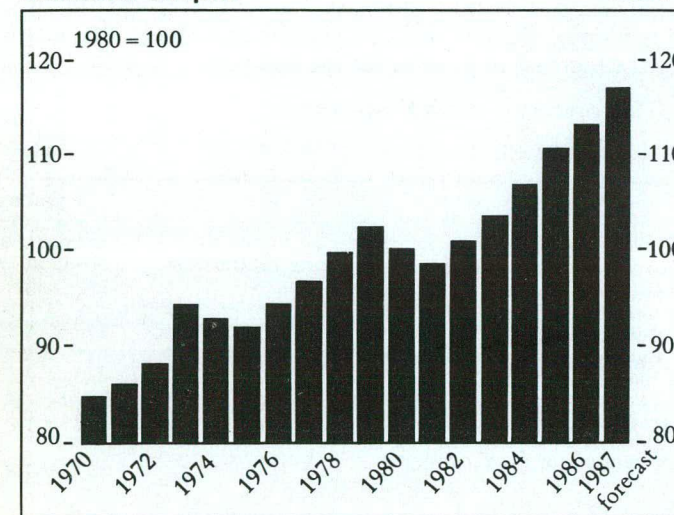
1960s	1970s	1980s
Italy	France	UK
France	Belgium	Germany
Netherlands	Italy	France
Germany	Netherlands	Italy
UK	Germany	Belgium
	UK	Netherlands

Source: OECD

Since 1981, total national output has risen steadily (see chart 1). Growth has averaged nearly 3 per cent, with little variation from year to year. In each of the last four years, the annual growth rate has been in the range 2½-3½ per cent, despite the coal strike and the disruption caused by the halving of oil prices.

National output

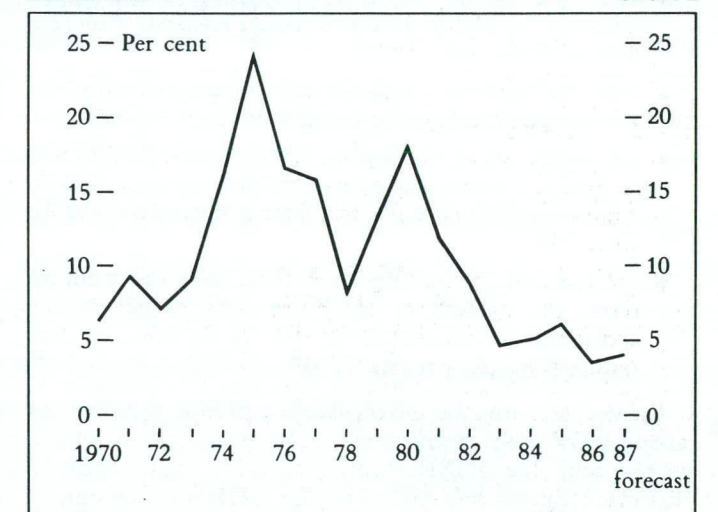
Chart 1



At the same time, inflation has been brought down and kept low (see chart 2). In 1986 it averaged 3.4 per cent, the lowest since 1967.

Inflation

Chart 2

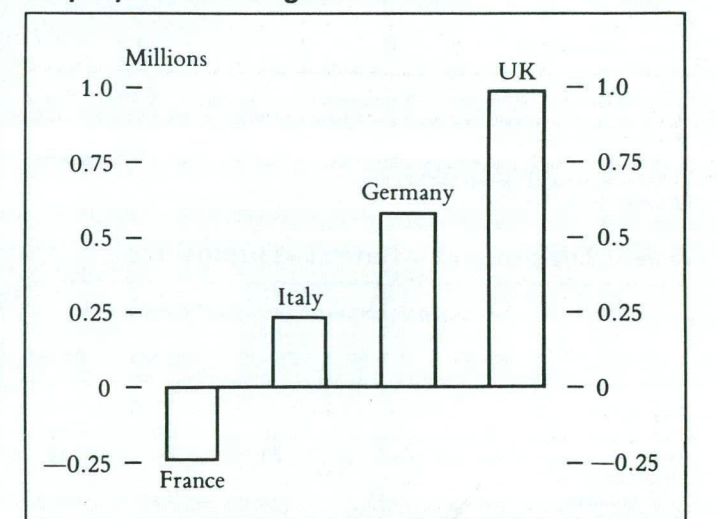


Manufacturing productivity has risen faster in Britain over the 1980s than in any of the other major industrialised countries which make up the Summit seven—the US, Japan, Germany, France, Italy and Canada. (See *Economic Progress Report*, January-February 1987.)

Over the last few years, employment has been rising faster in Britain than in other European countries (see chart 3). And unemployment is now on the way down.

Employment: change since 1983

Chart 3



pws

FROM: C W KELLY

DATE: 22 April 1987

MR CULPIN

cc Principal Private Secretary
Sir P Middleton
Sir G Littler
Sir T Burns
Mr Cassell
Mr Odling-Smee
Mr Peretz
Mr Scholar
Miss O'Mara
Mr Ross Goobey

TCSC REPORT ON THE BUDGET : MONETARY POLICY AND THE EXCHANGE RATE

The TCSC appear to have taken on board the spirit, if not the exact wording, of most of our comments on the sections of the draft report dealing with monetary policy and the exchange rate. In particular they have taken out the implication of a divergence between the Governor's and the Chancellor's views of the Louvre accord.

2. But the single most important misunderstanding still remains. Paragraph 16 says:

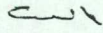
"We assume from this that the government bases its approach on funding the PSBR completely, and uses short-term interest rates to control any increase which may take place in the growth of credit about (sic) that deemed to be consistent with its overall macro-economic objectives."

3. This is a fairly basic misunderstanding. If asked about it you can of course say that it is not the case that the government uses short-term interest rate to control the growth of credit. Short-term interest rates are set after taking account of an assessment of all the indicators of monetary conditions, of which the growth of credit and broad money is only one. Moreover the aim is not to seek to use interest rates to control the growth of lending or broad money to particular rate. The aim is to keep

monetary conditions, judged as a whole, on track. Changes in interest rates have a wider effect on monetary conditions and on the economy, beyond the effect on the demand for credit.

4. If necessary, though there is probably no need to be over-defensive on the point, you can draw attention to the fact that the issue was addressed by the Chancellor, by the Governor and by officials in answer to questions 199, 136 and 18. It was also covered in the 1986 MTFS. Paragraph 2.18 of that explained that "experience has shown that a change in short-term interest rates is unlikely to alter the growth of £M3 significantly" within the financial year; but such action "clearly affects the tightness of monetary conditions, which is what matters, and this would be likely to show up in the behaviour of M0 and the exchange rate."

5. On one of the other main points in the report, I hope I am right in assuming that you do not need any additional briefing on whether or not we now have an exchange rate target.


C W KELLY

TCSC Questions.

From: J ODLING-SMEE

4th December 1987

MS C EVANS

cc PPS -12/2
Mr Evans
Mr Peretz
Mr Sedgwick
Mr Turnbull
Mr Bottrill
Mr S Davies
Mr Hibberd
Mr S King

TCSC QUESTIONS

Just to confirm for the benefit of copy recipients what I said to you last night about who is providing briefing on which questions:

Ms Evans: 1
Mr Davies: 2, 20
Mr Turnbull: 3-10
Mr Hibberd: 11-12
Mr Bottrill: 13, 14, 16, 17, 18 (second part)
Mr Peretz: 15, 18 (first part), 19, 21, 25, 28
Mr Evans: 21-23.

2. We are not planning to provide briefing for questions 24, 26 and 27. The Chancellor will want to give his own answer to 24; 26 is so vague and general that the only possible preparation is to remind oneself of the relevant phrases in the MTFs and various speeches; and the answer to 27 is that the talk of the Japanese wall of money was obviously wrong, but since we did not mention it we do not need to provide an explanation of why.

3. Your minute of 3rd December asked people to send briefing directly to Mr Allan. May I suggest instead that all the briefing today is sent directly to Sir Terence Burns, copied to the Chancellor. We may wish to put together a slightly different package of briefing for the Chancellor after the officials' hearing on Monday.

4. Knowing the style of the Chancellor and Sir Terence Burns, and the tendency of the Committee to stray away from the precise questions you were given, I suggest that the briefing should emphasise factual material and points to make rather than carefully crafted answers to the questions we have.

John O'x

J ODLING-SMEE

pcp

FROM: MISS C EVANS
DATE: 4 DECEMBER 1987

MR ODLING-SMEE

cc Chancellor 12/12
Sir Peter Middleton
Sir Terence Burns
Mr Anson
Mr Scholar
Mr Sedgwick
Mr Peretz
Mrs Lomax
Mr Turnbull
Mr Pickford
Mr Bottrill
Mr S Davies
Mr Hibberd

TCSC ADVISERS

The Committee has appointed the following specialist advisers for the Autumn Statement enquiry - but given the timescale they may not this time produce submissions for publication with the report.

Gavyn Davies
Bill Martin
Terry Ward
Christopher Johnson
Andrew Britton
Professor Brian Tew

Miss C Evans

MISS C EVANS

Mr ACS Allan 12/2
Mr Sargent
Sir Terence Burns
Mr Odling Smee
Mr Turnbull
Mr Sedgwick
Mr Peretz
Mr Pickford
Mr RIG Allen



COMMITTEE OFFICE
HOUSE OF COMMONS
LONDON SW1A 0AA
01-219 (Direct Line)
01-219 3000 (Switchboard)

pur

TREASURY AND CIVIL SERVICE COMMITTEE

PRESS NOTICE

To note
time and
venue

- 1 The Treasury and Civil Service Committee, which was nominated on 24 November 1987, has elected Mr Terence L Higgins to be its Chairman.
- 2 The Committee has decided to hold an inquiry into the Chancellor's Autumn Statement.

Evidence will be taken in public, in Committee Room 8:-

on Monday 7 December, at 4.45 pm, from Treasury officials,

and on Wednesday 9 December, at 4.45 pm, from the Chancellor of the Exchequer, the Rt Hon Nigel Lawson, MP.

NOTE FOR EDITORS

The Members of the Committee are:

- Mr Terence L Higgins (Chairman) (Con, Worthing)
- Mr Anthony Beaumont-Dark (Con, Birmingham Selly Oak)
- Mr A J Beith (Lib, Berwick-upon-Tweed)
- Mr Nicholas Budgen (Con, Wolverhampton South West)
- Ms Joyce Quin (Lab, Gateshead East)
- Mr Giles Radice (Lab, Durham North)
- Mr Brian Sedgemore (Lab, Hackney South and Shoreditch)
- Mr John Townend (Con, Bridlington)
- Mr John Watts (Con, Slough)
- Mr David Winnick (Lab, Walsall North)

For further information contact 01 219 3285/5766

1 December 1987

Campy Evans
2.12.87

bf 2/12



FROM: A P HUDSON

DATE: 26 November 1987

MR TYRIE

membership of TCSC

- cc: CST
- FST
- PMG
- EST
- Mr Cassell
- Mr Scholar
- Mr Peretz
- Mr Odling-Smee
- Mr Pickford
- Mr R I G Allen
- Ms Goodman
- Miss G C Evans
- Mr Cropper
- Mr Call

prep with TCSC stuff. M

MR BUDGEN

The Chancellor was grateful for your minute of 24 November, and he is most grateful to Miss Evans for her research.

2. The material did not prove useful for First Order Questions. But the Chancellor thinks it may well come in handy for the TCSC hearing.

Alase

Do you have a file of useful stuff for TCSC, or shall I keep this.

[Signature]

A P HUDSON

APH

7. 12.

Ch
Together Peter & Terry
have discussed the
May left it would
be better to have
David Peet along but
with Terry & shelter
Frank can't make
him if necessary
this

FROM: MISS C EVANS
DATE: 27 November 1987

CHANCELLOR OF THE EXCHEQUER

- cc Chief Secretary
- Financial Secretary
- Paymaster General
- Economic Secretary
- Sir Peter Middleton
- Sir Geoffrey Littler
- Sir Terence Burns
- Miss Mueller
- Mr Anson
- Mr Scholar
- Mr Monck
- Mr Cassell
- Mr Kemp
- Mr Odling Smee
- Mr Turnbull
- Mr Sedgwick
- Mr Peretz
- Mr Culpin
- Mrs Lomax
- Mr Pickford
- Mr R I G Allen
- Mr Dyer
- Mr Cropper
- Mr Tyrie
- Mr Call

AA
Mr Peretz turned on a
particular point
June: I would rather have a
journal prepared from Mr Cassell.
There is also a sketch case for
Law Mr O-Suite rather than
Mr Sedgwick, but that is not so
important. 2. X is OK.
AA

OK

TCSC: AUTUMN STATEMENT HEARINGS

This is to confirm that the Chairman will be writing next week to invite you to appear before the TCSC on Wednesday 9 December at 4.45pm. Officials will be invited for Monday 7 December at the same time. The Clerk has agreed to let me have informal notice of the line of questioning, in the usual way, next week.

2. If you agree we propose that the team for the officials' hearing should be:

- Sir Terence Burns
- Mr Turnbull
- Mr Sedgwick
- Mr Peretz

X As last year you may wish to be accompanied by Sir Peter Middleton, Sir Terence Burns and Mr Turnbull.

3. You may find useful the attached biographies of the members.

1986 As	1987 Budget
Burns	Scholar
Cassell	Peretz
Scholar	Odling Smee
Sedgwick	Sedgwick
Turnbull	Turnbull

CEvan
MISS C EVANS

BEAUMONT-DARK, Anthony Michael. (*Birmingham Selly Oak*) C.



B. 1932; ed. Cedarhurst Sch. Solihull, Birmingham College of Art and Birmingham Univ.; m. (1s 1d). Member of Birmingham City Council 1956-67 and Alderman of the City of Birmingham 1967-; Chrmn of Housing Cttee 1967-70 and Chrmn of Finance Cttee 1970-73. Chrmn of Shadow Min. of Transport's Advisory Cttee on Transport Policy 1966-70. Member of Treasury and Civil Service Select Cttee 1979-. Has travelled widely to study economic and trade affairs in Europe, USA, Africa and Japan. Contested Aston Div. of Birmingham 1959 and 1964. Member for Birmingham, Selly Oak since May 1979. — *House of Commons, Westminster SW1A 0AA.*

BEITH, Alan J. (*Berwick-upon-Tweed*) Lib.



S. of the late James Beith. B. April 20, 1943; ed. King's School, Macclesfield, Balliol and Nuffield Colls. Oxford BLitt, MA; m. Sept. 1, 1965 Barbara Jean, d. of S. E. Ward (1s 1d). Lecturer, Univ. of Newcastle-upon Tyne 1966-73. Councillor Hexham RDC 1969-74 Vice-Pres. National Assn of Local Councils. Chief Whip of Liberal Party March 1976-. Representative to the Council of Europe Assembly 1976-84. Chairman of its Sub-Cttee on Architectural and Artistic Heritage of Europe. Member of the Western European Union Assembly 1976-84. Member, House of Commons Commission 1979. Chief Whip of the Liberal Party 1976-85. Deputy Leader and Spokesman on Foreign Affairs 1985-. Alliance Spokesman on Foreign Affairs, 1987-. *Special Interests:* Parliamentary and Constitutional Affairs, Architectural and Artistic Heritage. *Recreations:* Music, walking. Member for Berwick-upon-Tweed from 1973. — *West End Cottage, Whittingham, Alnwick, Northumberland (Whittingham 313); House of Commons, Westminster SW1A 0AA (01-219 3540).*



BUDGEN, Nicholas. (*Wolverhampton South West*) C.

S. of Capt. G. N. Budgen (dec'd.). B. Nov. 3, 1937; ed. St. Edward's School Oxford and Corpus Christi Camb.; m. April 14 1964, Madelaine Elizabeth d. of Col. Raymond Kittoe, OBE (1s 1d). Called to the Bar 1962. Practised Midland and Oxford Circuit. Assist Govt Whip 1981-82. Fellow of the Industry and Parliament Trust. *Recreations:* Hunting, racing. Contested Birmingham Small Heath div. 1970. Member for Wolverhampton South West from 1974. — *House of Commons, London SW1A 0AA; Malt House Farm, Colton, nr Rugeley, Staffs. (Rugeley 77059).*

HAMILTON, (Mostyn) Neil. (*Tatton*) C.



S. of Ronald Hamilton, retd. engineer. B. March 9, 1949; ed. Amman Valley Grammar School, University College of Wales, Aberystwyth and Corpus Christi College, Cambridge; m. June 4, 1983, Mary Christine, only d. of Dr E. T. Holman. Barrister-at-Law, Middle Temple Economist. Formerly in charge of Parliamentary and European Affairs at Inst. of Directors. Sec. Conservative Trade and Industry Cttee 1983. Vice-chrmn 1984-. PPS to David Mitchell. Transport Minister, 1986. Vice-Pres. Federation of Conservative Students. Vice-Chrmn Smal. Business Bureau. Sec. All-Party ANZAC Group 1984. *Special Interests:* Finance, Taxation, Trade and Industry, The Arts, Privatisation. *Energy.* *Recreations:* Antiquarian pursuits, architecture, art, music, silence and country life. Contested Abertillery Feb. 1974 and Bradford North 1979. Member for Tatton since June 1983. — *House of Commons, SW1A 0AA (01-219 4157).*

HIGGINS, The Rt Hon. Terence Langley, MA. (*Worthing*) C.



S. of late Reginald Higgins. B. Jan. 18, 1928; ed. at Alleyn's Sch. Dulwich; Gonville and Caius Coll., Camb. and Yale Univ., USA. M. Sept. 30, 1961. Prof. Rosalyn Higgins, MA, LLB (Cantab.), JSD (Yale), d. of Lewis Cohen (1s 1d). Served in the RAF 1946-48. Employed New Zealand Shipping Co., in UK and New Zealand 1948-55. Economic Specialist, Unilever Ltd 1958-64. Former Pres. Cambridge Union 1958 and Treasurer of the Cambridge University Conservative Assn. British Olympic Team 1948 and 1952. Commonwealth Games Team 1950. Sec. Conservative Parl. Finance Cttee 1965-67. Conservative Opposition Front Bench Spokesman on Treasury and Economic Affairs 1967-70. Minister of State, Treasury June 1970-72. Financial Secretary, Treasury 1974. Opposition Spokesman on Treasury and Economic Affairs 1974. Opposition Spokesman on Trade 1974-76. Chrmn Cons. Transport Cttee 1979-82. Chrmn Cons. Sport and Recreation Cttee 1979-82. 1922 Executive Cttee 1980-85. PC 1979. Council Royal Institute of International Affairs 1980-85. Council Institute of Advanced Motorists. Chrmn Select Cttee on Procedure (Finance) 1981-82. Member Select Cttee on Treasury 1979-82. Chrmn House of Commons Liaison Cttee 1984-. Member Public Accounts Commission. Chrmn Select Cttee on the Treasury and Civil Service 1984-. *Special Interests:* Finance, Transport, Sport. Member for Worthing since 1964. — *House of Commons, SW1A 0AA (01-219 4471); Hawk's Club, Cambridge, Yale Club of London.*

ALL
MEM-
BERS

QUIN, Joyce Gwendolen. (*Gateshead East*) Lab. majority 17,228



D. of the late Basil Godfrey, schoolmaster, and the late Ida Quin, née Ritson, teacher; B. Nov. 26, 1944; ed. Whitley Bay Grammar School, University of Newcastle-upon-Tyne. (BA 1st Class Hons in French 1967), and LSE (MSc International Relations 1969); Hon. Fellow Sunderland Polytechnic 1986. Research Officer, Int. Dept. Labour Party IIQ 1969-72; lecturer in French, University of Bath 1972-76; tutor and lecturer in French and Politics, University of Durham 1976-79; Member of European Parliament for Tyne and Wear 1979.

Special Interests: European Policy, Industrial Policy, Regional Policy. *Recreations:* North-East local history, walking, music, reading, cycling, playing Northumbrian pipes. Member for Gateshead East since June 1987.—41 Preston Avenue, North Shields, Tyne and Wear, NE30 2BN (091 259 1006); *Joseph Hopper Homes, Windy Nook Road, Gateshead, Tyne and Wear* (091 487 1940); *House of Commons, SW1A 0AA* (01-219 3000).

RADICE, Giles. (*Durham North*) Lab.



S. of L. W. Radice. B. Oct. 4, 1936; ed. Magdalen Coll. Oxford; m. Mar. 4, 1971, Lisanne, d. of Adam Koch. Research Officer GMWU 1966-73. PPS to Mrs Williams, Sec. of State for Education and Science Jan. 1978-Apr. 1979. Opposition Front Bench Spokesman on Foreign Affairs 1981. Opposition Front Bench Spokesman on Employment 1982-83 and on Education Oct. 1983-. Publications: *Democratic Socialism* 1965; *More Power to People* 1968; (Co-Author) *Will Thorne* 1974; *The Industrial Democrats* 1978. *Special Interests:* Education, Employment, Industry and Industrial Relations. *Recreations:* Reading, tennis. Member for Chester-le-Street 1973-83 and for Durham North since June 1983.—*House of Commons, SW1A 0AA*.



SEDGEMORE, Brian. (*Hackney South and Shoreditch*) Lab.

S. of the late Charles John Sedgemoor. B. March 17, 1937; ed. State Schools and Oxford University; m. Dec. 19, 1966, Audrey, d. of Jubry Reece, QC (1s). Ministry of Housing and Local Government Principal 1962-66; Private Sec. to R. J. Mellish (then Junior Minister) 1964-66; Barrister 1966-74. Wandsworth Cllr 1971-74; Chrmn Community Relations 1971-74. With Granada TV 1979-83. *Special Interest:* Economic Policy. *Recreations:* Music, sleeping on the grass! Member for Luton West 1974-79. Member for Hackney South and Shoreditch since June 1983.—17 Sutton Square, Urswick Road, Hackney, London E9 6EQ.

TOWNEND, John E. (*Bridlington*) C.



S. of the late Charles Townend. B. 1934; ed. Hymers Coll. Hull; m. May 4, 1963, with four children. Articled clerk in chartered accountancy 1951-57 (in finals received Plender Prize for top paper). Served RAF 1957-59, commissioned Pilot Officer. Joined family business as Com. Sec. and Finance Dir. 1959; Managing Dir. 1961-79, now Chrmn. Chrmn of Yorks. and Humberside Wine and Spirit Merchants' Assn 1975-76. Underwriter at Lloyd's 1977. Elected to Humberside County Council 1973. Leader of Cons. Group and was shadow Chrmn of Policy Cttee. Member of Cons. National Advisory Cttee on Local Govt. Leader of the Humberside County Council and Chrmn of its Policy Cttee and Member of the Policy Cttee of the ACC 1977. Formerly Sec. Cons. Back Bench Finance Cttee. PPS to Hugh Rossi, Min. of Pensions and Disabled. Member Treasury Select Cttee. Vice-Chrmn Backbench Finance Cttee and Small Businesses Cttee. Fellow of the Industry and Parliament Trust. *Special Interests:* Treasury and Taxation, Small Businesses, Employment, Southern Africa. *Recreations:* Squash, tennis. Contested North Hull 1970 General Election. Member for Bridlington since May 1979.—*Sigglethorne Hall, Hull, North Humberside; House of Commons, Westminster SW1A 0AA* (01-219 5097); *Carlton Club*

WATTS, John, MA, FCA (*Slough*) C.



S. of the late Arthur Watts. B. April 19, 1947; ed. Bishopshalt School, Hillingdon and Gonville & Caius College, Cambridge (MA Cantab); m. Oct. 26, 1974, Susan, d. of Ronald Swann (1s 3d). Chartered Accountant. Chrmn Cambridge Cons. Assn 1968 and Uxbridge Cons. Assn 1973-76. Member, Hillingdon Borough Council 1973-86. Leader of Opposition 1976-78, Leader of Council 1978-84. PPS to Ian Gow, Minister for Housing and Construction 1984-85 and Minister of State Treasury Sept. 1985-. Member of Treasury and Civil Service Select Cttee March 1986-. *Special Interests:* Local Govt, Taxation, Accountancy Matters, Vocational Training. *Recreations:* DIY, reading. Member for Slough since June 1983.—*Slough Conservative Assn, Churchill House, Chalvey Road East, Slough* (23620), Berks; *House of Commons, SW1A 0AA* (01-219 3589).



WINNICK, David. (*Walsall North*) Lab.

S. of the late E. G. Winnick. B. June 26, 1933; ed. secondary sch. and London Sch. of Economics; m. Sept. 23, 1968 Bengisu Rona (m. diss.). Member Willesden Borough Council 1959-64. Member Brent Borough Council 1964-66. Member, Commons Select Cttee on the Environment 1980-84. Member, Commons Select Cttee on Home Affairs 1984-. Member of the Executive Council of the Association of Professional, Executive, Clerical & Computer Staff (APEX) 1978-. Vice-Pres. 1983-. Chrmn United Kingdom Immigrants Advisory Service 1984-. Candidate for Harwich 1964 and Croydon Central Oct. 1974 General Elections. Member for Croydon South 1966-70. Contested Walsall North in 1976 By-election. Member for Walsall North since May 1979.—*House of Commons, Westminster SW1A 0AA*.

UNCLASSIFIED

ms



FROM: A C S ALLAN

DATE: 1 December 1987

MISS C EVANS

cc Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr Peretz
Mr Sedgwick
Mr Turnbull
Mr R I G Allen
Mr Pickford
Mr Dyer
Mr Cropper

TCSC: AUTUMN STATEMENT HEARINGS

The Chancellor was grateful for your minute of 27 November, and is content with the arrangements you propose.

ACSA

A C S ALLAN

UNCLASSIFIED



ps1

FROM: A C S ALLAN
DATE: 8 December 1987

MISS O'MARA

cc Sir P Middleton
Sir T Burns
Mr Peretz
Miss C Evans

TCSC

The Chancellor would be grateful for the following additional information for his TCSC appearance:

- (i) figures for the yearly growth in all the main monetary aggregates back to 1979;
- (ii) the level of our reserves compared to other major countries, in both absolute terms and as proportions of imports and GNP;
- (iii) figures (not for public use) on the detailed composition of the reserves in 1979 and now;
- (iv) figures for the currency composition of our net reserves (again not for direct public use).

A large, stylized handwritten signature in black ink, appearing to read 'ACSA'.

A C S ALLAN

Copies for: Chancellor ^{-12/2}
Sir P. Middleton

Ms. Turnbull

From : D L C Peretz
Date : 4 December 1987

Miss Evans

SIR T BURNS

cc Sir G Littler
Mr Cassell
Mr Odling-Smee
Mr Sedgwick
Miss O'Mara
Ms Goodman
Mr Holgate

overbaken

pmf

TCSC QUESTIONS

I am attaching some points to make in answer to the various questions assigned to me.

2. I may have some further thoughts on the answer to question 25 after having a further word with the Bank of England. Meanwhile I should also be grateful for any comments from Sir G Littler, Mr Cassell and others, particularly on that answer.

3. I am also attaching, for you only, the following extra material :

- a general brief on monetary policy/exchange rate policy (the words in almost every case have been approved by the Chancellor at some point).
- a note about the growth of credit, particularly consumer credit (which seemed to be an obsession of the TCSC in the spring).
- a note about real interest rates (another obsession of the TCSC earlier in the year).
- a large bundle of relevant Chancellor speeches, records of evidence give to the TCSC, etc.

DLCP

D L C PERETZ

48/12

Q.15 Why is 3 DM the right level for the £?

A. It was right that there should be some fall in sterling last year to reflect the fall in the oil price. But by the autumn of 1986 this fall had gone far enough. [Chancellor Mansion House speech 1986 : average rate against DM in October 1986, DM 2.86]. Any further decline would have increased inflationary pressures. On other hand a substantial rise from the level then reached might have undermined industrial confidence. Keeping sterling in a range a little under 3 DM should provide a firm counter-inflationary anchor for the future while providing the exchange rate stability that industry wants.

Q.18 What effect has intervention had on the monetary aggregates?

A. Intervention involving sales of sterling tends to add to the growth of the broad monetary aggregates, to the extent that it is not matched by additional sales of gilt-edged stock. The relationship is not, however, necessarily one for one; and will be different in different circumstances, [depending on who is buying sterling, and what it is used for.]

However, as the Chancellor indicated in his Mansion House speech, intervention will be fully funded, to offset its effect on broad money, but not necessarily within the same financial year as the intervention takes place. In the unsettled market conditions of late October and November, it would clearly have been unwise to extract liquidity on a major scale.

Q.18 Is the purpose of intervention to keep the sterling/DM rate stable or to prop up the dollar?

A. The main purpose of intervention undertaken by the Bank of England has been to keep the sterling/DM rate stable. But the Louvre agreement was an agreement between the major countries to try to keep^{all} their currencies reasonably stable against each other.

Q.19 Do the monetary aggregates matter any more?

A. Yes. We continue to look at them closely alongside the other evidence - and have retained a target for M0. Way they are interpreted and affect interest rate decisions fully set out in FSBR. Clearly the exchange rate, and the desire to maintain exchange rate stability, have been given an increasing weight in interest rate decisions since the Louvre agreement.

Q.21 Did Louvre achieve anything?

A. Although the dollar has fallen sharply in recent weeks, Louvre did achieve a period of stability between the major currencies over a period of 8 months, which was certainly useful.

Do not accept the argument that stability in one market will necessarily lead to instability in others. [See ~~attached~~ note by Mr Pike]. Necessary adjustment to imbalances in the world economy will come about with less disruption if currency overshooting can be avoided.

Q.25 Is there a risk that by intervening to sustain the dollar, we have simply acquired depreciating assets and smoothed the fall of the dollar while the US authorities are deliberately engineering such a fall to avoid recession? What are we getting in return for intervention?

A. The main purpose of our intervention has not been to sustain the dollar, but to maintain exchange rate stability between sterling and the deutschemark.

Wrong to assume that intervention has only been in dollars, though choice of currency of course is affected by need for co-operation between all central banks to seek to maintain currency stability worldwide.

It is the longstanding practice not to reveal details of intervention or of the asset or currency composition of the reserves. However, it would also be wrong to assume that market intervention is the only means of changing the currency composition of the reserves. Also need to remember that we have significant dollar, and other foreign currency, liabilities. It is the net reserve position that is relevant in judging the impact of currency movements on the value of the reserves.

Whether any particular purchase of dollars in recent weeks will in the end prove to be profitable or otherwise depends, of course, on the exchange rate at which it is unwound, if it is, at some point in the future - possibly some way into the future : central banks are not short-term speculators.

Q.28 Can you say anything about the Federal Reserve's intervention to support to the dollar?

A. Only what the Federal Reserve themselves have published ...

ppp

BUDGEN

FROM: A G TYRIE

DATE: 24 NOVEMBER 1987

CHANCELLOR

- cc Chief Secretary
- Financial Secretary
- Paymaster General
- Economic Secretary
- Mr Cassell
- Mr Scholar
- Miss O'Mara
- Mr R I G Allen
- Ms Goodman
- Ms Evans
- Mr Peretz
- Mr Cropper
- Mr Call

Handwritten in red:
 Mark Gutteridge
 to Miss Evans

MR BUDGEN

I think Carys Evans' investigation into Budgen has found something rather useful, attached. If he sticks his head above the parapet in First Order PQs on Thursday you could certainly quote paragraph 24.

Handwritten:
 I'm not sure. It's a bit wordy for First Order PQs. But certainly have ready for your next TCSC appearance.

AGT.

A G TYRIE

Handwritten signature:
 AH
 25.11

Handwritten in red:
 Agree: TCSC material.

Forgetting²⁰ the lessons of success?

NICK BUDGEN MP argues that a Government policy switch into 'going for growth' could stand Mrs Thatcher's achievements on their head and render years of sacrifice pointless

The Prime Minister speak at the Lord Mayor's banquet. It is anticipated that she will point to the successes of the economy. She will explain that we are well placed to avoid the worst of a world recession. Then she will promise that if necessary the Government will act decisively to maintain growth.

What agony the Prime Minister must have gone through as she and her advisers wrote the speech. Within the last month in the House of Commons she reiterated her opposition to the European Monetary System and to the expensive and impossible system of government attempting to manage exchange rates. Her speech will be a triumph for her loyalty to her Chancellor over her gut instincts.

It is now fashionable to forget the arguments that were endlessly repeated over between 1974 and 1979. The two most important ideas were that the defeat — not the victory — of inflation was the most important task of government. Secondly that, for the rest, decisions were better left to the multiple and mysterious messages of the markets.

Maybe the attack upon inflation between 1979 and 1981 was too crude and mechanistic. Maybe there were too many ignorant enthusiasts going around explaining that there was a clear mechanical relationship between a change in money supply (Sterling M3) and rate of inflation about two to one and half years later. But there is no doubt that all were agreed that inflation was caused by government and that it was a monetary phenomenon, however you measured the money. That was generally held to be a problem for the wise like Nigel Lawson, the Financial Secretary and architect of monetarism.

Maybe there was too much euphoria about the market. But what a wonderful act of faith the freeing of exchange controls was. Reflect what the Governor of the Bank of England must have said: "Chancellor, the controls may be arbitrary, partial and unfair. They may even bite some worthwhile investment hard, but they are very useful in the Bank is ordered to manage the economy. If we cannot interfere with the flow of private funds, then

the management of currencies must all be done by public funds. That could be very expensive; not only that, if we pay for the intervention by printing money your new friends will tell you that there are consequences for inflation".

"Nonsense", Geoffrey Howe might have said ... no, he would not. He would have said: "Please put this in its proper context. We have no intention of either attempting to manage exchange rates or attempting the concerted reflation by the main industrial nations which was tried in 1978".

The abolition of exchange controls was the symbol of the new Government's recognition of the limits of government action. It was consistent with its attitude towards growth as well as exchange rates. Manufacturing industry was much squeezed as the pound bought more and more dollars, but the Government was only able to say that the value of currencies was decided by the market. It was not a matter over which the Government — any government — had control.

Internal growth was approached in much the same way. Government can hold the ring by providing sound money and freeing-up markets, but it cannot create growth — that is the role of individual enterprise and effort.

Tonight I do hope that the Prime Minister will explain in detail two things.

1. Why the Louvre Agreement is not to be supported when the EMS is not to be joined?

2. Why and how the Government can act decisively to maintain growth when it could not do so between 1979 and 1981.

The Chancellor's support for the Louvre Agreement was explained in the Commons on November 5. "At the time when inflation throughout the world was very high it was impossible to manage the evolution of exchange rates; market forces were all that could do the trick. I explained in considerable detail in my speech to the IMF's annual meeting in September — long before this financial storm broke — that the precondition of being able to create exchange rate stability was that first of all we got world inflation down, and inflation down in all the major nations. That is what we have done; now it is possible to intervene successfully to manage exchange rates."

I hope that we shall have some further explanation for this. Does an annual increase of about 20 per cent in Sterling M3 now have any significance for future inflation? Indeed, is it satisfactory that 4 per cent annual inflation will halve the value of money in 16 years? Is it clear that exchange rates are principally changed by comparative rates of inflation? I thought that exchange rates were decided by all the factors in the mystery of the market and

not by one statistic capable of some official adjustment.

More important even than the market argument is the almost mechanical one. Do not freely floating exchange rates allow a nation's exports and imports to balance? I thought that one of the advantages of freely floating exchange rates was in preventing friction and interference between nations. The falling dollar would have done the work of international statesman.

There would have been no need of advice to America. American politicians would no doubt have blamed ignorant foreign speculators. But the deficits would have been corrected. There would have been no resentment against unasked-for advice. There would have been less risk that the Americans might reconsider the vast cost of maintaining 300,000 men and their machines of war in Europe.

Could the Prime Minister also please explain what the cost of recent intervention has been? The Bank of England bought \$6.7 billion last month to support the American currency. The market seems to wish to place a lower value on the dollar. The losses might be quite large, perhaps even so great as to prevent the tax concessions to married women which the Tory party hoped for.

What happens if these purchases are not paid for properly? If the money is raised in the Gilts market, it must tend to push up interest rates. If it is simply added to the money supply, this must increase inflation sometime and to some extent.

This argument is connected with the argument about growth. The Chancellor has said that the cost of intervention will not be entirely sterilised in the Gilts market. This surely means that the money supply will be increased. If this is the decisive action to maintain growth, do we want it?

The Prime Minister has been our national symbol against inflation. The Chancellor recently talked about the advantages of "taking a bit of the froth off the market". If that is all it is it would be a real tragedy if the gains and sacrifices of the last eight years were put at risk by going for growth at all costs.

Nick Budgen is Conservative MP for Wolverhampton South-West.

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THE GUARDIAN

Forecasters predict slowdown in economy

By Christopher Huhne, Economics Editor

The growth of the British economy is likely to slow down to only 1.9 per cent next year in the wake of the stock market crash, according to the Cambridge Econometrics in a report published today.

The Cambridge forecasters, who specialise in industry by industry predictions based on a large computer model measur-

ing the input and output of each sector, believe that the fall in unemployment will come to an end while inflation will edge up to 4.7 per cent.

The current account of the balance of payments is expected to swing into a deficit of 1.1 per cent of national income, or about £3 billion. The borrowing requirement also moves back into deficit, reflecting slower growing tax revenues,

after the small surplus forecast for this year.

Overall Gross Domestic Product is expected to grow at an annual average rate of 2.4 per cent between 1985 and 1990, within which production and construction industries — about 42 per cent of GDP — are forecast to grow by 2.2 per cent. But this slower growth than GDP is largely due to the oil decline so that construction

rises at an annual average rate of 3.6 per cent and manufacturing at 2.9 per cent.

One of the fastest growing industries over this period is predicted to be electrical and instrument engineering (up 5.5 per cent a year).

Cambridge Econometrics Autumn Report: Industry and the British Economy to the Year 2000; 21 St Andrew's Street, Cambridge, £1,500.

REFERENCE
presentation
of policy

6

MINUTES OF EVIDENCE TAKEN BEFORE

£ was \$ 1.13

DM 3.58

28 January 1985]

THE RT HON NIGEL LAWSON, MP,
SIR PETER MIDDLETON, KCB and MR C W McMAHON

[Continued

[Mr Browne *Contd.*]

growth. They have been the objectives, and interest rates are an instrument.

17. Having said that, do you not accept that the market, in which I work in part, saw interest rates as being part of those two objectives and began to sell sterling short? If so, why did it take the Government so long to act in the defence of sterling? Why did it not act before January 14 to stem the tide in such a fragile market, because as you waited the market lost confidence and it cost more in terms of interest rates to restore confidence? It seemed a long time to have waited, and I wondering why it took so long?

(Mr Lawson.) That is not quite true. In the period you talk about, we moved very rapidly in July 1984; this is not the first time, because there were two earlier occasions when interest rates rose sharply, during the time of my predecessor, Sir Geoffrey Howe.

18. At these low rates of sterling do you not feel that British industry should be taking more advantage of them in terms of trying to improve market share by cutting prices rather than keeping to historical prices just to get a foreign exchange wind-fall profit?

(Mr Lawson.) That is a matter for industry. I think the huge American current account deficit is an open invitation to everybody; there is a big market there for goods from the whole of the rest of the world. I think British manufacturing industry in particular is taking advantage of it. How much advantage they ought to take is not for me to say; how much they increase their sales or take an increased profit margin varies from case to case. But you have to look beyond that simple division, because what are they raising profit margins for? If they use it to increase promotions and dealerships in the United States so as to set the conditions for bigger sales volumes in future, that may well be good business.

Mr Budgen

19. Chancellor, you come here today at an unhappy time, but no doubt when things look bright—

(Mr Lawson.) I am always happy to see you, Mr Budgen!

Mr Budgen: We are always happy to see you, Chancellor!

Chairman: It cheers us all up!

Mr Budgen

20. But you come here at a comparatively unhappy time. When things are easier, Chancellor, no doubt you will review the events that have led up to today's increase in interest rates and the increase last Monday, and you will think where your performance and the performance of the Government might have been better. May I suggest to you that there may be a strong case for decent obscurity in the control of the few levers that you have? Is there not perhaps an argument for saying that if there had been rather less prattling and rather less intellectualising in the recent past, then perhaps this crisis might have been dealt with without the use of quite such stringent levers?

(Mr Lawson.) I have heard this turbulence in the foreign exchange market described as a number of things. I have never before heard it described as "intellectualising", but no doubt this Committee will itself attempt to analyse the various factors, and I will read with interest the conclusions that it reaches. Where I think that obscurity is very necessary is that I do not think that it makes sense to talk about particular levels of exchange rates at which one might take particular actions, nor what actions one would take at those levels.

21. But, Chancellor, we on this Committee are semi-employed observers. You are operators in the market. Do not you think that it has been most unwise of the Government to give guidance like "Maggie won't waste money propping up sterling" and that sort of guidance, which, combined with the market's knowledge that you at any rate have a preference for market forces rather than regulated markets, has given the impression that you, the Government, would not use some of the few small levers at your command?

(Mr Lawson.) Even though I once had some small responsibility in another capacity, I am not responsible for what appears in the newspapers. I do not think there is anything that I have ever said which has indicated the sort of views which you mentioned a moment ago, except certainly a preference for market forces (which I always understood you shared, Mr Budgen). But that, of course, does not mean that we are not prepared to intervene in the foreign exchange market. We are so prepared, when it seems to us sensible to do so, and in fact we do.

REFERENCE
intervention
on interest rates
/ exchange
rates

28 January 1985] THE RT HON NIGEL LAWSON, MP,
SIR PETER MIDDLETON, KCB and MR C W MCMAHON

[Continued

[Mr Budgen Contd.]

22. Surely, in dealing with markets, it is not a question of what the intellectual prejudice of the sellers happens to be at any one time; it is very often a matter, is it not, of dealing with the prejudices of the customers, and sometimes, even if you disagree with the prejudices of those customers, you have to pander to them in order that they may sell the growing number of goods that you wish to put on their market? Is not that the position with you?

(Mr Lawson.) I am afraid I am not at all clear what you are driving at.

23. You want to sell a lot of debt, at as low interest rates as possible, do you not? Surely, if you are going to do that, you have to keep the market sweet by at least showing that you intermittently agree with some of their prejudices?

(Mr Lawson.) We do indeed have to sell Government debt. We aim, through our fiscal policy, to limit the amount of debt that we have to sell, and we have been extremely successful in selling that debt. There is considerable expertise in that field, in the Bank of England and also in the Treasury, and we have, as you know, over the years, considerably improved and increased the different kinds of debt instruments and the different kinds of techniques for selling debt. I think that our record on that has been, on the whole, a commendable one.

24. Yes, but are not you taking away some of the weapons that those distinguished technicians employ, if you allow it to be said on your behalf that you will not use the interest rate weapon, or you will not intervene at certain levels in exchange markets? You have relatively little power, and if you give an impression that you are not prepared to use the few levers at your command, do not you then restrict your room for manoeuvre?

(Mr Lawson.) I have never given that impression, nor do events bear it out.

25. No, they do not, but the result has been, has it not, that because you earlier gave the impression that you would not use those levers, you have now had to use them in double measure?

(Mr Lawson.) No, I have never given that impression. I think that there has been a misconception in some quarters, among commentators, that if a Government has no target for the exchange rate, then it is

indifferent to the exchange rate. That is not the case. I have made it clear that that is not the case, on previous occasions before this Committee, and so has my predecessor. Nevertheless, that misconception has, I think, to some extent, persisted.

Mr Budgen: Thank you.

Chairman

26. I wonder if I might seek to clarify one point on intervention, because in earlier evidence to this Committee you have always said, I think, that intervention has been restricted to occasions where there is a risk of disorderly markets. Am I right in understanding from your earlier statement that you are now saying that on a broad international basis intervention is taking place on a wider scale—that is to say, not only in the context of disorderly markets in some short-term sense, but with the international community as a whole taking some view as to what kind of changes ought to take place?

(Mr Lawson.) That is a very good question. As you will have observed, we all of us—all the Finance Ministers of the G5—have been careful to refrain from defining what we meant by “a disorderly market”. Therefore, it was always intended that there should be a certain freedom of action. Nevertheless, I think it is fair to say that there has been a shift in the American position, which was the key position on this particular topic of concerted intervention (and, indeed, of intervention at all), which does emerge when you look at the absence of any reference to “disorderly markets” in the communique that came from the G5. So the answer to your question is that yes, I think that there is a greater readiness now to engage in concerted intervention than there had been hitherto.

Chairman: Thank you very much.

Mr Mitchell

27. Chancellor, can I give you an interpretation of events, as it seems to me, because I am sympathetic in some respects to what has happened to you, and it seemed to me that there is a kind of learning curve in operation? The pound was coming down gracefully, which had beneficial effects for British industry, and so you were happy to see that process going on. You were running for the first time an accommodating money supply policy by buying up commercial

purp

FROM : MISS J C SIMPSON
DATE : 3 DECEMBER 1987

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Geoffrey Littler
Sir Terence Burns
Miss Mueller
Mr Anson
Mr Cassell
Mr Monck
Mr Kemp
Mr Scholar
Mr Odling-Smee
Mr Turnbull
Mr Sedgwick
Mr Peretz
Mr Culpin
Mrs Lomax
Mr R I G Allen
Mr Pickford
Mr Dyer
Mr Cropper
Mr Tyrie
Mr Call

TCSC : AUTUMN STATEMENT HEARINGS

Mr Odling-Smee suggested that you might find it useful to have a brief indication of the particular interests of the new members of the Treasury and Civil Service Select Committee, in preparation for next week's hearings.

2. A note is attached. It should supplement the information included in the brief biographies attached to Miss Evans' note of 27 November.

JS

MISS J C SIMPSON

POSSIBLE INTERESTS OF NEW MEMBERS OF TCSC

Alan Beith (Berwick-upon-Tweed)

Used to be Liberal spokesman on foreign affairs, so most of his contributions in House related to overseas matters. Still foreign affairs spokesman at time of Queen's Speech, so spoke on that in debate. In questions following Autumn Statement, referred to 'inadequacies' of its response to stock market fall, and to its inability to counteract 'funding crisis' in NHS, schools and universities.

Questions during 1986-87 wide-ranging, but most frequent topics were health-related; SDI; nuclear issues and the coal industry. Spoke on Mr Barron's Private Member's motion on coalfield communities on 20 November.

Neil Hamilton (Tatton)

Speaks regularly in economic debates. Generally supportive of Government's policy. Asks questions about taxation (especially income tax, VAT and CGT). Other particular interests seem to be: BBC and broadcasting generally, censorship and coal industry. But interests wide-ranging.

Joyce Quin (Gateshead East)

Made maiden speech during Queen's Speech debate on problems of inability of depressed areas to attract new investment, and absence of any 'regional policy worthy of the name'. Also spoke in debate on British Shipbuilders. Questions already wide-ranging: overseas aid, impact of community charge, consumer protection, airtraffic control at Heathrow, environmental matters including forestry and pollution. Likely to show regional bias. Former member of European Parliament. Has already had one adjournment debate, on percentage of ERDF funds going to Northern region.

Giles Radice (Durham North)

Used to be Opposition spokesman on education. Had virtually no other interests during 1986-87 session. Seems not to have widened his horizons as yet - only major contribution in 1987-88 session has been on Second Reading of Education Bill.

David Winnick (Walsall North)

Wide-ranging, but mostly social issues related to pensioners (concessional TV licences, severe weather payments), immigrants, housing (especially rented), police powers and local issues. Spoke on need for adequate provision of public sector housing in Queen's Speech debates. Also interested in activities of MI5 and MI6 and the Wright case.

NEW
MEM-
BERS

prop

FROM: MISS C EVANS

DATE: 8 December 1987

MR A C S ALLAN

- cc Chief Secretary
- Sir Peter Middleton
- Sir Geoffrey Littler
- Sir Terence Burns
- Mr Anson
- Mr Cassell
- Mr Monck
- Mr Scholar
- Mr Odling-Smee
- Mr Turnbull
- Mr Culpin
- Mr Peretz
- Mrs Lomax
- Mr Moore
- Mr H Evans
- Mr Sedgwick
- Mr Bottrill
- Mr Hibbard o.v.
- Mr Gieve
- Mr R I G Allen
- Mr Pickford
- Miss O'Mara
- Mr Hudson 13/2
- Mr Cropper
- Mr Call
- Mr Tyrie

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TCSC QUESTIONS FOR THE CHANCELLOR . 9 DECEMBER

We have received from the research assistant to the TCSC the attached list of questions contained in the Committee's brief for tomorrow's hearing.

As usual the venue is Committee Room 8, time 4.45.

CE

MISS C EVANS

TCSC: QUESTIONS FOR CHANCELLOR

Monetary Policy

How is interest rate policy determined? What is the relationship between the level of credit and interest rate policy? (ref paragraph 1.53 of AS).

Exchange Rate

How far do published changes in Reserves reflect intervention?

When and how do you decide whether to use interest rates, intervention or a combination of both in exchange rate policy?

Is £/3 DM the right rate?

Economic Prospects

What is the effect of exchange rate appreciation on the Industry Act Forecast?

What will the effect be on the forecast £2½ billion current account deficit. [The chairman thinks the Treasury forecast is too pessimistic.] Why are exports forecast to grow by less than the growth in world trade?

Has the increase in competitiveness in 1986 been wiped out by the appreciation in the £?

Prospects for further falls in unemployment?

International Developments

(Questions use as their base the Chancellor's Mansion House speech). What do you think of the US deficit settlement? To what extent have the US authorities supported the dollar? [Fed announced on Friday

supporting dollar, President said \$ low enough.] Has the dollar *bottomed* out? What is the outlook for the dollar and US interest rates?

Louvre Accord

Chancellor in Mansion House speech reaffirmed Louvre Accord but suggested minor adjustment needed in light of recent events. *What adjustment?*

Are Japan and Germany doing enough?

SPARE

FROM MISS C EVANS
DATE 7 DECEMBER 1987

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Sir Peter Middleton
Sir Geoffrey Littler
Sir Terence Burns
Mr Anson
Mr Kemp
Mr Scholar
Mr Cassell
Mr Odling Smee
Mr Turnbull
Mr Peretz
Mr A Edwards
Mr Sedgwick o.r.
Miss O'Mara
Mr Pickford
Mr Bothill

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I attach notes of the main questions and answers at this afternoon's hearing. There were no great surprises. The most persistent questions were those on Louvre (Mr Sedgemore), and intervention (Mr Budgen), and on public expenditure priorities/NHS spending (Mr Winnick and Mr Beaumont-Dark).

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MISS C EVANS

TCSC : OFFICIALS' EVIDENCE : 7 DECEMBER

Mr Townend

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Sir T Burns gave oil revenue ready reckoner figures.

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Why no fall in 1989-90?

Mr Turnbull: step change this year. Can't expect slope to be as fast. Aim of reducing share over medium term. Doesn't imply commitment to fall in any particular year.

If plans are set in ratio to GDP terms does this not create uncertainties for individual Departments?

Mr Turnbull: Departments have 3 year plans in cash. No programme is controlled

as per cent of GDP. Ratio constraint sets overall envelope for Survey - not relevant to individual Department's plans.

Mr Higgins: Committee will pursue this point in PEWP enquiry)

Mrs Quinn

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Mr Turnbull explained Government's negotiating position. Alternative Budget proposals assessed as part of Summit briefing.

But would GDP basis favour UK?

Mr Turnbull said he was not expert but he thought it would.

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How sensitive is Treasury to public opinion, MPs' concern about NHS, 3 senior Physicians' letter etc.

Mr Turnbull: Survey collective process, decisions taken collectively. Public concern is a factor influencing Department's case in Survey. Treasury's job to ensure overall policy on public spending adhered to. Chancellor explained to Committee in 1984 - no utilitarian calculus for deciding public spending priorities - ultimately political decision.

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Mr Turnbull: As well as looking at demand pressures on NHS (inflation, pay, demography) need to look at resources available to it - not just cash increase

also productivity - NHS output clearly rising.

(Mr Winnick asked whether Treasury officials used NHS - Chairman ruled out of order)

Mr Watts

Chancellor said PSBR must be reduced to get interest rates down. Now forecast to be $\frac{1}{4}$ per cent of GDP yet interest rates remain historically high.

Sir T Burns: PSBR only one of many factors influencing interest rates. If PSBR still as high as it was there would be more upward pressure on interest rates.

So what determines interest rates?

Sir T Burns explained policy. Economy very buoyant, interest rates set at appropriate level.

But what is main determinant: exchange rate discipline or domestic conditions?

Pressures in different directions. Demand strong. Exchange rate strong. All factors taken into account. Can't give precise weights to factors. When interest rate changes Chancellor gives reasons.

Reasons for credit growth?

Sir T Burns: Financial liberalisation, mortgages have large effect.

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Sir T Burns: whole point of market oriented system is to allow individuals to make up own minds how much they can afford to borrow taking into account interest rates, income etc. Our job to ensure we maintain correct degree of pressure across the board.

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Chancellor implied on Weekend World PSBR could be £4 billion next year?

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General attack on Louvre.

Sir T Burns Don't recognise your description. Emphasise Louvre about both policy action and exchange rate stability. US deficit reduced considerably, Japanese domestic demand rising rapidly etc. Also achieved degree of exchange rate stability February-October.

Was there a private agreement on exchange rates conditional on expansion by Germany and Japan? And is dollar now falling to force them to act?

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Do you agree that after Wall Street crash US policy changed - moved away from holding dollar to necessity of maintaining growth?

Sir T Burns: Mr Baker said he did not want to raise interest rates - clearly US policy focussed on domestic economy.

Mr Peretz: But President Reagan said he didn't want dollar to fall further.

Since Louvre parties bought \$90 billion of assets which have now depreciated by 10 per cent. Might have been avoided if Americans had stuck to Louvre eg by increasing interest rates. Have the Louvre signatories been conned by the Americans?

Sir T Burns: True that at today's exchange rate we have sustained book losses. This is often the case with intervention but not necessarily true over longer period. Cost must be measured at point of unwinding the intervention.

But cost of intervention will be added to money supply?

Sir T Burns: Yes, in short term no need to offset but aim to offset over medium term.

Do you agree that when Americans started to tighten policy in spirit of Louvre this made an important contribution to the crash?

Sir T Burns: Don't accept this view. Tightening went on over a period but didn't cause crash.

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FROM MISS C EVANS
DATE 7 DECEMBER 1987

CHANCELLOR OF THE EXCHEQUER

[Handwritten red note: Low risk of [unclear]]

- cc Chief Secretary
- Sir Peter Middleton
- Sir Geoffrey Littler
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Sir T Burns: Mr Baker said he did not want to raise interest rates - clearly US policy focussed on domestic economy.

Mr Peretz: But President Reagan said he didn't want dollar to fall further.

Since Louvre parties bought \$90 billion of assets which have now depreciated by 10 per cent. Might have been avoided if Americans had stuck to Louvre eg by increasing interest rates. Have the Louvre signatories been conned by the Americans?

Sir T Burns: True that at today's exchange rate we have sustained book losses. This is often the case with intervention but not necessarily true over longer period. Cost must be measured at point of unwinding the intervention.

But cost of intervention will be added to money supply?

Sir T Burns: Yes, in short term no need to offset but aim to offset over medium term.

Do you agree that when Americans started to tighten policy in spirit of Louvre this made an important contribution to the crash?

Sir T Burns: Don't accept this view. Tightening went on over a period but didn't cause crash.

GORDON BROWN - INTERVIEW ON TREASURY SELECT COMMITTEE QUESTIONSTranscript from: BBC Radio 4 , Today, 9 December 1987

INTERVIEWER: (PETER HOBDDAY) The Chancellor of the Exchequer will be appearing before the Treasury Select Committee later today. Among other things he'll no doubt be explaining his plans to raise another £15 billion over the next 3 years through more privatisation. But that policy is obviously going to be closely questioned given the present situation in the market following the great crash and of course the situation with BP with the Kuwaitis owning quite a chunk and BP in turn bidding for Britoil. Well with me is the Labour Party's Shadow Treasury Secretary Gordon Brown. Mr Brown, do you think the Government is right to press on with privatisation because it is still quite a popular policy with the voters?

BROWN: Well even the most dogmatic supporter of privatisation should be demanding from the Chancellor a pause in his privatisation policy and a review, and for a number of reasons. First of all, he cannot raise the money that he expects to raise because the stock market has fallen by about 25% and he's not going to get the money he expected from the sales he's going to make. Secondly, we've had the BP flop and we've seen that people have been reluctant to buy these particular shares and we're also seeing large numbers of people leaving, voting with their feet, and leaving other industries where they've bought the shares. We see today that there's a huge problem emerging as far as foreign control of strategic assets are concerned. And not just do we now have something approaching 20% foreign control of BP what we have in the other industries is approaching 45% foreign control of Jaguar, an industry privatised, 15% British Aerospace, 20% Rolls Royce and probably about 10% foreign control of British Gas and British Telecom. And on top of that we've got the final problem he's got to address today and that is consumer

dissatisfaction with the performance of these privatised industries. And that's not just British Telecom, there are serious question marks now over British Gas as well.

INTERVIEWER: Obviously a lot on his plate as you see it. Let's take the BP situation first of all. BP, yes the Kuwaiti's are building up a chunk but BP in turn of course is bidding for Britoil which makes BP bigger and presumably gives BP a strategic advantage in the market place?

BROWN: Well to use Chancellor's words, I think he would call this a grotesque and absurd result of free market forces. Because what we've got is the smaller Britoil company about to be eaten up and therefore any questions of competition resulting from the privatisation of Britoil is lost. And we've now got BP in turn about to surrender to a large foreign stake from the Kuwaiti's on top of what is owned abroad already. So we've got BP, a strategic asset, moving into foreign hands at a rate which I see this morning is alarming the directors of BP themselves. And therefore the Chancellor's got to ask himself if he is going to privatise industries is he going to allow foreign powers or foreign companies to buy up very big stakes in these industries.

INTERVIEWER: But he would no doubt argue that well, look at the situation over British Airways for example in their bid for BCal, the SAS, the foreign bid is more than likely to be blocked or at least whittled down?

BROWN: Well that's precisely Mr Tebbet's

INTERVIEWER: And he's got the use of the Golden Share of course in Britoil where he can say stop we don't want any more. There is that protective device?

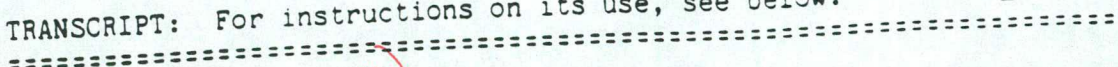
BROWN: Well Mr Tebbet is the person who's demanding that British Caledonian stay in British hands. But he doesn't seem to have made

the same demand about British Petroleum staying in British hands. And I would have been expecting some people on the Tory Party to say that oil is a very important strategic asset and should remain in British hands.

INTERVIEWER: You'll be asking him a lot of questions today won't you Mr Brown?

BROWN: Well we're going to be asking him also about the loss of privatisation revenues which he's got to answer very seriously.

TRANSCRIPT: For instructions on its use, see below. Ev 1



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HOUSE OF COMMONS
MINUTES OF EVIDENCE
TAKEN BEFORE

THE TREASURY AND CIVIL SERVICE COMMITTEE

MONDAY 7 DECEMBER 1987

SIR TERENCE BURNS,
MR A TURNBULL and MR D L C PERETZ

Evidence heard in Public

Questions 1-107.

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MONDAY 7 DECEMBER 1987

Members present:

Mr Terence L Higgins, in the Chair
Mr Anthony Beaumont-Dark
Mr A J Beith
Mr Nicholas Budgen
Mr Neil Hamilton
Ms Joyce Quin
Mr Giles Radice
Mr Brian Sedgemore
Mr John Townend
Mr John Watts
Mr David Winnick

Memorandum submitted by the Parliamentary Unit, University of Warwick on the 1987 Autumn Statement.

Memorandum submitted by the British Aggregates Construction Materials Industries.

Examination of Witnesses

SIR TERENCE BURNS, Chief Economic Adviser, MR A TURNBULL, Under Secretary, General Expenditure Policy Group and MR D L C PERETZ, Under Secretary, Monetary Group, H M Treasury, examined.
Chairman

1. Sir Terence, we are most grateful to you, Mr Turnbull and Mr Peretz for coming to give us evidence this afternoon on the Chancellor's Autumn Statement. It is of course some very considerable time since our predecessor committee had an opportunity to question the Treasury, or indeed to meet at all and there has been a very unfortunate long delay in re-establishing the Committee. Nonetheless, or perhaps because of that, we are particularly glad to see you this afternoon. There has been a very large number of interesting events taking place recently when we have not been able to pursue the normal matters via inquiry. Perhaps I might mention that given the pressure of time we would hope to report before Christmas in time for a debate on the floor of the House, but this will necessarily be done under very considerable restraints of time. We shall no

doubt wish to pursue a number of the aspects of these matters later on; as far as the public expenditure side is concerned, in the light of evidence on the Public Expenditure White Paper which we presume will be published fairly soon in the New Year. We may well wish to continue our inquiries into international monetary events where our previous reports have been indicated to a considerable extent by subsequent developments. It is also likely that we shall wish fairly soon to pursue our interest in matters relating to the European Economic Community. Today is really very much by way of first coverage of the situation. Perhaps I might begin by asking, given the fact that events have been moving so rapidly, whether there are any particular points as far as updating the Autumn Statement is concerned which was dated 3 November and whether you would wish to revise some of the views expressed therein?

(Sir Terence Burns) I have no further comments to make. Clearly things have moved on a little since the time that the Autumn Statement was published. We will be making our own update of that on the run up to the Budget, meanwhile I am afraid I do not have anything of substance to add. I try not to engage in the business of forecasting the forecasts at this time of year. It will not be very long before we set forth on the full round again. Obviously in so far as there are particular issues that you wish to raise we will do our best to answer them.

2. I am sure that there will be a great many. The Autumn Statement does actually say in paragraph 1.53 "The sharp fall in share prices will tighten monetary conditions somewhat. This will to some extent be offset by the recent fall in short term interest rates; and long term rates have also eased". Could you

X tell us to what extent the alterations in the forecast reflecting the stock market collapse and subsequent events does take place formally, that is to say, does the actual model cope with this kind of thing or are the adjustments made very much ad hoc?

(Sir Terence Burns) There are some effects directly leading from the movement of share prices ~~on~~ to various components of the ^{Model} market. These are particularly what have become known as the ^{"wealth"} "Walt" effects in the general discussion that has taken place since the decline of share prices. We think that we model that as well as the available information allows us to. We looked at it and asked ourselves to what extent it over- or under-estimates the position. In addition to that, and maybe much more important, is the whole general effect upon confidence of the very large changes that we have seen. Clearly they are not modelled formally; we have to make some kind of judgment about that. I could also point out that in addition to the change in share prices we have seen some other significant movements.

X As is mentioned in the Autumn Statement, there have been interest rate movements which tend to go in the other direction, as far as activity is concerned, to the fall in share prices, A and we have also seen some movement in the exchange rate of the dollar against the other major currencies which itself might be expected to have some effect upon the overall scene. It is a mixture really: in part we capture some of the effects through the formal modelling process, B but, as with many other things, we look at them in some detail and ask ourselves whether there are any other judgments that we should be making to take into account the speed of fall, what was taking place immediately before the fall and what general effect it may have had upon expectations.

Chairman: We shall probably wish to pursue a number of those points later on in our discussion this afternoon. It would, however, be appropriate to start off by looking at the particular issue/^{of} public expenditure and planning totals.

Mr Townend

3. The Committee were told on a number of occasions during the last Parliament that the Government worked on the principle that revenue should determine expenditure. Does that principle still hold?

(Sir Terence Burns) Yes. We have been through this issue a number of times in the predecessor committee. In broad terms it is fair to say that our position has not changed: our view on that has not changed.

(Mr Turnbull) We were trying to indicate a change in view that instead of building up plans from below and then subsequently finding the revenue to finance them the aim was to set a framework for expenditure, taxation and borrowing so that it was not simply taxation that was the residual from this process.

4. Should not the Treasury then provide more information on revenue so this Committee, for example, can ^{an} praise the expenditure figures rather more effectively?

(Mr Turnbull) ~~This was a subject which~~ the Chancellor spoke to the Committee ~~about~~ last year or the year before ^{on} the question of whether, at this stage in the year, there should be a revenue forecast. He took the view that there should not be a new revenue forecast at this time of year producing, as it would do, an estimate of the fiscal adjustment. He thought that was unhelpful, ^{as} ~~that~~ he was not taking decisions about taxation

at this stage and ~~that~~ it was liable to give impressions or signals about the future course of budgetary policy at a time when he was only just about beginning to address himself to those issues.

5. Perhaps you would agree that this year is an unusual year. Could you, for instance, give an estimate of what would be the effect of the fall in the dollar to date on North Sea oil revenues, taking into account the fact that the oil price has actually weakened as well?

X (Sir Terence Burns) There ^{are} ~~is~~ a number of things which have been going on. We have seen some modest changes in the oil price but it is really very little different to where we were at the time of the Autumn Statement.

6. But oil is priced in dollars and the dollar has slid significantly. That must have some significant impact on oil revenues must it not?

(Sir Terence Burns) Yes, there are some effects upon our oil revenue from the change in the sterling/dollar exchange rate but in terms of the movements we have seen I would not at this stage want to put a figure into circulation of the total impact of that upon our revenues for next year. A lot depends on just what happens to the exchange rate over that period.

7. You cannot give an estimate to the Committee today. or you do not want to give an estimate today.

X (Sir Terence Burns) It is partly a reluctance to get into the business of making assumptions ~~in the sense~~ of what would have happened to the exchange rate before and what we now expect to happen to the exchange rate. I am sure that we can provide you with a ready reckoner of what the impact is of a change of a dollar

on the oil price or a 10 per cent change in the sterling/dollar exchange rate if that would be helpful.

Mr Townend: Yes, that would be helpful.

Chairman: Certainly the figures in Table 1.10 show a change from £3.9 billion at budget time to £4.5 billion in the latest forecast. One presumes that has changed again in the light of changes in the dollar exchange rate since the Autumn Statement was printed. So if you could let us have a ready reckoner that would be helpful.

Mr Townend

8. The Government have changed their target for reducing public expenditure and are now working for a decline in public spending as a percentage of GDP rather than maintaining spending in real terms which was their previous objective. Does this mean that the Government have come to the belief that it is virtually impossible to maintain public spending in real terms?

(Mr Turnbull) I would not agree with either deduction or perception. ^{First} The record of ^{public} spending is that it is now growing more slowly than it ^{did} has done in either the four years to 1986 ⁻⁸⁷ or the four years to ¹⁹⁸²⁻ 1983, so the position we see is not one where expenditure in real terms is accelerating. The second question is that you described ~~this as~~ the Government ^{as (())} having ^{now} set this objective. It has been their objective ever since 1979 to reduce ~~public expenditure~~, public spending ^{The Government} as a share of national income. ~~What they have is that they~~ are running two concepts in tandem: one is a general objective which is the reduction of public spending which is defined in terms of the ratio of general Government expenditure to GDP. The second concept is the planning total which they use to

implement that general aim. It is not the case that they at one stage had one and not the other and they now have the other and not the first; they have both and always have had both. What has changed is the speed at which they were trying to reduce the growth of public spending. They have now accepted that a growth of 1.25 to 1.5 per cent in real terms, which is substantially less than the real growth of the economy, is something which is acceptable and which delivers their general objective for reducing public spending as a ~~ratio~~ ^{proportion of national income}. May I anticipate a further question. People will say that if you have this ratio and you use it as a target is it not a dangerous thing. Is it not procyclical? Does it not cause you to boost expenditure when the economy is growing rapidly? The second criticism of it is: is it not accommodating to inflation? The answer would be that if you used that ratio as your control target, yes indeed it would be but we do not. We have ^a ~~this~~ general objective, expressed in terms of the ratio, then ^{an} ~~this~~ intermediate target which is the planning total and that is in cash terms. That means that when you come to the Survey no programme has any right to additions, whether in response to high inflation or in response to higher output, they all have to be argued for from the cash base inherited from the previous Survey. It may be in the course of the Survey that Ministers decide that some additions to programmes and to the planning total are justified. But that is done as a conscious decision and is not conceded automatically as a result of operating the GDP ratio as a control target when in fact it is the way in which the general medium term objective is specified.

9. I am sure you would not want to mislead the Committee. You did infer that there had been no change of policy since 1979 but it is right, is it not, that originally in 1979 the Government's policy was to reduce public expenditure in real terms and then that was amended to maintain public expenditure at a constant level in real terms and then that was amended to reduce public expenditure as a proportion of GDP. So there have been subtle changes in Government policy since that day.

(Mr Turnbull) It has always been the case that the Government's objective has been to reduce ^{public spending} ~~it~~ as a proportion of GDP and that dates from 1979. What has changed has been the degree of ambition in that target, the speed at which the Government want to go about it.

10. Do you agree that originally the Government had the intention to reduce public expenditure in real terms and that has been accepted as no longer either possible or desirable?

(Mr Turnbull) It now accepts that some growth, but less than the growth of the economy as a whole, is justifiable.

11. So there has been a change of policy.

(Mr Turnbull) There has been a change of the setting of ^{but} policy, ^{but} the general objective of the Government ~~has~~ ^{has remained unchanged}

Chairman: Clearly slacker restraint includes the tighter one. Let us not spend more time on it.

Mr Townend

12. If the growth in GDP next year is much lower than is now forecast on the basis that the Government presently plan public expenditure, would you anticipate there would be a reduction in spending to keep it in line with the growth of GDP?

(Mr Turnbull) I implied the answer to that earlier. The use of this ratio is not a year by year controlled ~~at~~ total. If one adopted the position of following the course of the economy one would be acting in a pro-cyclical fashion.

It is the medium term path one is looking at ~~and if the economy grew more slowly...~~ The Treasury forecast does assume a slowdown in growth from the 4 per cent this year to 2.5 per cent next and that is in a sense built into the forecast. ^{expenditure plans} But you are asking what would happen if it slowed further, ~~and~~ There are some programmes that are affected, principally social security, but given the ready reckoner, the degree of sensitivity of expenditure to unemployment, one would not necessarily expect a large effect and I would certainly not draw the conclusion that an overshoot next year was unavoidable.

13. In Table 2.1.- public expenditure as percentage of GDP - there is no reduction between 1988-89, 1989-90; it would be possible in actual fact, if we do move into a recession, that public expenditure could rise in 1989-90 as a percentage of GDP.

(Mr Turnbull) We would need to have the economy slowing quite a lot beyond that which is already in the forecast.

Chairman

14. But the answer is yes. Is that right?

(Mr Turnbull) Obviously the answer is yes in the sense that it has happened before. It happened in 1981-82. There was a recession and the immediate effect of that was that the ratio rose during 1980-81, 1981-82, and has subsequently been coming down. ^{but} ~~So~~ this year it is now likely to be lower than at the start of the period.

15. But in 1981-82 it was against the policy that it should happen, whereas now you are saying that it would be desirable if it could happen. Is that right?

(Mr Turnbull) The policy is still, over a run of years, to bring this ratio down. It would be a disappointment if in any particular year the trend was actually upwards.

(Sir Terence Burns) In order to contain the flow of paper as far as we can I can now give you the ready reckoners about oil prices that I mentioned. For a one dollar change in the oil price with the exchange rate ^{up} change, we would ^{expect} get a number ~~round~~ about £300 million off the North Sea revenues in 1988-89, and for a 10 per cent rise in the dollar/sterling exchange rate for given oil prices we would get a reduction of about £ $\frac{1}{2}$ billion in 1988-89.

16. Thank you very much; that will certainly reduce the paper which the Committee are already finding substantial.

(Sir Terence Burns) As originators we are also aware of that.

Chairman: Yes, I assume that those producing it have as many problems as those receiving it.

Mr Hamilton

17. I should like to continue considering the Government's policy with regard to public spending as a proportion of GDP. Mr Townend pointed out that in 1988-89, comparing it with 1989-90, it is not expected that general Government spending as a proportion of GDP will fall but will remain constant at $40\frac{3}{4}$ per cent. I think you perhaps implied in your answer to him that this indicates that it is not necessarily the Government's policy in any individual year to see Government spending fall as a proportion of GDP but that

this is something which might be achieved over a period of time.

Would that be a fair way of expressing it?

(Mr Turnbull) Yes, it is a medium term objective and the precise figures attached to any particular year are only guidelines. In looking at a particular path, say between 1988-89 and 1989-90, one of the things one has to take into account is that in the current year 1987-88 there looks like being a very significant stepdown in that ratio. One should not ^{necessarily} therefore expect that, having had a step change down, necessarily the slope thereafter is as fast as it was previously, although it is the case that in 1989-90 we expect this ratio to be about half a percentage point lower than it was in the previous plans.

18. Could you tell me perhaps why you expect there to be no reduction in public spending as a proportion of GDP uniquely in that one year whereas in all other years either we have seen such a reduction or we expect it?

(Mr Turnbull) You can get variations in the path in particular years. ^Lit depends on the pattern of particular programmes. The most dramatic example of this is the pattern for ^{European} Community net contributions, given the way they are calculated and then abatements are paid. There is a very large abatement in 1988-89 and so you get a relatively small growth that year, ^{producing} and so the base is artificially depressed that year and then it is a larger ^{growth rate} figure in 1989-90. For that reason one cannot take the particular path down to the nearest quarter percent as being of particular significance. It is the general trend over a three or four-year period ^{that matters.} and between 1986-87 and 1990-91 we would expect the ratio - we prefer to express it excluding privatisation proceeds - to fall from about 44 per cent to 41½ per cent. That is a quite significant fall.

19. Have these estimates been affected in any way by the repercussions from the Wall Street crash and fallout from that? Do you still expect these estimates to be realised?

(Mr Turnbull) There are no direct links between these figures other than through the question of the BP shares. All these figures in the Autumn Statement assumed that there would be no BP partly-paid shares taken in by the Bank of England. However, in terms of the figures excluding privatisation proceeds, I cannot see any particular links at all.

20. If there were to be a downturn in the world economy which reduced our projected rate of growth of GDP what would that then do to the projected growth of Government spending? Would you not expect the one to fall and the other to rise and therefore to be an even greater/proportional rise in Government spending compared with GDP?

(Mr Turnbull) Arithmetically that is the case but the Chancellor does not accept that particular premise. He has expressed the view that provided policy, not only here but in other countries, is handled properly then a slowdown is by no means inevitable.

21. But if a slowdown did occur what would your expectation then be? That Government spending would rise as a proportion of GDP or that we could see further cuts in Government spending to maintain the percentage which is projected in the Autumn Statement.

(Mr Turnbull) I cannot in any sense prophecy what the result of the next survey would be. It would still be the case that over the length of a survey period the Government would want this downward trend to be maintained but that does not mean that it has

to follow precisely the path that has emerged from this last survey.

22. Could I ask a question on a slightly different tack but arising out of the Government's target of its expenditure as a proportion of GDP rather than producing targets in cash terms for departments to work to in any one year. Are there any particular difficulties that spending departments face in trying to estimate what their budgets might be in succeeding years because they have to do it on the basis of an estimate of growth and an estimate of a proportion of that growth rather than fixing a particular cash figure which they can then divide up into all the various functions that their departments have to perform and so within the total budget individual budgets can relatively easily be found.

(Mr Turnbull) Can I go back one stage. You referred to the ratios ^{as a} of target. In the generally accepted "managementspeak" I would not refer to that as a target: I would refer to that as an objective. One would have an aim of reducing inflation, making the economy function better: ^{and then} ~~this is~~ a general objective. ^{of reducing public spending as a proportion of GDP} The target in a sense, the precise figure that you are trying to deliver, is ^{the} a planning total. That is what the departmental programmes, ^{plus} minus the reserve, sum to. From ^{Departments'} their point of view the path in relation to GDP does not come into the equation at all. They have their three-year projections of cash figures and that provides the basis for ^{their} ~~them~~ for planning. ^{and} The presumption is that when the survey is rolled forward that is ^{the} a starting point. Circumstances change and in some cases they submit bids for additional expenditure and in some cases those are agreed to and in other cases refused. That is the basis ^{for} of their planning and it gives a reasonable degree of assurance to them.

23. I am interested that dart players in the Treasury do not have targets but objectives. I am wondering whether in setting expenditure targets of individual departments for years ahead any guidance is given as to what proportion of the GDP those departments' spending is likely to, or it is desirable that they should meet.

(Mr Turnbull) There are no programmes that are controlled in terms of maintaining a particular ratio to GDP, indeed there are virtually none where there is a target of maintaining it constant in real terms. The plans are set in cash terms and if circumstances change either in the form of higher or lower output, or higher or lower inflation their plans are their plans, and there is no automatic right of adjustment on either basis.

Chairman: That raises a number of questions we might wish to pursue on the Public Expenditure White Paper in rather greater depth. Could we turn to some particular aspects now affecting the European Economic Community.

Ms Quin

24. I should like to ask one or two questions about the assumptions which have been made in your Autumn Statement concerning the future financing of the EEC and in particular the assumptions that have been made concerning VAT. In paragraph 2.11 it says that you assume a continuance of the 1.4 per cent VAT ceiling. We should like to know whether you feel this is realistic in view of the fact that there is undoubtedly pressure within the EEC to increase spending and increase the size of the budget and also introduce new elements into the way the EEC is financed?

(Mr Turnbull) The position of the Government is that they have said they will not agree to a change in this proportion until satisfactory mechanisms have been introduced to provide proper control for agricultural spending. As you know, this weekend there were long discussions on that and agreement was not reached. I understand that the Prime Minister ^{will} make a statement about that tomorrow and they ^{European Council is} are to meet again in February. Meanwhile the status quo is that the figures are based on the assumption of 1.4 per cent. ~~On that basis~~ I cannot see how the UK Government could publish projections on any other basis.

25. Knowing what the pressures are for changes within the EEC have you considered what the effects might be or have you not done that at this stage?

(Mr Turnbull) I am sure that those who work on this have done all sorts of calculations of numerous different combinations of numerous different bases of financing. But in effect what is going on is a negotiation and in those circumstances the Government, quite rightly, do not publicise any other basis.

26. Nonetheless, one of the ideas that has been around for quite a long time relates to a form of payment which would involve the relative prosperity of the country in the EEC's league table and would relate to its level of GDP. Have any assumptions been made in the Treasury about that system being introduced?

(Mr Turnbull) Certainly work has gone on on differing bases as part of the briefing for the last two summits and certainly for the next one.

27. Would it be good news or bad news as far as the exchequer is concerned?

(Mr Turnbull) ~~I do not think it is any secret.~~

A The change in the basis ^{would be part of a} depends on the total settlement. You can have a settlement in which any one element is not favourable to you but the whole package is.

28. Would the GDP element work in our favour?

(Mr Turnbull) I am not expert enough to answer that but the answer is probably yes.

29. Have any assumptions been made as to goods which may have VAT applied to them which currently do not in Britain, in particular the cases currently being considered by the European Court and also the other cases which have been well publicised such as the pressure for VAT on books and newspapers and on food?

? (Mr Turnbull) The answer to all these is that they have almost all been examined. At this point you are getting into territory where you really need a European Community expert to answer them in so far as he can answer them without revealing the things Government do not want to reveal at this stage.

(Sir Terence Burns) As far as the calculations are concerned which are presented here in the Autumn Statement they are done on the assumption that the tax rates remain unchanged.

30. But the phrase in paragraph 2.11 is "a revised forecast of the UK's VAT base". What does that entail?

(Mr Turnbull) That refers to the fact that in calculating this one has to take account of the fact that the UK's growth rate relative to the growth rate of other members of the Community ~~is~~ ^{has} been revised upwards ~~relatively high.~~ Nevertheless part of the explanation for the increase in the provision made in 1988-89 and 1989-90 over previous

plans is the fact that our VAT base will be higher and our contribution correspondingly higher. That is just one factor ^{and} another is that we expect we ~~would~~ ^{to} receive a smaller proportion of total ^{agricultural} receipts ~~and~~ Both those factors are, even on the basis of 1.4 per cent contribution, worsening the net contribution.

Chairman

31. Could I just clarify that last point. Is it simply the wording in paragraph 2.11 is ambiguous? The final section reads "... reflecting higher customs duties and levies and a revised forecast of the UK's VAT base". Does it mean higher proceeds from customs duties and levies? Customs duties and levies have not been raised have they?

(Mr Turnbull) Your interpretation is correct ^{that it refers to} ~~that this~~ ~~is~~ higher proceeds and not higher rates.

32. It is a very slack piece of wording is it not? It does not say what you say it means. I am referring to the final sentence in paragraph 2.11 which reads "... an increase in our share of gross contributions, reflecting higher customs duties and levies and a revised forecast of the UK's VAT base" but there are no higher customs duties and levies are there? The rates have not changed.

(Mr Turnbull) Levies could have changed because of the difference between world and Community prices but the duties are unchanged and the VAT rate is unchanged. It is mainly a statement about proceeds.

Mr Winnick

33. As I understand it, priorities were only identified in the Treasury and not across departments. For example the nurses' pay had to be met from the existing health budget. Does that remain the position?

(Mr Turnbull) In any organisation one can choose the level at which one decides to conduct a debate about priorities. In any corporate structure I would imagine that one does not have a system in which any decision means subsidiary A has to be related to something in subsidiary F; that is an impractical way of working. So one has to provide successive tiers of decisionmaking. The factor you have referred to comes up in the discussion about the health programme. ~~In effect~~ In the course of a survey the health programme is in effect bidding against all other programmes, with the forces coming from higher pay for people who work in the Health Service being one of the main pressures that the Secretary of State for Social Services has got to take account of. That will affect the way in which he presents his case. There is no mechanism in which a particular factor of that kind can be related to something very specific in say the transport programme.

Mr Beaumont-Dark: I have never heard such gobbledegook. It is rubbish, it really is.

Mr Winnick

34. That is a very diplomatic answer and one which we all appreciate. Perhaps that will be a matter we can pursue with the Chancellor. Given the present crisis in the Health Service and the letter which has been published in the media from the Royal Colleges, how does that affect the department concerned? Are we being told that the sum of money in the estimates as far as this financial year is concerned for the health budget remains absolutely firm?

(Mr Turnbull) If you are talking about this particular year, it is always open to any Minister, if he feels the strength of argument is such on one of his programmes, to submit a bid to the

X Treasury as a claim on the Reserve. If he is arguing in the Survey context about future years one of the factors that will be taken account of in those discussions is the degree of public opinion. He is trying to persuade not just the Treasury but indirectly the remainder of his colleagues to back his case. If he can produce evidence from people like the Royal Colleges that strengthens his case in this argument ^{he can} ~~and~~ ^{it} feeds in as one of the factors that influences the decision.

35. You, the Treasury, are considered to be the villains so far as the Health Service is concerned, leaving aside other departments. If you take the crisis in the West Midlands Health Service the spotlight is on the Treasury because it is argued that it is the Treasury's policy which has resulted in the sort of situation which you have read about as much as the rest of us I am sure. What would be your response to that?

(Mr Turnbull) I would not accept the characterisation of the constitution as you are putting it.

36. So you do not think that the Treasury have any responsibility for what has occurred and the shortfall of funds?

(Mr Turnbull) Yes, the Treasury are part of a collective responsibility. This is a collective Ministerial decision and the Treasury are implicated in that no more and no less than the department sponsoring it or even Ministers collectively.

37. But in the negotiations which we all know take place between the spending department and the Treasury, clearly the wish of the Treasury is to limit the amount of money being spent. It is presumably the whole purpose of the negotiations. When you referred a moment ago to public opinion were you saying that in so far

as there is now increased public awareness of what is happening in the Health Service, the letter from the Royal Colleges, is a factor which the Treasury will be taking into consideration?

(Mr Turnbull) Certainly we are aware of influences of that kind and they affect the decisions which get taken. Ultimately the Treasury's job is to make sure that bids for different resources compete against other resources and we are trying to maintain some kind of envelope to ensure that the policy on public expenditure generally which has been endorsed is adhered to. But ultimately it comes down to the strength of the case that is made.

38. Is that case strengthened by what goes on on the floor of the House of Commons and by public opinion generally?

(Mr Turnbull) Most of the public services are determined by process of political judgment. When this Committee has discussed priorities before, as it has done several times, that has been made clear. ^{When} The Chancellor spoke to the Committee ^{in the hearing on the 1984} ~~in 1984 at this~~ ~~time of year~~ and he made it clear that most public expenditure

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~~time of year~~ and he made it clear that most public expenditure decisions are ^{political judgements} ~~to~~ use his words - "no utilitarian calculus that permits numerical comparison with ^{of the} respective benefit of say ^{extra} military aircraft as against more disaster relief or more equipment for research councils. There is, of course, extensive analysis and appraisal ^{but} and at the end there is a political judgment to be made".

(?)

The political judgment is affected by the case made by the people working within a particular sector and by the case made by MPs.

39. What a good civil service reply. I am sure we will be willing to pursue that in other quarters. I wanted to ask a related question on the increased takeup of benefits and the slowdown

in growth forecasts for 1988. Does the Treasury really expect spending on social security to decline by 0.2 per cent?

(Mr Turnbull) This is the figure for next year and there is a number of factors behind that. One is that the assumed level of unemployment for 1988-89 is lower than the level in 1987-88. Another is that one of the major benefits was frozen. So there are reasons why one would expect a slower growth in social security expenditure next year.

Mr. Beaumont-Dark

40. I get so confused at these things. As I understand it 76 per cent of hospital expenditure goes on wages and salaries. The so-called increase for the hospital service this year is some £700 million. I know the Government's main object is to reduce direct taxation which is £1½ billion per penny. Where is the extra wage increase for the nurses to come from? If the nurses only get a miserly 7 or 8 per cent that means something like £1½ billion will have to be found. Is there going to be in the Government's plans a genuine increase in expenditure upon the health of the people or are the wage increase to come off at the actual usage of the Health Service as it has for the last 12 months: there has not been a genuine increase? The Health Service actually has had less money because the money has had to go quite properly upon wage increases. Is there going to be a real increase or not or is that going to come out of this very sensible reserve that the Government have put on one side in the cocoa tin?

(Mr Turnbull) There are several ^{influences} inferences and several variables that one has to take.

41. I am only seeking information.

(Mr Turnbull) Which I shall provide. The resources available to the Health Service are ^{not only} the money provided in cash terms. One can deduct from that the general rate of inflation; one can deduct from that the effect ^{of} that the pay ~~is~~ rising faster. You might then say that only leaves so much but if you are going to present a true picture of what is going on in the Health Service you are going to have to take account of the fact that productivity ^{is} ~~does~~ actually ^{increasing} take place in the Health Service.

42. Do you mean people die faster or get treated faster?

(Mr Turnbull) If one is going to present a full picture of the demands on the Health Service in terms of inflation, the pay differential, the demographic factors, one has also got to present a true picture of the resources available to it and they are not simply the cash that is provided by Government. ^{But} At the end of the day what one looks at is the output which comes out of the Health Service. All the evidence is that the output that comes out of the Health Service is rising. The question is whether it is rising as fast as political priorities in the country as a whole or as fast as demand would wish it to, but undoubtedly the Health Service output is rising.

43. But a hospital is not the same as a factory. If you are going to treat more people you need more genuine money. It is no good saying that a surgeon should be docked 40 minutes for an operation so that he can get more throughput. If people need treating they need treating and the Government have got to wake up to the fact that if 76 per cent goes on wages you cannot go on giving 3.75 per cent increase/ ^{for} a 9 per cent wage increase. Pay the wage increases and possibly the Health Service will survive. If you do not

at least pay the wage increases the Health Service and the hospital service will not survive.

(Mr Turnbull) I do not recognise the figure of 3.75.

Mr Beaumont-Dark: In Birmingham we had 3.75 to a 9 per cent wage increase. That is why we are in such a terrible mess.

Chairman: These may well be matters to which we will want to return but we should move on now.

Mr Winnick: Would it be in order to ask - I do not know whether this is too personal - whether any of the witnesses before us actually use the National Health Service?

Chairman: That is not at all relevant to our consideration this afternoon. Let us turn to broader issues.

Mr Watts

44. Let us move to something for which you are responsible. The original version of the MIFS stated that "if interest rates are to be brought down to acceptable levels the PSBR must be substantially reduced as a proportion of GDP over the next few years". That was in 1980-81. According to the Autumn Statement the PSBR for the current year is now forecast to be £1 billion of one quarter of one per cent of GDP yet interest rates remain historically high in spite of recent cuts. Why should that be?

(Sir Terence Burns) Simply because the level of public sector borrowing is not the only factor which determines the level of interest rates. I have no doubts that had the level of public sector borrowing still been as high as it was at a time when the MIFS was first introduced we would have much greater pressure upon our level of interest rates. ^{even if} ~~Had~~ ^{had} we achieved the success against inflation that ~~had~~ ^{is} been achieved. It may have been that under a

different sort of regime one may not have^{had} that success against inflation. ~~It~~^{But the PSBR} is not the only thing that matters; I fully accept that.

45. What then is currently the prime determinant of interest rate policy?

(Sir Terence Burns) Interest rates are set in order to deliver the monetary conditions which the Chancellor thinks appropriate for the continuing maintenance of low inflation; and indeed to continue to bring down the rate of inflation. So you have to look and then ask what is determining the level of monetary conditions that we have. The fact is that we have had an extremely buoyant economy, an economy in which demand has been growing relatively rapidly and we have felt that these were the level of interest rates that were appropriate to that economy.

46. Within that generic term "monetary conditions" we are looking presumably at exchange rate levels and also at growth of money supply within the economy. Last year the Chancellor and you explained to us the connection between maintaining discipline on inflation through seeking to set certain levels of exchange rate so in the current climate which of those components of monetary conditions is the prime determinant of where our interest rates are?

(Sir Terence Burns) At the moment some of the different components of that assessment of monetary conditions are pointing in different directions. We have a fairly rapid growth of broad money, we have a growth of narrow money which remains within the target that was set, although it is within the upper part of that target. We have also been experiencing

relatively rapid house price increases which is something to which we would give some weight. On the other hand we have had a strengthening exchange rate, ^{and} we have had the significant reduction of share prices which would have to be set on the opposite side to that. Each of these factors is taken into account.

47. Which is currently being given the greatest weighting?

(Sir Terence Burns) There are ^{the} various factors concerned. I cannot give particular weights to them. We do not try to explain in great / ^{detail} or with any mathematical precision ~~which~~ ^{are} the weights that we give to the various factors. Usually though, when interest rates are changed, the Chancellor does offer some general explanation as to what have been the main factors which have caused him to take that action.

48. Looking at the demand for credit, how is that split between the domestic sector and industry and have there been any significant changes in the demand for those two sectors over recent years?

(Sir Terence Burns) In general ^{throughout} with the general liberalisation of financial regulations, ^{the} the whole of the financial system, credit has been growing fairly rapidly across the board. The biggest component, certainly on the personal sector side, has been a growth of mortgages but there has been a fairly rapid growth across the board. Part of the difficulty of interpreting the significance of that is that it has taken place against the background where there have been such large changes, ~~in a sense,~~ to the whole way in which the financial system has operated.

Mr Winnick

49. Is there any concern about the increase in domestic credit, leaving aside mortgages. There is a programme tonight on

"Panorama" that clearly there is increasing debt which in many cases people are unable to meet. We know the constant pressure from the banks and the rest to borrow, borrow and borrow. Is it the view of the Treasury that it is a desirable state of affairs?

(Sir Terence Burns) Within our system people make their own minds up about how much they wish to borrow, taking into account their income, their expected flow of income and interest rates. That has been the whole aim of the deregulation which has been to put these decisions back to both the individuals concerned and the institutions concerned. Our job is to ensure that in the process of that taking place we maintain the correct degree of total tightness of monetary conditions across the board. We leave individual decisions to be taken by the people concerned. That is the whole point of the return towards a more market orientated financial system.

Mr Watts

50. What information do you have about the elasticity of demand, particularly for consumer credit?

(Sir Terence Burns) By consumer credit do you mean the non-mortgage part of credit or do you mean the whole of credit which is taken out by the personal sector?

51. What I want to get at is the sensitivity to interest rates of demand for consumer credit and if you wish to take mortgages into that as well I am perfectly happy.

(Sir Terence Burns) We do not have any very precise estimates of those effects, largely because of the huge changes which are taking place in the system. The way in which we normally try to identify these effects is by going back and looking what has

happened in the past. We try to relate what has happened to changes in interest rates to changes in the amount of credit which is taken out, but when you ^{have} ~~get~~ large changes in the whole system of the kind we have seen in recent years, it makes the data much more difficult to interpret. We believe that there are effects from them and indeed within our own formal modelling of this we do have effects from interest rates onto the amount of credit outstanding, but I would not wish to imply that the this is a figure we ^{put} ~~put~~ on with any great confidence.

52. Would ^{your} model suggest that the recent 1 per cent reduction in interest rates would lead to a substantial increase in demand for credit?

(Sir Terence Burns) The direction would obviously be for greater amounts but I would not call it substantial.

Chairman

53. There is a figure in the model presumably?

(Sir Terence Burns) Yes. It varies across different components. For example we would put the effect of interest rate changes upon mortgages probably rather more than the effect of ^{on} some other component^s.

Mr Radice

54. Obviously the Autumn Statement has been very much overshadowed by the stock market crash and by the possible dangers of world recession as a result of adjustment in the United States, fall in the value of the dollar and so on. The Chancellor and the Prime Minister have been suggesting that the West Germans and Japanese take compensatory action. Would you not agree that the United Kingdom

as a member of G7 and one of the main economies - strong economies the Chancellor has often been telling us - which has much higher real interest rates than either the Japanese or the West Germans and a much higher level of unemployment actually is also in quite a good position to take some compensatory action?

(Sir Terence Burns) The statements which have been made by the Chancellor and the Prime Minister about Germany and Japan have related to the growth of their domestic demand, suggesting that it is important in this situation when US domestic demand may be slowing down that domestic demand in the other two big countries should grow faster. It is worth pointing out of course that in the UK there has been no problem of domestic demand being sluggish as from time to time there has been in Japan and for a good number of the recent years there has been in Germany. We have no reason to chastise ourselves about inadequate growth of domestic demand. Secondly, we have actually reduced interest rates here since October 19 rather more than they have done in Germany and Japan, so by that standard we have also certainly been playing our part. In the general terms of looking at G7 and asking who is doing their bit towards the growth of domestic demand we have nothing to be embarrassed about at all.

55. The argument for cutting interest rates is presumably not to reduce inflation.

(Sir Terence Burns) The interest rates have been cut because of an assessment that has been made of the implications of various developments for monetary conditions.

56. So that is in fact a new policy.

(Sir Terence Burns) No, this is very much the approach that has been taken for many years: we adjust interest rates in the

light of an assessment of monetary conditions. Our assessment in recent weeks has been that within that framework there was scope for lower interest rates so decisions were taken.

57. Given the fact that our real interest rates are in fact higher than in West Germany and Japan is there ^{not} a case for us reducing our interest rates further?

(Sir Terence Burns) On their own looking at real interest rates tells you very little about what you should be doing to your nominal interest rates. The crucial thing is what is happening to the economy generally, what is happening to monetary conditions. One country may be very buoyant and may be roaring away with quite ^{high} real interest rates: another economy may be growing rather sluggishly even with quite low real interest rates. You have to take that into account. Secondly, measuring real interest rates is itself an almost impossible activity because it should depend upon inflationary expectations which you cannot identify and which you can only guess at. If you look at our interest rates relative to the most recent inflation figures, we are a little bit higher than some countries, ^{but} we are a little bit lower than other countries. We are not terribly out of line. *I have some figures for real*

(Mr Peretz) Interest rates in G7 countries measured precisely in the way Sir Terence describes, that is short term interest rates divided by current inflation rate, ^{is} is an imperfect measure of real interest rates but it is one which is quite widely used. As it happens we are precisely in the middle of the G7 countries. There are three with real interest rates on that basis higher than us and three lower than us.

58. Do those include West Germany and Japan?

(Mr Peretz) Italy, Canada and France are higher than us. Germany, Japan and the United States, just, are lower than us.

Mr Townend

59. Could you just repeat the equation?

(Sir Terence Burns) It is looking at nominal interest rates minus the most recent 12-month inflation rate.

(Mr Peretz) Consumer price inflation rate.

Mr Radice

60. Thank you for those very pragmatic answers. Could I ask you something about the Government's fiscal plans. In the Autumn Statement / ^{they} put forward a forecast of a £1 billion PSBR for 1987-88 but I understand that the Government have now abandoned that. I understand that in "Weekend World" the Chancellor suggested it might well / ^{be} £4 billion PSBR for 1987-88.

(Sir Terence Burns) That is not my understanding.

61. That is not your understanding.

(Sir Terence Burns) No. In this document we have published a forecast for 1987-88 and we have an assumption for 1988-89. We chose to make the assumption for 1988-89 the same figure as we are looking for for 1987-88. As far as the PSBR for next year is concerned, that will be decided at the time of the Budget. The Chancellor made some comments, conditional statements, about how things may move if the economy slowed down rather faster than we were expecting. It may be that that you have misunderstood.

62. So in fact the Government would be prepared to run a larger PSBR if necessary. Is that right?

(Sir Terence Burns) He suggested that if output growth was to be somewhat less than we are currently looking for then one would expect the PSBR to come out a little higher than was currently

being assumed for next year but he also suggested that he would be very reluctant indeed to see borrowing rise above the one per cent of GDP which was set down in the MIFS.

63. What is the economic justification for having a higher level of PSBR at a time when economic activities are perhaps rather lower?

(Sir Terence Burns) The argument is that you should be aiming to bring down your level of borrowing, or to stabilise it, at whatever you think is the appropriate point when you have finally got it to that level. You should be aiming for that over the medium term. To the extent that activity may fluctuate in the short run and itself cause the tax collection and the expenditure level to fluctuate you would not necessarily want to offset that one for one in each particular year. There is no presumption that you should always automatically allow any of these effects to come through. Economists call them automatic stabilisers but it is a statement which is rather easier to make than it is computed. The presumption is that you would expect to see some effects from those although you would not necessarily expect to see them fully allowed for. In his statement he was giving some idea of the extent to which he might be prepared to go on that.

Chairman

64. Did the original medium term financial strategy include any such automatic stabilisers?

(Sir Terence Burns) They were certainly allowed to operate to some degree in 1981-82. If you recall, the first MIFS was in March of 1980. The PSBR for 1981-82, the following year, was put at a rather higher level than had been originally intended in

the March of 1980 and one of the reasons given for that was that activity was weaker. There is no presumption that you would necessarily allow the full extent of these activity changes to feed through into the PSBR.

Mr Radice

65. Thank you again for those very pragmatic answers.

(Sir Terence Burns) I am not sure what to make of this use of the word "pragmatic".

Chairman

66. The Committee has only recently been reconstituted and therefore the extent to which we discount expletives of various kinds, depending on who is using them in the Committee, will be something which we shall have to establish on a pragmatic basis.

(Sir Terence Burns) It is very unnerving when you think something was rather sensible and someone says it was pragmatic.

Chairman: It depends whether you think pragmatic is an insult or not.

Mr Radice: It is the highest form of compliment.

Mr Sedgemore

67. There is no need to be touchy. Some of us here cannot quite find the intellectual basis of your arguments these days and we think you do it by hunch, by guess and by God.

(Sir Terence Burns) That is what I thought.

68. Could I ask you about the Louvre accord. It seems to have been one of the least prescient and most disastrous accords ever entered into by human beings who claim to be rational. What are you going to put into its place? Are we going to see a new accord with new bands set at different levels or are we going to go back to floating exchange rates?

(Sir Terence Burns) I do not recognise the Louvre accord as described by you. The Louvre accord was an agreement which was put into place in February which had a number of components. Much of the communique, if you read it, is about the policy actions which the governments were intending to pursue in order to bring about a better balance between their economies. It also had a paragraph in suggesting that in current circumstances they would cooperate closely to promote further stability of the dollar.

Mr Budgen

69. Which paragraph was that?

(Sir Terence Burns) The one about exchange rate stability?

It is the final paragraph. I think you will find that it is paragraph 10. The first nine paragraphs are about the various policy measures which governments said they would take. You will find that most of the governments concerned have been moving policies in the directions as set out in the Louvre accord. As far as the exchange rate component is concerned we have actually had between February and the middle of October a period of considerable exchange rate stability, as it was supposed to be. So in both those respects I would have said that the Louvre accord had fulfilled its purpose. Of course, as we have seen, there have been some events during the course of October which have brought about circumstances which have led to changes in those exchanges. ^{rate.}

Mr Sedgemore.

70. Am I hearing you correctly? The Louvre accord served its purpose, given the US budget deficit, given the level of the dollar, given what has happened since, almost directly out of the

US budget deficit and the level of the dollar inside the Louvre accord: a crash on the world stock markets, a threatening world recession and it is serving its purpose?

(Sir Terence Burns) The first thing is that the US budget deficit was brought down very considerably this financial year. Secondly, we have recently had measures announced to make further progress against what otherwise might have taken place in 1988-89. We saw Japan take measures during the course of 1987, very substantial measures, in order to boost domestic demand within their country. I am sure you will have seen the most recent figures which suggest that domestic demand in Japan is rising relatively rapidly. During the course of the year also we have seen measures from Germany. They brought forward some of their tax reductions. They are all actions which you would describe as being within the framework of the accord that was made in February. In addition to that there was the objective of bringing about a greater degree of currency stability. That was also achieved between February and mid October. I would suggest that if you take the period from February to date you will find that exchange rates have been more stable than they were in the period that went before it.

71. Are you saying that it is a measure of success of an accord only entered into this year that in fact the dollar has gone completely outside of those exchange rates with horrendous consequences, with all the governments in the world talking about having new meetings already? You are describing that as some kind of success on exchange rates?

(Sir Terence Burns) First of all, governments frequently have these meetings, not only in circumstances where conditions are

X turning out unexpectedly. I was measuring the success in terms of the action that has been taken relative to the action that was promised in the accord. Very few people read the accord when they pronounce upon either its intention or its effects. Bear in mind also that back in the winter everyone was extremely worried about the performance of the world economy. Indeed right through February, March, April, there was a lot of concern because we had been through - indeed I think it was the Chancellor who christened it - the pause. Part of the problem was the adjustment to the lower oil prices, part of it we believe was the adjustment towards the very rapid change in exchange rates that had taken place. Within the post Louvre framework we have seen until 19 October a rather better climate altogether in terms of activity. We have seen strengthening activity in the United States. We have seen strengthening activity in Japan. We have seen the United Kingdom economy growing reasonably well. We then have the events of mid October which brought forth some changes in interest rates which themselves have then had some effect upon exchange rates. Even taking that into account, if you look at the volatility of exchange rates ^{over} at that period I would suggest that they are somewhat lower than they were in the period pre Louvre.

X
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X
72. Was there any possibility that when this accord was drawn up there was a private agreement that was never made public which was that the exchange rates which were fixed for the dollar would be conditional on Germany and Japan expanding their economies and what we are now seeing is that Germany and Japan did not do that and the Americans are now letting the dollar fall in order to force Germany and Japan to do what they originally privately agreed to do and did not do?

X X
X X
(Sir Terence Burns) As I have explained, both Germany and Japan did take action in the context of the Louvre accord, indeed I have already explained that in the case of Japan one can see the position has changed very startlingly. How much of that is the result of that we can only guess but certainly the Japanese economy at the moment is growing quite rapidly, which ^{was} ~~is~~ not ~~as~~ the position ~~was~~ at the beginning of the year. In the case of Germany, some action has been taken but the results of that have possibly been rather more disappointing than was the case with Japan. I do not regard that as deserving the description that you have given.

73. Could I ask some questions about intervention in relation to these bands? Have the Federal Reserve to your knowledge intervened to support the dollar?

(Sir Terence Burns) Since February?

74. Yes.

(Sir Terence Burns) Yes. The Federal Reserve publish their intervention with a delay of three months.

75. Since 19 October?

(Sir Terence Burns) You will have to put that question to the Federal Reserve.

76. You do not know the answer.

(Sir Terence Burns) I do, but it is not my position, I am afraid, to disclose that.

(Mr Peretz) The Americans have a practice of publishing their operations for three-monthly periods three months in arrears. So they have just published a piece in the Federal Reserve Bulletin about the period May-July in the October Federal Reserve Bulletin.

If the Committee/^{are} prepared to wait for a few months they will get an account of the more recent three months.

77. But you know what has been happening more recently but you will not tell us?

(Mr Peretz) Yes of course we do and of course we could not.

(Sir Terence Burns) Of course we will not. Sometimes answers to questions sound more flippant than they really are but there are some things which are within our ability to disclose and some things which are not.

Chairman

78. The Committee generally have accepted that if you do not feel able to answer we may need to and wish to pursue the matter with the Chancellor. We can take it from there.

(Mr Peretz) The Americans do publish their reserve figures every month. That does not necessarily tell you about intervention but it does tell you about changes in the Reserves

Mr Sedgemore

79. I am trying to find out whether there is an open conflict between the American authorities and the British authorities. It may be that the Americans have not intervened and they have been deliberately letting the dollar fall - perhaps for reasons I was mentioning just now - forcing it down or just letting it go and that the British have actually been intervening to keep the dollar up. I am trying to find out whether there is a conflict between the British Government and the American Government over intervention.

(Sir Terence Burns) No, there is no conflict over the intervention.

80. So they are acting in parallel. Whether they are intervening or not intervening they are both doing the same thing at the same time for the same reasons.

(Sir Terence Burns) Their actions have both been in the same direction.

81. I am reading this out but it strikes me as an interesting question. Paragraph 150 of the Autumn Statement points out that following the conclusion of the Louvre agreement "there has been a substantial inflow into the reserves amounting to some \$16 billion". The question down here which I am asking you is: to what extent does this reflect official intervention on the foreign exchanges aimed at supporting the dollar rather than holding the pound below three Deutschmarks? Is there any question of the UK buying dollars and switching them into Deutschmarks?

(Sir Terence Burns) ^{For} /most of the period since February exchange rates were relatively stable and therefore there was no difference in terms of intervening to hold our exchange rate against the dollar and intervening to hold our exchange rate against the Deutschmark. The differences only emerged in the middle of October, since which time it is fair to say it has been directed more towards the Deutschmark exchange rate than it has been towards the dollar exchange rate.

82. Have we been buying dollars and switching them into Deutschmarks?

(Sir Terence Burns) It is not the normal practice to disclose the operations of the reserve management. That is very much a question for the Chancellor.

Mr Budgen

83. I should like to ask you a bit more about these successes in the Louvre agreement. The Louvre agreement was not a treaty, it was not a contract and it was hardly an agreement. It set out a number of fairly loose statements of intention by the contracting parties and the only bit of substance was the last two sentences /of the last paragraph. Further substantial exchange rate shifts among the currencies could damage growth and adjustment prospects in their countries. In current circumstances therefore they agreed to cooperate closely to foster stability of exchange rates around current levels. That was taken to mean that they were going to defend the then level of the dollar, was it not?

(Sir Terence Burns) I am sorry but I do not know what it was taken to be; I am sure you can tell me.

84. Is it true, as was alleged by Mr Brian Redding quite recently, that official purchases, that is to say purchases by the countries at the Louvre agreement, amounted to a total of \$90 billion after the Louvre agreement?

(Sir Terence Burns) It has been very substantial and I have seen a number of figures in that region, yes.

85. Is it true that in October alone the published figures show that the British Government through the Bank of England purchased \$6.7 billion?

(Sir Terence Burns) Yes.

(Mr Peretz) Not necessarily dollars. There was an underlying increase in the reserves of \$6.7 equivalent in foreign currencies.

86. Some would have been Deutschmarks.

(Mr Peretz) I can help the Committee on one point which is no secret. Part of that was foreign proceeds of the BP share sale so it is common knowledge that some of that would have been yen.

87. That part of the picture we get are paragraph 1.50 in the Autumn Statement where you say that the reserves have enjoyed an inflow amounting to some \$16 billion. So the position is this, is it not, that after the Louvre agreement the high contracting parties set out to buy a very large quantity of dollars.

(Sir Terence Burns) I am not sure that they set out to buy them.

88. Well they did. Whether they set out to, they did, did they not?

(Sir Terence Burns) They did. no: ~~yes~~

89. Then after the crash on Wall Street the Americans decided that they were less concerned about the value of their currency than about the risk of recession. Is that true?

(Sir Terence Burns) If you will forgive me, I do not like this style of interrogation where various questions are put to me and I am asked to reply yes or no.

90. I am not asking you to confine yourself to yes or no. If the question is susceptible to a longer answer would you please give a longer answer.

(Sir Terence Burns) In that case I would rather the questions were phrased slightly differently.

91. It is in order and a perfectly civil question. Is it true that on your interpretation of American policy after the crash the balance of policy moved away from holding up the value of the dollar against other currencies and moved towards what they saw as the necessity of keeping economic growth going?

(Sir Terence Burns) There were several statements made by Secretary Baker that he was not prepared to raise interest rates and risk recession. Therefore in the changed climate of the time it was quite clear that interest rate policy has been directed more towards the domestic aspect of their economy than it has been towards the maintenance of the dollar exchange rate.

92. So the answer to my question is: yes, with qualifications. Is it not?

(Sir Terence Burns) It is.

Chairman

93. You have been given a perfectly fair answer. There is no need to push that.

(Mr Peretz) President Reagan himself made a ^{statement} ~~speech~~ at one point and said he did not wish to see the dollar fall any further. He made it very clear. X

Mr Budgen

94. So that meant that the contracting parties had bought about \$90 billion and they were left then with the Americans deciding that those purchases were going to be allowed to depreciate and they did, did they not?

(Sir Terence Burns) The market value of them is not what it was.

95. The market value of them has diminished by not less than 10 per cent in respect of the dollars value against each of the currencies in which the purchases had been made. Is that true?

(Sir Terence Burns) Broadly.

96. Ten per cent is rather too little actually is it not?

(Mr Peretz) Where were you measuring 10 per cent from?

97. I suppose from the moment of ---

(Sir Terence Burns) From 19 October?

98. But on the other hand the purchases were made before: between the Louvre agreement and 19 October. Roughly speaking they would all have suffered a 10 per cent loss.

(Sir Terence Burns) Yes.

99. A loss which, had the Americans adhered to the policy imperatives of the Louvre, might, just might, have been avoided. They could have put up their interest rates and from the point of view of people like you who believe in the efficacy of intervention presumably they could have purchased more dollars to drive up the value of dollars could they not?

(Sir Terence Burns) Yes.

100. The result is, if one uses the language Mr Beaumont-Dark uses, that the high contracting parties have been conned by the Americans, have they not? They have bought a lot of expensive dollars, the Americans have changed their policy and they are left sustaining very substantial losses.

(Sir Terence Burns) I do not accept the characterisation.

101. Which part of the analysis is wrong?

(Sir Terence Burns) The part which is true is that at today's market exchange rates there are some book losses on the intervention that has taken place. Also, this is very often the case with intervention in the period immediately surrounding the intervention and yet in a large number of cases when you look at it over a rather longer period of time of course it turns out to be rather profitable because you have to measure ~~the thing~~ ^{the intervention} relative to the point at which you unwind it.

102. It may come right, is what you are saying.

(Sir Terence Burns) It very often does.

103. The Chancellor has said that if it does not come right, the losses will be printed, has he not? What is in effect what he is saying when he says that the cost of intervention will not be sterilised in the market. /added to the money supply will it not?

(Sir Terence Burns) He would hope over the medium term to offset foreign exchange intervention by gilt sales but there is no need to do this necessarily in the year in which it happens; you can be slightly more relaxed over the timescale over which this takes place.

104. So it may be added to the money supply.

(Sir Terence Burns) In the short run it would be added to broad money.

105. And we must trust his stringent control of broad money to correct it later. Is that how it is to be put?

(Sir Terence Burns) Yes.

Chairman

106. Perhaps I might just add a postscript. When our predecessor committee discussed these matters some while ago we were told that there would be intervention as far as smoothing was concerned. Would I be right in thinking that policy changed at the time of the Louvre agreement? What was envisaged then was not simply smoothing but a longer term operation?

(Sir Terence Burns) It was an inevitable part of the Louvre agreement that we would see larger amounts of intervention, more sustained than we had done in the previous period. I emphasise that the Louvre agreement was not simply about intervention. It was

Is he talking about losses or gross intervention.

done by Coping

X about adjustment of underlying policies to correct imbalances; it was about the adjustment of monetary policy in general in order to achieve greater exchange rate stability, ^{of} ~~at~~ which intervention had to play a part. The characterisation that in some sense this was simply an agreement whereby governments would try to stick to existing exchange rates by ever increasing amounts of intervention is an incorrect characterisation of it.

Mr Budgen

107. Do you agree that as a result of the Louvre agreement in the period when the Americans were trying to follow it in the spirit of 22 February they put up interest rates and that had an important effect in causing the crash?

(Sir Terence Burns) I do not accept the second part. I do accept the first part. Inevitably as a part of the process of maintaining the dollar exchange rate they had to tighten their monetary policy. This went on fairly steadily over the period. There is nothing which could have brought you to believe that it would have brought about the conditions that suddenly emerged on 19 October. Indeed, obviously there is an awful lot of hindcasting that now takes place but that is all the fun of the fair is it not?

Chairman: We are most grateful to you for answering so many questions over a considerable period. We are grateful to your colleagues also. A number of these points we shall wish to pursue with the Chancellor on Wednesday on what is a very compressed timescale. We are particularly grateful to you for your efforts this afternoon. Thank you very much.

**BACKGROUND ECONOMIC BRIEFING
SELECTED STATEMENTS BY MINISTERS
ON ECONOMIC AND FINANCIAL POLICY**

ppp

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This issue contains statements on economic and financial policy made inside and outside Parliament. Factual statements should be checked before further use in case new information is available.

The selection in this issue covers statements made outside Parliament between 16 May 1987 and 8 October 1987.

The General Election took place on 11 June. The Queen's speech was on 25 June, and the Debate on the Address took place on the 25, 26, 29, 30 June, and 1, 2 July. The Second and Third Readings of the Finance Bill took place on 8 and 20 July respectively with the Committee of the Whole House on 16 July. The Conservative Party Conference took place from 6 to 9 October.

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1. ECONOMIC STRATEGY

Speaking to the Conservative Party Conference on 8 October the Chancellor said:

"The British economy is in better shape than at any time since the War."

During the Debate on the Address the Chancellor commented on changes in the economy since 1979:

"It is, however, a measure of the transformation that we have achieved over the past eight years that the whole tone and tenor of the economic debate have changed. In 1979 the questions were whether accelerating inflation was inevitable and whether the country had become ungovernable. Runaway price increases, balance of payments crises, and an appalling strike record seemed to be endemic features of British life. We were the sick man of Europe, and many thought that the illness was terminal.

By 1983 we had demonstrated that the answer to both those questions was an emphatic no, and the questions themselves had changed. In 1983 the question was how soon would the recovery peter out, or inflation take off again. It was thought that one or the other, if not both, must most surely occur.

By 1987 we had demonstrated, once more, that no such fate lay in store. The economic upswing that began a little over six years ago is today stronger than ever, while inflation remains low. Last week's figures showed a healthy rise in national output in the first three months of this year, to reach a level more than 4 per cent higher than a year ago, with manufacturing and services contributing in equal measure, and exports up sharply, too.

So now, at the start of our third term in office, the question has changed yet again. No longer do people ask whether Britain can have sustained growth without rising inflation. We have that, and everybody knows it. The question now is what is it that has brought about the remarkable transformation of our economic performance; and what is it that has brought about an unprecedented six years of steady growth and low inflation, with no sign of a let-up? ...

The answer to the question that I raised a moment ago about how we have achieved the transformation that we have brought about is clear. At the heart of our success has been a fundamental change of approach to economic policy. No longer do we rely

on the failed nostrum that it is Governments who can stimulate faster growth by expanding budget deficits, and no longer do we attempt to tackle inflation by distorting controls on prices and incomes, instead, we have used a firm monetary policy to control inflation, we have backed that up with a prudent fiscal policy that leaves room for the private sector to expand, and just as important, we have reformed the supply side of the economy. We have liberated the private sector from unnecessary shackles that have held it back for too long, we have restored incentives, and we have created the conditions in which enterprise can flourish - and it has."

[OR 2 July vol 113 no 10 cols 653-654]

The Queen's Speech said:

"My Government will continue to pursue policies of sound financial management designed further to reduce inflation and to promote enterprise and increased employment. They will maintain firm control of public expenditure so that it continues to fall as a proportion of national income and permits further reductions in the burden of taxation. Legislation will be brought forward shortly to implement the tax changes proposed in the last Budget but not yet enacted."

[OR 25 June vol 118 no 5 col 39]

The Chancellor added during the Debate on the Address:

"... There is now an international consensus on the importance of firm fiscal and monetary policies, backed by economic freedom and lower taxes, and privatisation is one of our most successful exports. These policies command the confidence of the British people."

[OR 2 July vol 118 no 10 cols 656-657]

Speaking at the Annual Dinner of the Finance Houses Association on 17 June the Chancellor set out some of Government's objectives for the third term:

"We embark upon our third term in office with an economy that is growing faster than any other major industrial country, with inflation low, and with living standards at record levels. The task for the third term is to ensure that this excellent performance is sustained, and to spread its benefits more widely still:

- to maintain the steady fall in unemployment;
- to extend further home ownership, share ownership, and pension ownership;
- to widen choice in the provision of education and housing;
- and to stimulate and accelerate the regeneration of our inner cities.

Speaking to the Keynes Conference on 15 September the Chancellor reached the conclusion that:

"We must direct macro-economic policy to the suppression of inflation and rely on micro-economic (or supply side) policy to provide the conditions conducive to improved economic performance in terms of growth and employment ...

... The Budget deficit, even without the benefit of privatisation proceeds, has been more than halved, and real interest rates have been consistently historically high, while a succession of supply side reforms designed to allow the market to work better have been introduced.

The result has not merely been five years of low inflation - though it needs to be lower still - but a sustained period of growth at some 3 per cent a year that is almost unprecedented in British economic history and during which we have out-performed most of our principal competitors."

GENERAL ECONOMY

2. Growth

During his speech to the Conservative Party Conference on 8 October the Chancellor said:

"This year, a full six years after the recovery from the recession began, it now looks as if we shall grow at 4 per cent, faster than any other major economy in the world. And we shall achieve this while resolutely keeping inflation low."

Speaking at the Annual Dinner of the Finance Houses Association on 17 June the Chancellor added:

"... We are now into our seventh successive year of growth, proceeding at a remarkably steady rate, in stark contrast to the faltering progress of previous recoveries for so much of the post-war period."

The Chancellor went on to say:

"One of the main reasons for this steady and sustained performance is that, unlike in the past, growth has been well balanced. Since the trough of the recession, in the first half of 1981, consumers' expenditure has gone up by an average of 3 per cent a year, whereas investment and exports have each gone up by 4 per cent a year. Last year did see investment and exports falling behind consumer spending, in large part because of

the pause in world economic growth which followed the collapse of the oil price. But this year, investment and exports are once again forging ahead: indeed the latest Investment Intentions Survey from the Department of Trade and Industry shows that industrial investment is expected to rise by no less than 8 per cent in real terms this year.

These figures clearly give the lie to the suggestion that the remarkable growth of the economy is at bottom nothing more than a credit-based consumer boom."

At a press conference on 25 May the Chancellor said:

"By the end of this year we shall have registered the longest period of economic growth at a rate of approaching 3 per cent a year that we have known since the War."

In his statement to the joint annual meeting of IMF and IBRD on 30 September the Chancellor said:

"The United Kingdom is now well into its seventh year of steady growth at 3 per cent a year. During that period there have been minor fluctuations, and after the slight spurt this year, I would expect something closer to the 3 per cent average rate next year."

3. Manufacturing

In reply to Parliamentary Questions on manufacturing the Economic Secretary said:

"... The rate of growth of manufacturing productivity in this country has exceeded that in every major industrial country, not excluding Japan, since 1979.

... Manufacturing industry is now increasing productivity. It is doing so because we have restored to management the power to manage and to trade union members the power to control their unions. As a result we have better industrial relations and greater incentives to increase production."

[OR 9 July vol 119 no 15 col 500]

Speaking to the Conservative Party Conference on 8 October the Chancellor said:

"In the eighties, manufacturing productivity in Britain has climbed right from the bottom of the league to the top. Right to the top. We have out-performed all the others, not just in Europe but the Americans and Japanese, too."

In an interview on BBC Radio 4's 'World at One' programme on 2 September the Chancellor said:

"The latest CBI survey shows that investment is set to rise, investment in industry in plant and equipment, to make us even more efficient, more competitive and more productive. That is likely to go ahead very substantially. Our manufacturing output is rising fast, indeed faster than that of any other major country at the present time. And so the economy is in very good shape and there's no question of some candy floss boom."

4. Balance of payments

In response to a Parliamentary Question on the level of United Kingdom overseas assets the Chief Secretary said:

"Net United Kingdom overseas assets are estimated to have increased from about £80 billion at the end of 1985 to about £110 billion at the end of 1986. This is equivalent to 28 per cent of GDP, the highest recorded level since the war."

[OR 9 July vol 119 no 17 WA col 257]

Answering a Question the Minister of Trade and Industry said:

"What matters most of all is the state of our manufacturing industry, which, as I have said, is increasing output and investment and has extremely good prospects for the immediate future in world trade. I do not accept that it is right, when we look at the whole range of economic indicators, to place excess weight on any one of them. At present, the economy has a good rate of growth, low inflation and improving productivity. It is a strong economy, and a quite disproportionate emphasis is being put on that one feature. Many wealthy countries go into deficit on manufactured trade from time to time, and, taken in isolation, that deficit does not justify the weight placed on it by the Opposition."

[OR 8 July vol 119 no 14 col 340]

5. Employment

The Parliamentary Under Secretary of State for Employment said:

"At March 1987 the latest estimates for employees in employment in Great Britain showed that there were 16.1 million full-time jobs and 5 million part time jobs. This represents an increase of 121,000 full-time and 607,000 part-time jobs since March 1983. Over the same period there has been an increase of 378,000 full-time and 117,000 part-time jobs in self-employment.

- More people are being employed in small firms, not least as many more new businesses start up, often choosing specialised niches in markets in which they have particular expertise. One study has estimated that firms employing fewer than 20 people created a million jobs in the period 1982-84.
- There are now three quarters of a million more self-employed people than in 1979 - an increase five times as great as over the whole of the previous thirty years.
- More part-time working is taking place, which suits both the needs of employers, and the preference of many people - particularly married women - for a part-time rather than a full-time job."

[OR 21 July vol 120 no 24 WA col 150]

In a speech to the Bury North Conservative Association on 16 July the Chancellor commented on the changing patterns of employment:

"The latest published figures show that self-employment in the United Kingdom has increased by over $\frac{3}{4}$ million since June 1979."

Answering a Parliamentary Question the Economic Secretary said:

"Self employment has increased by 40 per cent, which is five times the increase in self-employment that has occurred over the past 30 years."

[OR 9 July vol 119 no 15 col 496]

The Chancellor told viewers and listeners of BBC's "Election Call" on 26 May that:

"Job opportunities do exist and you only have to look at the advertisements in the newspapers these days - the job advertisements - to see how many more there are than, say, a year ago."

6. Unemployment

During his speech to the Bury North Conservative Association on 16 July the Chancellor said:

"Unemployment is falling faster than in any other industrial country."

He went on to say:

"It must be abundantly clear by now that the reason for high unemployment is not any lack of demand in the economy. We have already enjoyed a longer period of steady economic growth combined with low inflation than at any time since the War. Indeed, we now have the fastest rate of economic growth of all the major economies of the world. So it is clearly not a matter of inadequate demand. What, then is it?

One reason why unemployment has been slow to come down lies in the rapid growth in the labour force over recent years. Though growth in the labour force will eventually lead to a similar growth in the number of people in work, the adjustment is seldom immediate."

Speaking in the Debate on the Address the Chancellor said:

"The significance lies not in one month's figures, but in the trend of unemployment, which has fallen each month for the past 11 months. In the year to May 1987 unemployment has fallen by almost a quarter of a million. It is firmly established on a downward trend."

[OR 30 June vol 118 no 8 col 465]

The Paymaster General made the comment:

"We must in particular look very carefully at the labour market and the ways in which it works, because it clearly isn't working well enough. We have recently seen record falls in unemployment, and record levels of unfilled vacancies. But if unemployment is to come down more quickly, as we all wish, if there are to be more real jobs with a future in productive industries for our school-leavers to go to, and if the new jobs which are being created are to be secure, we need to give the highest priority to reforming the shortcomings of the labour market. One part of that - only a part, but a critical part - is to improve the ways in which pay systems work. The pricing mechanism is fundamental to the operation of the labour market, as to any other."

[Speech to the Conference of Company-Wide Incentive Schemes 15 July]

At the Bury North Conservative Association Dinner on 16 July the Chancellor said:

"Another important factor in the present high rate of unemployment lies in the changes that have taken place to the industrial structure of the country. The most notable of these has been the relative - and in some cases absolute - decline of traditional heavy industry and the growth of the service sector of the economy."

7. Inflation

During the CBI Annual Dinner on 19 May the Chancellor commented on inflation:

"... the outlook for inflation this year is now rather better than I forecast in the Budget. At that time, I said that I expected inflation to edge up for a time perhaps exceeding 4½ per cent by the summer, before falling back to 4 per cent by the end of the year. Now, though the profile will be much the same, I no longer expect the peak to exceed 4½ per cent, while the rate at the end of the year is likely to be below 4 per cent."

At the Conservative Party Conference on 8 October the Chancellor said:

"Let us be under no illusions. Inflation has been scotched, but not yet killed."

8. Pay

During his speech to the Conference of Company-Wide Incentive Schemes on 15 July the Paymaster General said:

"Although there are welcome signs of change, the rigidity of pay and the systems which determine it are still a major problem - perhaps the greatest problem which our economy faces."

Speaking at the CBI Annual Dinner on 19 May the Chancellor said:

"Wages in this country continue to rise faster than in our main competitors. While the sharp - and welcome - improvement in productivity has meant that the effect on unit labour costs is relatively modest, the fact remains, as the CBI has repeatedly made clear, that some deceleration in the rate of wage increases is essential if we are adequately to improve the competitiveness of British industry and speed up the creation of new jobs. It is the responsibility of management to bring this about."

9. **UK economy : International comparisons:**

During the Chancellor's speech to the CBI Annual Dinner on 19 May he said:

"The British economy today is stronger and sounder than at any time since the War. Indeed, it is a measure of what has been achieved that, for the first time for decades, the biggest source of concern about our continued economic success lies in fears that in a number of key respects the world economy may not perform as well as we ourselves are doing."

At the Joint Annual Discussion in Washington on 30 September the Chancellor said:

"Since the sharp fall in the oil price in 1986, the growth rate of the UK economy, so far from slowing down as was expected, has actually picked up. At the same time, the growth rate for the major industrial countries as a whole has been below expectations."

10. **North Sea oil**

Speaking to the Edinburgh Chamber of Commerce on 23 June the Chancellor said:

"There should be no doubt of the overall benefits of North Sea oil to Scotland and the UK as a whole ...

... But by the same token, this meant that the impact of last year's collapse in the oil price would inevitably be severe ...

... To assist the oil companies in adjusting to the new climate, I took steps to accelerate the repayment of Advance Petroleum Revenue Tax, to boost companies' cash flow and to reduce the risk of delay to worthwhile projects. This measure was worth some £300 million to the industry in 1986-87. In this year's Budget, I introduced two further tax reliefs to encourage new projects, which will, of course, benefit not just the oil industry itself but also the offshore supplies industry. These measures will help to keep together carefully nurtured UK capability for which further opportunities might arise."

MONETARY POLICY

11. General

At the Finance Houses Association Annual Dinner on 17 June the Chancellor said:

"Alongside reducing our own borrowing, we have removed a large number of administrative controls and directives, including hire purchase controls, which were inhibiting the free working of the financial system, and thus limiting the availability of finance and worsening the terms. The removal of these controls has not only improved the options for borrowers at home, but has significantly contributed to the growing importance of London among the leading financial centres of the world."

12. Interest rates

On 9 July the Economic Secretary told Parliament:

"As I mentioned, it is our policy to keep interest rates at a level sufficient to keep money GDP on a steady downward path and, therefore, to maintain downward pressure on inflation. We shall continue to do that ...

...Interest rates are not inhibiting output. Output is growing more rapidly and the CBI survey shows that investment intentions are very strong. The hon. Gentleman spoke about the remarks of the Bank of England. They were directed towards the prudential aspects of borrowing. Of course it is correct that financial institutions should look closely at the ability of borrowers to repay their debts and the effect that that has on their balance sheets. We support that."

[OR vol 119 no 15 col 505]

The Chancellor told listeners to BBC Radio 4's 'Today' programme on 7 October:

"Interest rates have to fluctuate in accordance with the needs of financial policy to keep everything on track. At the end of the day our success in getting interest rates down will be tied to our success in getting inflation down."

At the Press Briefing on the Washington IMF/World Bank meeting on 30 September the Chancellor said:

"... The determination of short-term interest rates is increasingly pursued with an eye to sustaining this exchange rate regime."

During an interview on BBC Radio 4's "World at One" on 6 August the Chancellor said:

"Throughout our time in Government one of our great successes, and I think this was important in the recent election victory, was in getting inflation down and keeping it down. And to achieve that you have to have sound financial conditions. And that means from time to time being prepared to put interest rates up whenever it's necessary to do so, just as at other times they can come down. This was a time when I judged it was right to move interest rates up a bit."

He later spoke on BBC'S "News Afternoon" saying:

"From time to time it is necessary to put up interest rates, at other times interest rates can come down. And this is one of those occasions when I judged that looking at the whole picture it was right to put interest rates up a bit."

13. Personal debt

At the Finance Houses Association Annual Dinner on 17 June the Chancellor commented:

"Personal borrowing has been growing at a faster rate but contrary to popular mythology the vast bulk of this is mortgages, which represented over three-quarters of all outstanding personal sector debt at the end of last year. Indeed, the increase in overall borrowing as a percentage of GDP in the 1980s is entirely attributable to the growth in mortgage borrowing, as a result of the 2 million increase in the number of families buying their own homes."

He also said:

"The reduction in public borrowing has reduced the public sector's demands on the capital and credit markets, and has indeed made room for higher private borrowing, which has risen from around 8 per cent of GDP in 1979-80 to over 10 per cent now. Indeed, it is striking how closely the paths of public and private borrowing are the mirror image of each other: as one has fallen, so the other has risen."

The Chancellor went on to say:

"Certainly it is necessary to take account of changes in the level and composition of credit, along with all other indicators, in assessing monetary conditions. In the past, I have not hesitated to act when I judged that there was a risk of being pushed off the path which I had set for inflation. Nor shall I do so in future."

14. Exchange rate policy

At his pre-Venice Summit press briefing on 2 June the Chancellor said:

"Exchange rate stability is my objective."

The Chancellor speaking at the CBI Annual Dinner on 19 May said:

"I allowed, last year, a proper adjustment in the exchange rate as we lost, in short order, half the value of our oil. I made clear in the autumn that the adjustment had gone far enough. I have made equally clear this Spring that I do not want to see it reversed. And I have shown, as plainly as possible, that I share the overwhelming view of British industry that a period of exchange rate stability is now highly desirable."

The Chancellor also said:

"So my message to industry is very clear. Do not expect me to bail you out, through sterling depreciation, if you let your costs rise too fast. That would be a surrender to inflation. But, equally, do not worry that I shall impose an unnecessary and undesirable squeeze on you either, whether through the exchange rate or in any other way."

The Chancellor told listeners of BBC Radio 4's "World at One" on 2 September:

"For the past 6 months or so we've been pursuing a policy of keeping the exchange rate stable - that's in the context of the international agreement reached in Paris in February of this year between all the major nations of the world. And that's been very successful and it's what business and industry want. But it does mean that in some months the reserves go down, other months the reserves go up. For the year as a whole so far our reserves have increased by very nearly \$10,000 million."

In his statement to the joint annual meeting of the IMF and IBRD on 30 September the Chancellor said:

"We have ... been prepared in practice to give significant weight to exchange rates in the conduct of monetary policy ... [and] to back up our agreement with co-ordinated intervention, sometimes on a substantial scale ...

... We can and should use the experience we have gained to build a more permanent regime of managed floating ... to maintain the maximum stability of key exchange rates and to manage any changes that may be necessary in an orderly way.

... It is important that we continue to keep an adequate degree of flexibility in terms of the width of the bands within which currencies are able to fluctuate. And, if and when the time comes to adjust one of the rates, that adjustment should be made by moving the mid-point within the confines of the existing range."

And at a press conference on the same day he said:

"We have to make sure not merely that there is exchange stability, but that this exchange rate stability is anchored. And ... the anchor has to be either looking at the path of money GDP for the Group [G7] as a whole or the average inflation rate, for the Group as a whole ...

... Concerted intervention is one essential element of the commitment. From time to time that intervention may need to be on a substantial scale. We would when the pressure is off take steps to sterilise the intervention. ... Once the thing has been in place and working satisfactorily for a sufficient time to have got a real degree of market credibility, then I think publication of the bands could become positively helpful ...

... The determination of short term interest rates is increasingly pursued with an eye to sustaining this exchange rate regime."

At a press conference following the European Summit on 30 June the Prime Minister said:

"We [the UK] will still take quite a long time to consider it [joining the ERM] and one day we will join, but they [... ERM countries] have got to come up to us on things like capital movements etc and no exchange controls."

On 15 June following ECOFIN the Chancellor said:

"It would have been too complicated to consider membership [of the ERM] before the election. Clearly now that [the General Election] is out of the way, it becomes something we can consider on its merits. That was the only change in the [Government's] position."

15. FISCAL POLICY

Speaking at the Finance Houses Association Annual Dinner on 17 June the Chancellor said:

"We have brought about a steady reduction in the PSBR, and last year it stood at a little less than 1 per cent of GDP. That is the level which I judge to be sustainable for the medium term, and I intend to keep it there."

In his statement to the joint annual meeting of IMF and IBRD on 30 September the Chancellor said:

"The United Kingdom's strong growth performance has not been brought about by any fiscal stimulus. The public sector borrowing requirement has in fact been reduced to less than 1 per cent of GDP. We have been able to bring down tax rates by maintaining a declining path for public expenditure as a proportion of GDP."

TAXATION

16. Income tax

During his speech to the Conservative Party Conference on 8 October the Chancellor said:

"We will continue to cut taxes in general and income tax in particular, bringing the basic rate down to 25 pence just as soon as it is prudent to do so."

The Chancellor replied to a Question on the reduction of income tax:

"I aim to reduce the basic rate of Income Tax to 25p in the £ as soon as I prudently can."

[OR 9 July Vol 119 No 15 Col 503]

The Prime Minister told readers of the 'Daily Telegraph' on 21 May:

"25p is quite a high starting rate. Don't take it as the final target. With your National Insurance contribution you're coming up to 35p in the pound. It's a hefty chunk."

At a press conference in London on 25 May the Chancellor said:

"We will have to look at what is the effect on the jobs market for people of very great talent when the Americans bring down their top rate, which they will do, to 28 per cent ...

We will obviously have to have regard to the brain drain and keeping talented people here. But there is no commitment on that front. I wish to see what the situation is then. But it is significant that in almost every country in the world now the top rates of tax are coming down."

The Financial Secretary gave the following reply to a Question on income tax in other countries:

"The lowest nominal rates of national income tax for the countries concerned are:

Italy	12%
Japan	10.5%
West Germany	22%
United States of America	11%
France	5%"

[OR 6 July vol 119 no 12 WA col 18]

17. **Burden of tax and tax reform**

During the Finance Bill the Financial Secretary said:

"In successive Budgets, the Government have held steady to the objectives of cutting taxes and simplifying the tax system to reduce distortion and lighten the administrative burden. Tax reform and reduction is a vital part of our overall strategy. We want to see a society in which enterprise is rewarded and where individuals are allowed to keep more of their money to spend or save as they wish. We want to provide greater incentives for individuals and their families. The pre-election legislation implemented vital measures to enable us to pursue these objectives. Overall, taxes were reduced by over £2.6 billion, the basic rate was cut by two percentage points to 27 per cent, inheritance tax was reformed and there was a package of measures to reduce the burden of VAT on small businesses.

The record is clear. Personal tax rates have been reduced and we have introduced reforms in business taxation that are being copied in other parts of the world. We have a system of business taxation that rightly rewards enterprise by allowing companies to retain more of the profits that they have made to spend as they wish, rather than the old self-defeating system that gave tax subsidies to encourage investment but taxed away the incentive to invest properly."

[OR 20 July vol 120 no 22 col 54]

See also:

- the extract from the Queen's Speech in paragraph 1.
- the extract from the Chief Secretary's speech in paragraph 22.

18. Reform of personal taxation

The Financial Secretary told Parliament:

"Following the publication of the Green Paper "The Reform of Personal Taxation" responses were received from around 70 organisations and about 400 individuals. Although a majority of those who expressed a preference favoured the introduction of a system of independent taxation of husband and wife with transferable allowances, the total number responding was low. In these circumstances we did not yet feel there was sufficient support to go ahead with so far-reaching a reform. We are exploring the possibility of finding a halfway house to the Green Paper approach. Ministers continue to receive correspondence on the issues discussed in the Green Paper."

[OR 9 July Vol 119 No 17 Col 255-256]

At the Conservative Party Conference on 8 October the Chancellor said:

"I agree that the existing tax treatment of married women is no longer acceptable, and that it will have to be changed."

19. Business taxation

On the merging of capital gains and corporation tax the Financial Secretary said:

"To the Government, that seems a desirable simplification. For small companies it will mean that the rate on capital gains is reduced to 27 per cent. With the reduction in corporation tax rate to 35 per cent, the difference between the capital gains rate and the corporation tax rate did not appear great, and it seemed a desirable simplification of the tax system to merge the two. For companies, there are often a wide range of choices as to whether gains are taken as capital gains or as income."

[OR 8 July vol 119 no 14 col 442]

20. Personal pensions

Speaking during the Third Reading of the Finance Bill the Financial Secretary said:

"At present, more than 10 million people are members of such schemes, [occupational pension schemes] but there was clearly considerable scope for much to be done. Some 10 million employees are still not in occupational schemes and make no private

provision for retirement. A central feature of our strategy is to bring private pensions within the reach of those employees, for two reasons: first, to provide them with a pension of their own, and, secondly, to increase their independence.

The new personal pensions will be available to all employees who are not in occupational schemes, to the minority of employees who choose to opt out of their occupational scheme and to the self-employed ...

...the Bill enables a much wider range of pension providers to establish personal pension schemes. As well as insurance companies and friendly societies, the field will be open to banks, building societies and unit trusts.

... During the debates in Committee, a number of hon. Members suggested that some aspects of these proposals - in particular, the rules on accelerated accrual of pensions - would restrict job mobility.

... I am still not persuaded that any change in our proposals is justified, but I can assure my hon. Friend and the House that we shall keep the position under review, and if the rules appear to have a wider and more adverse impact on job mobility than I expect, we shall urgently consider the case for modifying them."

[OR 20 July vol 120 no 22 cols 47-48]

21. Indirect taxation

The Prime Minister told viewers of Thames Television's "This Week Election Special" on 4 June:

"If anyone tried to put Value Added Tax on children's clothes and shoes, they would never, never get it through the House."

She added:

"Let me say to people I have undertaken not to do it on food - that was in right from the beginning - and on gas and electricity."

The Prime Minister re-stated her position to the House of Commons:

"I will repeat precisely what I said during the election campaign. We shall continue to have zero rating on food and that is crucial. The question then arises about electricity, gas and fuel. It is not our intention to put VAT on those. If anyone tried to put VAT on children's clothes and shoes, they would never, never get it through the House. I repeat that."

[OR 7 July vol 119 no 13 col 192]

She later said:

"I made it very clear during the election precisely what undertakings I would give. I also made it very clear that although there were certain people in this House, particularly right hon. Members on the Opposition Benches who wish to constrain the Chancellor of the Exchequer, it is not part of my duty to constrain him in his annual Budget."

and went on to say:

"With regard to the veto, I think he (Mr Kinnock) is referring to proposals that have come forward through the European Commission. They are not out in detail, but as he knows, partly due to our very vigorous fight on the Single European Act, any tax changes can be made only by a unanimous vote. Not only would this Government vote against Lord Cockfield's proposal, but a number of our European partners would do so as well ...

... we must be able to determine our own structure of VAT. A number of other countries also take the view that they must be free to determine their own structure, and they are just as much against the proposals as we are. The possibility of this going through is negligible."

[OR 16 July vol 119 no 20 cols 1270-1271, 1273-1274]

In response to a Question on the introduction of VAT on bus fares, rail fares, and newspapers the Prime Minister said:

"I am not quite sure to which of the three aspects the right hon. Gentleman is referring. He is probably referring to the proposal before the Commission that there should be some approximation of value added tax. That proposal could only be passed by unanimous vote of all countries. It is not a question of vetoing - we should vote against it. That is not a veto; it is a vote against. A veto is the phrase used for the Luxembourg compromise."

[OR 23 July vol 120 no 14 cols 443-444]

22. Profit-related pay

During the Second Reading of the Financial Bill the Financial Secretary said:

"We have sought to introduce profit-related pay because we believe that it can bring a much-needed flexibility to the labour market. Opposition Members have tried to characterise profit-related pay as a policy for low pay. However, profit-related pay seeks to make all pay - high, low and average pay - responsive to market conditions and the ability of firms to pay."

On 15 July the Paymaster General spoke to the Conference on Company-Wide Incentive Schemes:

"The incentive effects of PRP and the signals which it sends to employees will be the stronger, the higher the proportion of their pay which is profit-related. And when a significant element of total pay is PRP, it brings the added benefit of pay flexibility ...
... The effects of profit-related pay flexibility are simple. If profits improve, PRP will rise. So total pay will be higher than it would otherwise have been, but crucially that is because it has been justified by the competitive success of the firm. PRP is emphatically not about low pay. But of course, if times are difficult, total pay will be lower than it would otherwise have been. However, that in itself helps to offset the fall in profits, making output more sustainable and jobs more secure."

He went on to say:

"The idea of PRP is very simple, but putting it into practice may not be. But I hope employers are not going to be put off by that ...

... our traditional pay systems have not worked very well, for employers, employees and the unemployed. At best they convey a heavy opportunity cost, and all too often they carry a tangible cost in terms of lost output and redundancies."

He later outlined the new income tax relief:

"The purpose of the new income tax relief is to help the process of change ...

... I hope nobody will underestimate the value of the new relief. For a man on average earnings with 20 per cent of his pay as PRP, it would be worth the equivalent of 4p off the basic rate of tax. I hope that, seen in those terms, it is clear that it is not something to be taken lightly."

Speaking to the Wider Share Ownership Council on 9 September the Chancellor said:

"The objective of encouraging employees to identify more closely with the firms in which they work will also be helped by another major initiative I introduced in this year's Budget, concerning Profit Related Pay. Profit Related Pay reinforces the link between the employee and the company he works for, by making part of his pay vary directly with the fortunes of the business. This can also have a helpful effect on employment, by making firms readier to take on extra people when times are good, since their costs will automatically adjust when times are harder. In order to encourage the spread of PRP, I have introduced a valuable tax relief - worth up to the equivalent of 4p off the basic rate of income tax to a man on average earnings.

...There has been an encouraging response to my PRP initiative: over 20,000 employers ordered copies of the Inland Revenue's guidance notes before they were even published

... I would urge all employers who are thinking of participating, but have not yet done so to act quickly to register schemes with the Inland Revenue in time to offer this tax relief to their employees in the 1988-89 tax year.

I believe that PRP will complement employee share schemes and help to make employees identify more closely with the fortunes of their employer - an important objective of both. There are benefits from employees having a direct stake in the ownership of their company and a share in its capital growth, as well as having a direct link between their pay and the profitability of the unit where they work."

PUBLIC EXPENDITURE

23. General

On 23 July the Prime Minister announced:

"We had an excellent Cabinet meeting this morning. We issued a statement as follows:

"The Cabinet had its usual July discussion of public expenditure today ...

... It reaffirmed the policy that public expenditure should continue to take a declining share of national income, as set out in the last Public Expenditure White Paper"

[OR vol 120 no 25 col 482]

Speaking to businessmen in Huntingdon on 28 June the Chief Secretary said:

"In order to reduce taxes and hold down borrowing we shall stick to our objective of reducing public spending as a share of national income ...

The growth of public spending in the 1960s and '70s averaged around 3 per cent in real terms - substantially in excess of the growth of the economy as a whole. We have brought the rate of growth down to less than half that, so that it is now substantially less than that of the economy as a whole. Since 1982-83 public spending as a proportion of national income has been reduced from 47 per cent to 43 per cent. This year will see a further fall and our plans imply a continuing reduction to around 41 per cent, which would be the lowest level since the early 1970s.

We must not let the growing strength of the economy delude us into thinking that restraint of public spending is unnecessary, for it was that restraint which has produced that strength ...

But it will be clear from the Queen's Speech that there can be no blank cheques. This has never solved problems in the past and it will not in the future."

Speaking at the Conservative Party Conference on 8 October the Chancellor said:

"Throughout my time as Chancellor, public spending has each year taken a smaller share of the national income - the longest sustained fall for a generation. That restraint has been crucial to our success and you can be sure that we shall stick to it."

24. Health

At a press conference on 4 June the Prime Minister told the public:

"I, along with something like 5 million other people, insure to enable me to go into hospital on the day I want; at the time I want, and with a doctor I want. For me, that is absolutely vital. I do that along with 5 million others. Like most people, I pay my dues to the National Health Service; I do not add to the queue, and if I said, "Look, because I cannot come when you want me, I must come when I want to", you would accuse me of jumping the queue. I exercise my right as a free citizen to spend my own money in my own way, so that I can go in on the day, at the time, with the doctor I choose and get out fast.

It might be different if it were a very very complicated operation because, quite honestly, that is much much more expensive."

Later on she said:

"We took over a Health Service on which 4.8 per cent of GDP was spent. Now, it is 5.5 per cent. Not only have we increased the amount absolutely, but we have increased the percentage."

On 30 June the Minister for Health announced:

"From estimates provided by regional health authorities and special health authorities for the London postgraduate teaching hospitals, we expect new savings of some £39 million to accrue for the first time in the financial year 1987-88 from competitive tendering for cleaning, laundry and catering services. We also estimate that by the end of March 1987, annual savings generated by the competitive tendering initiative in England exceeded £93 million."

[OR Vol 118 No 8 Col 72-73]

The then Secretary of State for Social Services at a press conference on 4 June said:

"But the point that I am making is that we are increasing. The real growth of total health spending per head between 1978 and 1983 was higher in this country than in any other country in Western Europe. In other words, the real growth of total health spending per head between 1978 and 1983 was 21.29 per cent. So the increase under this Government has been a faster increase, certainly, than under Labour, but also than under European Governments as well. We are devoting an increasing proportion of GDP to health care in this country, not a decreasing one."

25. Education

During the Debate on the Address the Chancellor turned to education:

"The need to improve standards of education in Britain is as essential to our economic success in the world of tomorrow as it is to the quality of life in this country. The universities, and higher education generally, have on the whole reacted well in recent years to the need to become more responsive to their industrial hinterland, and it is up to an increasingly profitable industry to take greater advantage of what is now on offer, particularly in the field of research and development.

We have not seen a comparable improvement in our schools."

[OR 2 July vol 118 no 10 col 656]

26. Housing

During the Conservative Party Conference on 8 October the Chancellor said:

"It is not only the economy that has been transformed. It is society too. Above all, by the massive extension of ownership which is causing so much agonising among our opponents. Home ownership - for 2½ million more families."

Speaking in Bristol on 28 August the Minister for the Environment pointed out:

"I can see no arguments for generalised new build by councils, now or in the future. Receipts should not be used for new build and sale as if councils were a sort of property company. They can and should be used for repair of existing stock, some for sale and some to retain ...

... The next great push after the right to buy should be to get rid of the state as a big landlord and bring housing back to the community."

Later on he said:

"In the short term, many poorer people will still rely on the private rented sector, as they do now. Our major reform on the supply side of the housing market will be to free new tenancies from the restraints of the Rent Acts in order to encourage serious amounts of private capital back into the provision of housing for rent. One of the catastrophes of post war housing policy has been the rendering uneconomic of let property, except at the very top of the market. Year after year, so called fair rents have lagged behind any reasonable estimate of the increase in the costs of maintaining property, or any reasonable return on capital."

During the Debate on the Address the Prime Minister said:

"Our new task must be to extend the benefits of greater choice and independence to those in rented accommodation. Rent controls have reduced the private sector to a mere 8 per cent of the housing market, with the result that there is almost a municipal monopoly in rented housing. Too many tenants are confined to large monolithic and sometimes badly kept council estates. It is high time for town hall monopoly to be replaced by individual choice in renting. We shall therefore introduce major housing reforms in this Session.

First, we shall give council tenants - where they are dissatisfied with their landlords - the right to transfer to other approved landlords, such as tenant co-operatives and

associations. Secondly, urban development corporations have been successful in restoring derelict industrial areas, and we believe that a similar approach could be adopted for housing in some places. We will therefore take powers to create housing action trusts initially on a pilot basis - to take over and renovate areas of council housing in especially bad repair.

But wider choice in housing also requires a revival of the private rented sector. For new lettings I repeat, new lettings - we will therefore bring forward a series of proposals to reduce rent controls which have so greatly restricted the supply of homes for rent. Half a million private sector properties now lie empty, and our proposals will help to bring those back on to the market."

[OR 25 June vol 118 no 5 col 157]

27. Law and order

In a speech to the Crosby Conservative Association on 24 July the Home Secretary spoke about the prison building programme:

"We have increased the programme in each of the last two years. The existing building and refurbishment programme will create 17,500 extra prison places. Last week I was able to announce that there would be a further substantial increase in the prison building programme - an area of spending which we have already more than doubled since 1979. This represents a further major investment in the Prison Service."

28. Inner cities

On 28 July the Chief Secretary said:

"We can only tackle the problems of the inner cities by direct action to encourage local initiative, by giving people the opportunity to be self reliant. That is why the Government is investing so much in training the young, particularly the young of the inner cities."

[Speech to Women's Constituency Committee]

The Prime Minister told listeners of BBC Radio 4 on 12 June:

"The inner cities we have been trying to put a good deal more resources and new task forces in and start urban development corporations for some time but particularly in the last year. We stepped up the number of urban development corporations because

look at the fantastic success of Docklands and also stepped up the number of action teams because we found that some of the monies we were allocating to inner cities were not going to the projects which we felt would revivify and regenerate those cities."

The Prime Minister also told the House:

"I am sure that the hon Gentleman is aware that total expenditure on the urban programme in England increased from £93 million in 1978-79 to £324 million in 1987-88 - a 73 per cent increase in real terms. One of the difficulties about inner cities, as I am sure that the hon. Gentleman is aware, is that some councils are positively hostile to the private sector, which could solve their problems."

[OR 2 July Vol 118 No 10 Col 622]

29. Research and development

The Prime Minister commented on the Government's response to the First Report of the Select Committee of the House of Lords on Science and Technology:

"The response recognises the importance of increasing the civil share of the very substantial sums allocated to publicly funded R&D. The Government agree with the Committee that the main responsibility for investing in development rests with industry; its own role is to create a climate in which industry is encouraged to do so. Some sectors have responded and are increasing investment in R&D; others need to do more."

[OR 21 July vol 120 no 23 WA cols 2-3]

The Financial Secretary said:

"A recent Inland Revenue and Her Majesty's Treasury study "Fiscal Incentives for Research and Development Spending" reviewed the tax treatment of R&D spending in the United Kingdom and nine other OECD countries, including the United States of America, Japan, West Germany and France. In all the countries studied most research expenditure, being on current account, is allowed for tax purposes in the year in which it is incurred. In the United Kingdom this treatment extends also to trade-related capital expenditure on scientific research. The position in each of the other countries is described in the survey referred to.

International comparisons are difficult, but, broadly speaking, while the overall effect of the corporate tax systems in the United Kingdom, Japan and West Germany is more or less neutral in relation to R&D investments, France and the United States offer very small incentives to invest. The evidence of the cost-effectiveness of such incentives remains uncertain but in general it suggests that only one half the value of tax revenues forgone by companies to additional R&D."

[OR vol 120 no 25 WA col 229-230]

30. Value for money

Speaking to businessmen in Huntingdon on 28 June the Chief Secretary said:

"The benefits of the pursuit of value for money may not be as apparent as a new hospital or a new bypass, but let me assure you that its results are accumulating in an impressive way:

- £75 million improvements in government purchasing;
- £140 million a year saving from contracting out;
- £400 million from the cost improvement programme of the health service;
- we can now build four miles of motorway for the money which in 1978 would build only three."

31. Social services

Speaking on the future of the Welfare State to a Conservative Political Centre Conference on 26 September, the Secretary of State for Social Services said:

"Only a successful economy can afford to provide adequate welfare, whether through Government or otherwise. Wealth is a necessary precondition for welfare; and certainly the caring of politicians is of little use without the material resources to back it up ...

... For at least thirty years after the war wealth creation took a back seat to wealth distribution, and for a while looked in danger of being thrown out of the vehicle altogether."

He went on to speak about the Social Security Act:

"Under the new Social Security Act it will be possible, for the first time in Britain, for an individual to have his own personal pension, which he owns himself and can transfer from one job to another ...

... The Act also takes a step towards increasing independence, by reducing the disincentives to work that the poverty and unemployment "traps" set up, and by increasing the help available to working families on low incomes. In addition, the Act tries to lessen the dependent status of people who do receive benefit by providing a steady, regular weekly income which they have to plan and organise as do people in work."

LOCAL AUTHORITIES

32. Community charge

During the Debate on the Address the Secretary of State for the Environment spoke about the community charge:

"The community charge is a charge made for the services provided by a local authority. It is like a service charge, which is rather different from a poll tax. Against that background I must mention three allegations that have been made about it - curiously enough - mainly since the election.

First, the community charge is said to be inequitable between the north and the south. However, surely the right principle is that between two different areas, having taken account of differing needs through needs grant or the GREs, people should pay the same charge for the same level of services, except of course that the less well-off will be protected by rebates and up-rating of benefits ...

...Another argument is that it is inequitable that all should pay the same amount. It is simply not true to say that all will pay the same for local authority services. As I have said, those on low incomes will be protected by the 80 per cent rebate and the uprating of benefits by 20 per cent of the average community charge. Old people living in residential homes and the severely mentally handicapped will be entirely exempt. Students will pay only 20 per cent ...

... Secondly, about half of local authority expenditure will be met by the Exchequer, which is financed by a most progressive income tax. The better-off will certainly contribute more through the national tax system, but they will not have to pay a premium on top through the local tax system. That is as it should be. Redistributive taxation should be for one authority only - the Chancellor of the Exchequer."

FROM : MS L A HOOSON
DATE : 5 November 1987

SELECTED STATEMENTS BY MINISTERS

It has been drawn to my attention that one of the statements contained in the most recent edition of the Selected Statements is no longer accurate, and should not be used.

2. The statement in question was about the community charge by the Leader of the House, and is to be found on page 28 of the edition which covers the period 16 May to 8 October 1987. This statement starts with the words "I must say that the revelations of what the poll tax will be..." and ends with the sentence "That amounts to millions of people".

3. Could all recipients of the Selected Statements please delete this statement from their copies as soon as possible so as to avoid its accidental use.

Lynn Hooson

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LONDON SW1.

And in response to the allegation that the community charge is a tax on voting he said:

"That allegation is totally groundless for three reasons. First the right to vote will not depend on registration for or payment of the community charge. Secondly, it will not be possible to avoid registration for the community charge by failing to register to vote. Thirdly, there will be completely separate registers compiled on a different basis for community charge and for electoral purposes."

[OR 1 July vol 118 no 9 cols 536-538]

The Leader of the House provided some figures:

"I must say that the revelations of what the poll tax will be in some Socialist-controlled local authority areas relate to the level of spending of those local authorities more than anything else. The community charge will not be unfair because 69 per cent of single pensioners and 83 per cent of one-parent families will be better off. There will be generous rebates of up to 80 per cent for all those on low incomes. Income support levels will be increased to reflect the average charge. The severely mentally handicapped and old people living in homes and hospitals will also be exempt. That amounts to millions of people."

[OR 30 June vol 118 no 8 col 371]

PRIVATISATION AND WIDER SHARE OWNERSHIP

33. Progress and aims

The Chancellor commented during his speech to the Wider Share Ownership Council on 9 September:

"Britain's success in privatisation has led countries throughout the world to follow suit. Governments of all political persuasions, in developed and developing countries alike, are returning state-run industries to the private sector. And UK firms are in considerable demand as their advisers."

Speaking to the Conservative Party Conference on 8 October, the Chancellor said:

"The next five years will see the further steady onward march of privatisation and wider share ownership. The nation of owners we now are will ensure that the next generation is a nation of inheritors, too. The ultimate entrenchment of the property-owning democracy."

supporting dollar, President said \$ low enough.] Has the dollar bottomed out? What is the outlook for the dollar and US interest rates?

Louvre Accord

Chancellor in Mansion House speech reaffirmed Louvre Accord but suggested minor adjustment needed in light of recent events. *What adjustment?*

Are Japan and Germany doing enough?

Q: QUESTIONS FOR CHANCELLOR

Monetary Policy

How is interest rate policy determined? What is the relationship between the level of credit and interest rate policy? (ref paragraph 1.53 of AS).

Exchange Rate

How far do published changes in Reserves reflect intervention?

When and how do you decide whether to use interest rates, intervention or a combination of both in exchange rate policy?

Is £/3 DM the right rate?

Economic Prospects

What is the effect of exchange rate appreciation on the Industry Act Forecast?

What will the effect be on the forecast £2½ billion current account deficit. [The chairman thinks the Treasury forecast is too pessimistic.] Why are exports forecast to grow by less than the growth in world trade?

Has the increase in competitiveness in 1986 been wiped out by the appreciation in the £?

Prospects for further falls in unemployment?

International Developments

(Questions use as their base the Chancellor's Mansion House speech). What do you think of the US deficit settlement? To what extent have the US authorities supported the dollar? [Fed announced on Friday

pan

FROM: MISS C EVANS

DATE: 8 December 1987

MR A C S ALLAN

- cc Chief Secretary
Sir Peter Middleton
Sir Geoffrey Littler
Sir Terence Burns
Mr Anson
Mr Cassell
Mr Monck
Mr Scholar
Mr Odling-Smee
Mr Turnbull
Mr Culpin
Mr Peretz
Mrs Lomax
Mr Moore
Mr H Evans
Mr Sedgwick
Mr Bottrill
Mr Hibbard *o.r.*
Mr Gieve
Mr R I G Allen
Mr Pickford
Miss O'Mara
Mr Hudson
Mr Cropper
Mr Call
Mr Tyrie

TCSC QUESTIONS FOR THE CHANCELLOR - 9 DECEMBER

We have received from the research assistant to the TCSC the attached list of questions contained in the Committee's brief for tomorrow's hearing.

As usual the venue is Committee Room 8, time 4.45.

CE

MISS C EVANS

First, that the level at which we start to calculate agricultural spending in the future should be the bloated level of current overspending,

and second, a decision now to increase the Community's resources before we had established effective and binding control over the use of that money ...

... If the Council is really serious about getting its expenditure properly under control then it cannot possibly take decisions now on raising more money before it has demonstrated beyond any possible doubt that it is ready, willing and able to install foolproof mechanisms to prevent overspending."

On research and development, in order not to hinder work on agreed programmes, we proposed that spending could continue at present levels. The question of additional funds falls to be settled later, along with other decisions on future financing.

I made it clear that the United Kingdom would not agree to the new tax on oils and fats, which was proposed by the Commission and supported by France and others. I am glad to tell the House that it was not adopted ...

... On the 1987 Budget, the Council agreed to a solution on the lines we have advocated: Community funds for agricultural support, instead of being paid in advance, will now be paid in arrears. The Commission's proposal for an intergovernmental agreement to raise additional funds outside the Community Budget was rejected."

[OR 1 July vol 118 no 9 col 493-494]

Answering a Question on food surpluses the Foreign Secretary said:

"We are seeing worthwhile progress in the European Community in price reductions. For example, there was a 10 per cent reduction in grain prices last night. The next step will be taken at the GATT, where we shall table comprehensive proposals for the dismantling of agricultural protection. The tide is running for reform. That tide is being sustained by the imperatives of budgetary discipline. We have to keep it moving."

[OR 1 July vol 118 no 9 col 109]

The Prime Minister also said:

"Expenditure on the common agricultural policy totally unbalances the entire budget. Most of that expenditure does not go to farmers, but to maintaining or disposing of surpluses. The whole Community budget is 33 billion ecu a year, of which 17 billion ecu goes either to maintaining surpluses or to disposing of them. Because of that, we are trying to persuade our partners to our point of view, which is good shopkeeping and good housekeeping."

[OR 2 July vol 118 no 10 col 626]

The Prime Minister told the European Council in Brussels on 30 June:

"... The lack of unanimity stems from the United Kingdom's refusal to accept two things:

... the third element in the initiative - reduced interest rates on official debts - has proved the most difficult for other creditors to accept. But it is of critical importance if we are to make any real progress in easing the debt of burden on the poorest countries.

This is not some kind of optional extra: it is absolutely essential ...

... since 1982 the debt burden of the sub-Saharan African countries has increased by no less than 60 per cent. And the problem is still getting worse ...

... I can give a clear assurance that, provided all the other creditor countries are prepared to play their part too, the UK will contribute its share of the finance needed to enable the IMF to increase its lending at concessional interest rates. I have in mind a UK contribution of up to thirty million dollars a year, which would support an outstanding level of concessional lending of up to \$500 million ...

... The UK already directs a substantial part of its aid programme to support adjustment in sub-Saharan Africa, in close coordination with the Bank and Fund. Over the last two years, we have committed £161 million in programme aid to sub-Saharan Africa, of which £138 million has been directed to Commonwealth countries."

49. EC

In a statement to the House on the Brussels European Council the Prime Minister said:

"We were not prepared to accept that there should be a decision now on the size of Community resources. We have made it clear throughout the discussions that it is necessary, before that question is addressed, to have agreement on effective and binding control over Community spending, including, in particular, agricultural spending. Secondly, we could not accept that the level from which we start to calculate agricultural spending for the future should be simply revised upwards to include every element of overspending in the current year.

... The Council reaffirmed the importance which we attach to meeting the target of removing, by 1992, the remaining barriers to trade within the Common Market. We should look for decisions by the end of 1988 on product standards, the wider opening of public contracts, the liberalisation of capital movements, insurance, and the mutual recognition of qualifications. These measures, by leading to a freer flow of goods and services and opening up a genuine single market, would help the creation of wealth and jobs.

sub-Saharan Africa. There is simply no way these countries can ever service their debts in full, and most of their debts are due to Governments and official institutions not to banks. That is why, for these countries, I put forward a three-point plan at the spring meetings of the International Monetary Fund this year.

First, I asked the creditor Governments to continue the process of converting old aid loans into grants. The United Kingdom has already done that on a substantial scale. I am glad to say that a number of others are now following suit.

Secondly, I urged the creditor Governments to agree to reschedule the debts of sub-Saharan African countries over longer periods than before, with grace periods for the repayment of capital. Since I put that forward, I am glad to report to the House that the so-called Paris Club of creditor Governments has agreed four such reschedulings. I look forward to more.

Thirdly, and absolutely crucially, I argued that we have to consider reducing interest rates on official debt to well below market rates for those countries. That is the only way that we can permanently lighten the burden on the poorest countries, rather than just rearranging it. That costs money, but at the end of the day it amounts to little more than facing up to reality. I take considerable satisfaction in the fact that the idea was given a fair wind at the Venice summit last month, and is reflected in the communique from that summit. I look forward to progress before the end of the year.

Finally, we are now beginning to look at ways of applying similar principles to the arrangements made by the poorest countries with the IMF. Here, too, the Venice summit promised work in the spirit of the ideas that I canvassed in Washington in the spring. There is still some way to go, but, step by step, we are demonstrating that the political will is there."

[OR 2 July vol 118 no 10 col 657-87]

Speaking at the Commonwealth Finance Ministers' Meeting on 24 September the Chancellor said:

"For most of the debtor countries, the amount of debt outstanding has actually risen in relation to the size of their economies. Countries with recent debt servicing difficulties have seen their debt to GDP ratio rise from 44 per cent in 1982 to 53 per cent this year ...

... in the spring of this year, I launched an initiative for lightening the debt burden on the poorest, most debt-distressed countries in sub-Saharan Africa ...

... on the specific proposals in the initiative I can report useful progress on the first two ...

48. Debt

The Foreign Secretary commented on the debt situation in discussing the outcome of the Venice Summit:

"The amount of time that we devoted to discussing the problems of developing countries, in particular debt, reflects the importance that we and all summit countries attach to the economic progress and stability of those countries. While underlying the continuing appropriateness of the case by case strategy, with its central roles for the IMF and World Bank, we recognised that the problems of sub-Saharan Africa were unique and deserved special treatment. The Chancellor's initiative for granting debt relief to those of the poorest developing countries undertaking adjustment efforts was given broad support and we welcomed the proposal by the managing director of the IMF to increase substantially the resources of the structural adjustment facility, which lends on very concessional terms to the poorest countries."

[OR 1 July vol 118 no 9 col 109]

The Minister for Overseas Development said:

"The unilateral imposition by debtors of repayment ceilings risks damage to their long-term creditworthiness and can hinder their development. I would prefer to see the genuine problems of the poorest and most indebted countries settled by joint action on the part of creditors.

Proposals made by the Government for easing the debt burden of certain sub-Saharan African countries received broad support at the Venice summit."

[OR 29 June vol 118 no 7 col 251]

During the Debate on the Address the Chancellor said:

"There remains the problem of managing the huge debts that were accumulated by many developing countries in the 1970s, and here there have been a number of encouraging developments, all in the direction of greater realism.

... The commercial banks have used the five years since the debt crisis broke to strengthen their balance sheets considerably. I welcome unequivocally the steps that the banks have taken. I hope too that they will open the way to developing more market solutions - for example, an improved secondary market in some of the debts that are owed to the banking system. But we have to recognise that that process will not meet the needs of the poorest and most heavily indebted countries of

"The key to long-term growth is the supply performance of our economies. Experience all around the world has shown how this can be helped by deregulation, by privatisation, by increasing competition, and by facilitating the free flow of goods, of services and of capital. These supply-side policies need to be pursued within a stable framework of fiscal, monetary and exchange rate policy."

47. Protectionism

At the CBI Annual Dinner on 19 May the Chancellor made the point:

"...As for protectionism, that is no answer at all. For nations as powerful as the United States and Japan to make their markets less, rather than more, free would not be a sign of virility, but rather an admission of defeat. And the effect would inevitably be to provoke retaliation and counter-retaliation, with the risk of plunging the world into a disastrous trade war."

Following the Venice Summit the Foreign Secretary commented on protectionism:

"We noted with concern rising protectionist pressures, and reaffirmed our commitment to maintaining and strengthening the multilateral open trading system through the Uruguay Round of the GATT. We agreed to table a wide range of substantive proposals in Geneva over the coming months. Progress in the Uruguay round will be kept under close political review. We regarded a strong credible GATT as essential to the well-being of all trading nations, and the best defence against mounting protectionist pressures."

[OR 1 July Vol 118 No 9 WA Col 109]

Answering a Question the Minister of Trade and Industry said:

"This country, more than most countries, has an interest in a liberal trade regime, with free trade between countries. Our response to free trade if we are in difficulties should be to improve the competitiveness and keep down the unit costs of our products, and improve their quality. Obviously, however, on some occasions unfair trading practices arise and our interests are exposed to dumping. That includes selling below cost, and other improper trading practices. It is only right that the British Government should act promptly, and expect the European Commission to do so, when our industries are exposed to that kind of unfair competition."

[OR 8 July vol 119 no 14 col 340-341]

INTERNATIONAL DEVELOPMENTS

45. World Economy

Following the Venice Summit the Foreign Secretary made a statement:

"On economic policy, we acknowledge the positive developments over the past year. Growth has continued into its fifth year, inflation continues to fall, interest rates are generally declining, and exchange rates have reached more appropriate levels. But we recognised that the world economy still faced a number of challenges: large external imbalances, continued high unemployment, large public sector deficits, and interest rates that are still too high in real terms. We welcomed the clear undertakings by both surplus and deficit countries to reduce imbalances and the agreement recorded in the economic declaration on strengthened arrangements for multilateral surveillance and greater co-ordination of our economic policies to strengthen the world economy. We also agreed to continue to co-operate closely to foster stability of exchange rates."

[OR 1 July vol 118 no 9 WA col 109]

During the Debate on the Address the Chancellor said:

"The chief causes for concern are, first, the threat of a slowdown in Germany, Japan and the United States; secondly, the risk of a slide into protectionism; and, thirdly, the continued difficulty of managing the international debt problem ...

...The agreement that we reached in Paris in February to stabilise exchange rates has been an undoubted success, despite widespread initial scepticism in both the markets and the press. What we have to do now is to ensure the full and speedy implementation of the policy commitments which backed it up. That means, in particular, reducing the budget deficit in the United States, and reducing and reforming taxation in Germany and Japan.

Meanwhile, we simply must not allow the world economy to be side-tracked into a retreat into protectionism. That would solve none of our problems, and aggravate many."

[OR vol 118 no 10 col 657-80]

During his speech to the Interim Committee of the IMF on 27 September the Chancellor said:

of overall living standards - was higher in Scotland than anywhere in the UK apart from the South East and East Anglia. And average male earnings in Scotland have consistently been higher than in any other part of the UK outside the South East ...

... Many of Scotland's traditional manufacturing industries have experienced difficulties and closures. Meanwhile, new industries have grown up, and the service sector has expanded. And the development of the oil industry has had a particularly marked impact on Scotland ...

... Governments cannot sensibly stand in the way of long-term developments in the industrial pattern of the world, either by trying to cut their people off from the competition from the newly industrialising countries, or by artificially shoring up domestic firms. That approach merely makes the inevitable decline more traumatic when it finally occurs.

Nor can Governments by themselves regenerate the economy of an area and create new jobs, through the means, which is so often urged on us, of higher public spending ...

... Within manufacturing, the new technology industries now employ more people than all the traditional heavy industries combined. Output in the micro-electronics industry more than doubled in real terms in the four years between 1981 and 1985. And total sales by the electronics industry are estimated to have reached £2.3 billion in 1984, representing 13 per cent of total sales of Scottish manufacturing industry. More semi-conductors are produced per head of population in Scotland than in any other country in the world - five per head per week, compared with three in the USA and $3\frac{1}{2}$ in Japan.

The development of the electronics sector has demonstrated how, given the right economic conditions, a new industry can emerge."

The Minister of Trade and Industry commented:

"We have a national economy that is plainly thriving, with rapid economic growth, stable and low inflation and falling unemployment across the country. We now have to concentrate on ensuring that the success that we can achieve by reviving the wealth-creating process and encouraging and stimulating the enterprise economy is extended to the depressed towns in parts of the north and Scotland and to the inner-city areas, which run the risk of being excluded from economic advance if we are not careful."

[OR 29 June vol 118 no 7 col 345]

- VAT registration and deregistration thresholds increased broadly in line with inflation;
- Enterprise Allowance Scheme expanded;
- employee share schemes: improved access for unquoted family companies, employee controlled companies, worker co-operatives;
- Loan Guarantee Scheme extended and premium halved.

1987 Budget

- small companies' CT rate reduced to 27 per cent;
- unincorporated businesses benefit from income tax basic rate cut to 27 per cent and indexation of the tax threshold;
- package of measures to lighten VAT burden on small businesses including: cash and annual accounting for businesses with turnover up to £250,000; registration threshold increased to £21,300 and period in which businesses obliged to register extended to 30 days, simpler schemes to be more widely available for small and medium sized retailers;
- standstill in fuel duties and most vehicle excise duty rates;
- BES changes to reduce effect of investment bunching in last quarter of tax year;
- small companies' capital gains charge reduced to 27 per cent with advance corporation tax offset against liability on gains;
- ceiling for capital gains retirement relief increased to £125,000;
- Inheritance tax (IHT) business relief increased from 30 per cent to 50 per cent for minority holdings over 25 per cent in unquoted companies; IHT threshold increased;
- new simplified occupational pension schemes will help small employers set up own schemes.

The success of the Government's policies to improve the climate for small businesses is indicated by the rate of net business startups which, on the basis of VAT registration, averaged around 500 per week between 1980 and 1985."

[OR 22 July vol 120 no 24 WA cols 72-73]

45. Regional developments

Speaking to the Edinburgh Chamber of Commerce on 23 June the Chancellor gave an example of prosperity in the North:

"In fact there is a good deal of evidence that Scotland is sharing in our growing economic prosperity. For example, in 1985 GDP per head - one of the best measures

substantially. The two year Youth Training Scheme offers high quality training to our young people. And the new Job Training Scheme offers practical training, on and off the job, for people who have been unemployed for more than six months. The Technical and Vocational Education Initiative, and the broader reforms of education that we are embarking upon, will help to ensure that young people have the skills they need to enter the world of work.

Again, the challenge now is for British industry to expand its own training schemes, which generally speaking fall well short of those in most of our major competitors. Greatly increased profitability means that most companies can now afford to do this. And spending extra money on training, rather than on higher pay, will be of much greater benefit in the long run to the business, the employee, and the unemployed person looking for a job."

44. Small business

In answer to a question about achievements of his Department in helping business the Chief Secretary said:

"The Government's economic policy is designed to maintain a vigorous economy in which business and enterprise can flourish. Specific measures helpful to small businesses have been introduced in each of the last three Budgets. These include:-

1985 Budget

- self employed benefit from continuing reduction in Class 2 NIC and tax relief on half Class 4 NIC;
- NIC restructuring;
- extension of Business Expansion Scheme (BES)
- reform of Capital Gains retirement relief, extension of indexation, relief for long term holding;
- VAT threshold increase in line with inflation, extension of bad debt relief;
- abolition of Development Land Tax;
- unincorporated businesses share benefit of real increase in income tax thresholds.

1986 Budget

- small companies' corporation tax (CT) rate reduced to 29 per cent;
- unincorporated businesses benefit from basic rate cut to 29 per cent and indexation of tax thresholds;
- BES extended and targetting improved;
- Inheritance Tax exemption for lifetime gifts;

a healthy rate. And British firms are competing with the best on quality, design and efficiency."

42. Investment

During the Debate on the Address the Chancellor said:

"The venture capital industry, which was very small indeed - virtually non-existent - when we took office in 1979, is now higher in proportion to our GDP than the United States' venture capital industry is in relation to its GDP. The growth of the venture capital industry has been one of the Government's most remarkable success stories."

[OR 2 July vol 118 no 10 col 565]

In an interview on BBC Radio 4's "World at One" on 2 September the Chancellor said:

"The latest CBI survey shows that investment is set to rise, investment in industry in plant and equipment, to make us even more efficient, more competitive and more productive."

43. Training

During the Debate on the Address the Prime Minister told Parliament:

"There will be guaranteed places on the youth training scheme, which is an excellent scheme, for school leavers under the age of 18 who do not go into employment or further education.

Legislation will be introduced to enable benefit to be withheld from young people who deliberately choose to remain unemployed, and quite rightly so ...

... Job opportunities are growing steadily - 1,100,000 more since March 1983. Our task is to help to ensure that those who are seeking work have the right training to fill those opportunities and the help to start a business on their own if they so wish."

[OR 25 June vol 118 no 5 col 56]

On 16 July the Chancellor said to the Bury North Conservative Association:

"A further aspect of a properly functioning labour market is that workers need the skills required for the new jobs. Government spending on training has increased

start of this year, and getting on for £300 million has been invested. I believe that more and more investors will take advantage of PEPs.

Meanwhile, I can announce one new development today. Special arrangements have been made to help PEP plan managers to apply for BP shares on behalf of their customers. PEP plan managers who register at the Share Information Office will be able to get the same guaranteed allocation and preferential treatment for their PEP holders as is being offered to individuals who register directly. I am delighted that we have been able to bring PEPs and privatisation together in this way."

[Speech to the Wider Share Ownership Council, 9 September]

BUSINESS AND INDUSTRY

41. Supply side

Speaking to the Edinburgh Chamber of Commerce on 23 June the Chancellor pointed out:

"But controlling inflation does not by itself explain our new economic strength. At the heart of that success has been the dramatic improvement in the supply side of the economy.

The essence of this lies in producing goods and services more efficiently. This is not something that Governments can achieve - it depends on managers and workforces in businesses up and down the country. What the Government has done is to abolish the battery of unnecessary rules and regulations which were inhibiting management from doing their job properly.

- By having no truck with incomes policy, we have placed firmly on management the job of determining pay levels.
- Through three Employment Acts, we have given trade union members a greater say in the running of their unions and redressed the balance of power between management and the union bosses.
- By abolishing controls on foreign exchange, hire purchase, and bank lending, we have paved the way for the rapid development of the financial sector. This has brought a new range of options for companies in meeting their financial needs, along side the benefits to financial companies themselves, which are so evident here in Edinburgh.

British managers have seized the opportunities with both hands. Industrial relations are better than they have been for half a century. Investment has been proceeding at

"The Government are working to secure a very successful future for the electricity supply industry in the private sector. We are urgently tackling the important issues involved, and consulting widely, and will bring forward proposals as soon as this work is complete."

He later added:

"I cannot imagine any circumstances in which the regulations under which the nuclear industry operates could be weakened or in any way lightened."

[OR 13 July vol 119 no 17 cols 686, 688]

37. BP

Speaking to the Wider Share Ownership Council on 9 September the Chancellor said:

"The BP sale will be an even bigger share offer than British Gas, and we are once again making special arrangements for small investors, so as to encourage a substantial further widening and deepening of share ownership."

38. Number of shareholders

Speaking to the Wider Share Ownership Council on 9 September, the Chancellor said:

"A survey commissioned jointly by the Treasury and the Stock Exchange at the beginning of this year showed that 8½ million people now own shares. This means that the number of individual share holders has trebled since 1979. And that was before the privatisation of British Airways, Rolls Royce and BAA."

He went on to point out:

"It is interesting to note that as the number of shareholders has risen from 3 million in 1979 to nearly 9 million now, the number of trade unionists has simultaneously fallen from over 13 million to around 10 million. At this rate it cannot be long before the two lines cross, and we have more shareholders in this country than there are trade unionists ...

...Our privatisation issues have themselves attracted over 3½ million new shareholders. We have successfully returned sixteen companies to the private sector, more than a

third of the state-owned sector of industry in 1979, to the benefit of customers, employees, shareholders, and indeed the economy as a whole."

In response to a question on employee share ownership in privatised industries the Financial Secretary said:

"In total, 430,000 employees have taken up shares when their companies have been privatised. Most have kept their shares."

[OR 10 July vol 119 no 17 WA col 277]

During the Debate on the Address the Chancellor said:

"One in five of the adult population now directly owns shares in British industry, very nearly as many as are members of affiliated trade unions."

[OR 2 July vol 119 no 11 col 658]

39. Employee share schemes

In his speech to the Wider Share Ownership Council on 9 September the Chancellor said:

"There are cogent and compelling reasons for seeking to encourage employee share ownership in particular, in addition to wider share ownership more generally. That is why we have transformed the tax reliefs available for employee share schemes. Our first steps, as early as 1980, were to strengthen the existing employee share scheme, doubling the value of shares which firms could allocate, and to introduce a new tax relief for savings-related share schemes. The result has been dramatic. In 1979 there were only 30 all-employee share schemes in existence. The total now is over 1,300 such schemes, and 1½ million employees have benefited."

40. Personal equity plans

The Chancellor announced:

"Another major initiative we have taken to encourage wider share ownership has been the introduction of Personal Equity Plans, or PEPs. These provide a unique, simple and attractive way for small investors to buy shares in a range of British companies and to benefit from income tax and capital gains tax relief. They are proving a considerable success. Some 165,000 people have already taken out Personal Equity Plans since the

34. British Telecom

The Under Secretary of State for Trade and Industry told the Commons:

"Waiting lists for telephones numbered 200,000 prior to privatisation. That is now almost eliminated. On the question of business use, I can recall from vivid personal experience that if one wished to get a modem from the old BT network, one had to put one's name down and was privileged to receive it within five or six months. We do not say that all is universally well with BT. We say that it would be held to account and that where it abuses its monopoly position, we have given the DG OFTEL powers to request variations on licence conditions, which, in my view is an effective sanction ...

...There has been a massive investment programme. Since 1983 an additional 2 million exchange lines have been installed. Our consumer and business expectations are increasing and that is exactly right. However, through the regulatory and other mechanisms, we must ensure that BT delivers according to customer preferences ...

...During the past three years, controlled telephone prices have declined in real terms by just over 8 per cent, thanks to the RPI minus three formula. I do not recall that happening when British Telecom was in public ownership. Last November's changes resulted in an average reduction of 0.3 per cent. For the average domestic consumer OFTEL estimates an increase of 1.9 per cent, which is still a fall in real terms."

[OR 8 July vol 119 no 14 cols 351-352]

35. British Gas

The Secretary of State for Energy commented on the performance of British Gas:

"It was widely predicted that the only way that British Gas would increase its profits was by shoving up prices, but following the first financial results and the pricing formula that we imposed on British Gas it has reduced its prices by 4.5 per cent. That was because the price of its basic supplies had been reduced, but the benefit of those cost reductions was passed on to the customer."

[OR 13 July vol 119 no 17 col 687]

36. Electricity

In response to a Question on the privatisation of the electricity supply the Secretary of State for Energy said: