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PART C

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PART C

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PART C

TREASURY AND CIVIL SERVICE COMMITTEE (TCSC) ENQUIRY ON THE 1985 AUTUMN STATEMENT AND OTHER HEARINGS

(TCSC)

PO -CH /NL/0103 PART C

Begins: 20/11/85

Ends: 12/12/85

DD: 25 years

5/9/95

RR3.48

1. ~~Sutton~~
2. ~~Tyrie~~
3 ~~[illegible]~~
4 [illegible]

FROM: MRS R LOMAX

DATE: 20 November 1985

cc Mr Scholar
Mr Pratt

PS/M - Scholar confirmed time + venue at X1.

SIR P MIDDLETON

SIR T BURNS

MR TURNBULL

DL 22/11

CHANCELLOR'S APPEARANCE AT THE TCSC: TUESDAY 26 NOVEMBER

The Chancellor would be grateful if you would accompany him to his appearance before the Treasury Select Committee next Tuesday 26 November. We are assuming that the time and place indicated for the date originally offered still hold - that is 4.30 pm in Committee Room 15. Mrs Lester will confirm.

X1

RL

RACHEL LOMAX

1-10

PCP

To Sir [illegible] for Ch ~~[illegible]~~ revised version

Ch

how grade transcript: we'll get a corrected version for the C/E

RC 21/11

FROM: R PRATT
DATE: 20 NOVEMBER 1985

SIR TERENCE BURNS*
MR CASSELL*
MR EVANS*
MR TURNBULL*
MR SCHOLAR*

cc Chancellor of the Exchequer*
Sir Peter Middleton*
Sir Geoffrey Littler
Mr Bailey
Mr Anson
Mr Monck
Mr Lavelle
Mr Fitchew
Mr Odling-Smee
Mr Culpin

TCSC ENQUIRY INTO THE AUTUMN STATEMENT

... I attach (for those marked *) a copy of the transcript of the evidence that officials gave to the TCSC on Monday 18 November.

2. We are invited to return a corrected copy by close of play tomorrow, Thursday, 21 November. I should be grateful, therefore, if action addressees could let me have their copies, corrected as appropriate, by lunchtime tomorrow, Thursday 21 November. I will then return a single, corrected, copy to the Committee within their deadline.

Richard Pratt

RICHARD PRATT

SUPPLEMENTARY QUESTIONS FROM THE TCSC

Question 1. The December 1983 version of the Treasury model included a retentions rate effect in the private sector earnings equation which represented an increase in nominal average earnings of 0.5 per cent if take-home pay was to be raised permanently by 1 per cent. Is this effect still operative in the current version of the model?

A. The retention ratio effect included in the private sector earnings equation in the December 1983 version of the Treasury model implies that a 1 per cent reduction in take-home pay induced by a change in income tax would raise nominal earnings by a $\frac{1}{2}$ per cent in the long run, other things being equal. The effect builds up from under a $\frac{1}{4}$ per cent in the first year, in contrast to the effect of price changes which come through fully within a year. These features are retained in the latest public version of the model.

2. Estimates of the retention ratio effect are subject to considerable uncertainty. There are clear theoretical reasons for the existence of a retention ratio effect, and the effect in the Treasury model appears to be quite consistent with the available data.

Question 2. Is this effect largely responsible for the reduction of inflation as a result of tax cuts? How does this compare with simulations on other quarterly models, like those in the London Business School and the National Institute?

A. The retention ratio is not the only mechanism temporarily reducing inflation in simulations of income tax cuts. Given the rate of growth of the money supply, there will also be a significant effect through a higher level of the exchange rate.

2. The London Business School model incorporates a similar, though smaller, retention ratio effect on earnings. The National Institute model has no such mechanism. Other things being equal, inflation will be correspondingly higher in these models, following a cut in taxes, than in the Treasury model, but the difference in response is only temporary.

Question 3. The simulations referred to above also show that the effects on unemployment differ. Increasing Government expenditure by £2¼ billion would reduce unemployment by at least 150,000 after 4 years, while an equivalent cut in income tax taking 2 per cent off the basic rate reduces unemployment by 50,000 at most, according to Davies and Metcalf (Simon and Coates, 1985). What is the outcome in terms of unemployment of similar exercises with the Treasury model?

A. In common with most macro-economic models, the Treasury model produces a larger initial response in ~~output~~ demand to an increase in government expenditure than to a cut in taxes. This mainly reflects leakages into saving and imports. As the simulations reported in the 1984 supplement to the Treasury model manual show, the initial change in output is completely crowded-out within four years, for given growth in the money supply. At the end of the period, inflation is higher when public expenditure increases but lower when taxes are cut. If monetary policy is accommodating, crowding-out takes longer but occurs nevertheless, and inflation is significantly higher in both cases.

2. In the longer term unemployment is mainly determined by the supply-side response of the economy which, in the Treasury model as in most other macro-economic models, is not well developed.

Question 4. A recent study by Professors Layard and Nickell suggests that the 'natural rate' of male unemployment in the UK in 1980-83 grew from 8.6 per cent in 1975-79 to 11.2 per cent in 1980-83. Is this evidence consistent with the implied natural rate in the Treasury Model?

A. The estimates of the natural rate given by Professors Layard and Nickell are based on a structural model of the labour market which takes explicit account of various factors, such as unemployment benefits, personal taxes, labour taxes, industrial mismatch, trade unions' power and competitors' prices, in estimating relationships for labour demand and labour supply (real wages and prices). Their estimates of the natural rate are obtained by solving the model for unemployment under the assumption that inflation is non-accelerating.

2. The same approach cannot be applied with the Treasury model because of the more complex interactions in the model and the absence of unemployment from the wage equation. An analytical solution for the natural rate would involve, in principle, all the equations in the Treasury model instead of just three simple labour market equations as in Layard and Nickell's model, and it would be impossible to find. An empirical solution is in principle possible, but a variety of numbers could be produced depending on what assumptions were made about the reasons for the changes in the pressure of demand that would have been needed to keep inflation constant. No such calculations have been carried out.

5. The shortfall on oil revenue is mainly attributable to a higher sterling/dollar exchange rate than assumed in the Budget forecast (paragraph 1.57). Is the sterling-dollar rate assumed for 1986 the average since March as for the trade-weighted index?

DRAFT REPLY

Part 1 of the Autumn Statement follows the usual practice of making an explicit assumption about the sterling index. The forecast for 1986 assumes (paragraph 1.16) not much change in the sterling index from the average level between March and November. This is also consistent with an assumption of no major change in the sterling/dollar rate, but from more recent levels: there has been a fall in the dollar against nearly all other currencies between March and November. Some decline in oil prices is allowed for - as indicated by the futures market (paragraphs 1.13 and 1.22).

Chancellor - 2nd

COMMITTEE OFFICE
HOUSE OF COMMONS
LONDON SWIA OAA
01-219 5766 (Direct Line)
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TREASURY AND CIVIL SERVICE COMMITTEE

PRESS NOTICE

Autumn Statement

The Committee will take evidence in public on Tuesday 26 November at 4.30 pm in Committee Room 15 from the Rt Hon Nigel Lawson, MP, Chancellor of the Exchequer.

Civil Servants and Ministers: Duties and Responsibilities

The Sub-Committee will hold its first oral evidence session on Wednesday 27 November at 4.30 pm in Committee Room 6 in public. The witness will be Sir Robert Armstrong, Head of the Home Civil Service. The Sub-Committee is basing its inquiry on the note by Sir Robert Armstrong on the Duties and Responsibilities of Civil Servants in relation to Ministers, issued in February 1985.

S PRIESTLEY
Clerk

21 November 1985

c Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Anson
Mr Kemp
Mr Cassell
Mr Turnbull
Mr Scholar
Mr Evans
Mr Odling-Smee
Miss Kelley
Mr Culpin
Mr Truman
Miss O'Mara
Mr Cropper
Mr Davies
Mr Lord

pse

FROM: R PRATT
DATE: 21 NOVEMBER 1985

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Cassell
Mr Odling-Smee
Mr Evans
Mr Scholar
Mr Turnbull
Mr Gray
Ms Boyes
Mr Robson
Mr Culpin
Mr Stredder

TCSC ENQUIRY INTO THE AUTUMN STATEMENT

... I attach a draft note, prepared by Mr Turnbull, for the Committee covering the points about which the Chairman asked for written notes during officials' evidence on Monday. Also attached are responses, prepared by Mr Odling-Smee and Mr Evans, to the supplementary written questions attached to the Clerk's letter of 19 November to Mr Scholar. Finally, I attach a list of the questions the Clerk proposes to brief the Committee to put to you next Tuesday.

2. When officials gave evidence on Monday, the Chairman asked for three notes:

(a) on the cost of the coal strike;
(b) on the priority given to the health service;
(c) on whether or not the increase in housing expenditure presented a real terms increase.

3. In the event, the Clerk told me that he had agreed with Mr Higgins it was not necessary for us to provide a note on the cost of the coal strike. Given that the Times reported that the PSBR cost was £5-6 billion, you may feel that it would, in any case, be helpful to offer a note on the coal strike costs, in order to put the Treasury's position on record (and a passage on coal has been included in the attached draft note for the Committee). However, so far, the press response to what Treasury officials said to the Committee about coal strike costs, was relatively muted. On balance GEP and PE judge that it is probably best to leave well alone and to omit the coal section from the attached draft.

273/008

pS8

FROM: M C SCHOLAR
DATE 22 November 1985

MRS LOMAX

cc: Sir P Middleton
Sir T Burns
Mr Turnbull

TCSC: BRIEFING

Comparing notes after the Chancellor's meeting this afternoon, Mr Turnbull and I reckoned that the Chancellor wanted briefing as below:

1) an opening statement by L Speaking notes on privatisation (1A) by Sir T Burns and Mr Aaronson (attached) (1)

2) Notes for some extended remarks about the accuracy of the forecasts in recent years and since the 1983 Election (by Mr Davies on Monday)

3) Runs of money GDP growth figures and PSBRs in successive MTFSs (attached)

4) Notes to draw on in answer to the question on company profitability and rising labour costs and other questions on the forecast (by Mr Evans, attached)

5) Copy of the Chancellor's remarks last year on how public expenditure priorities are determined (attached)

6) Record of past cash public expenditure plans and outturns (attached)

7) Table of trends in real public expenditure growth in recent years (attached)

8) Speaking note on why the Committee should have confidence that real public expenditure growth has come to an end (defence, unemployment etc)

9) Table and speaking note on reserves in previous years (attached)

10) Record of local authority overspending compared with central government (to come)

11) Notes for an extended disquisition on current and capital (attached)

12) Notes on the reasons for optimism on local authority overspending in future (to come)

13) Housing - reconciling increased provision and reduced allocations (attached)

14) Form of words on the unallocated margin

15) A copy of the Odling-Smee/Riley disclaimer (attached) and note by MP Division ~~(submitted separately tonight)~~ Circ— below

16) Defensive note on whether the social security uprating date was changed to save money (material on how well pensioners are doing with 7 per cent uprating and 5½ per cent RPI) (to come

2. We will submit the remainder as soon as possible on Monday.

MCS

M C SCHOLAR

You have some relevant quotes from [illegible]'s evidence + the AS itself in what we already have. [illegible] or I will check through for further useful references on Monday.

From: J W GRICE

22nd November 1985

CHANCELLOR OF THE EXCHEQUER

cc Sir Terence Burns
Mr Odling-Smee
Mr Culpin
Miss O'Mara
Mr Riley
Mr Aaronson
Mr Pickering
Mr Spencer
Mr Vernon

BILL MARTIN ON THE AUTUMN STATEMENT: REFERENCES TO ODLING-SMEE/RILEY

Bill Martin, a specialist adviser to the Treasury Committee, has argued that unchanged policies in the Autumn Statement should be defined by reference to unchanged public sector net worth. He cites a published paper by Messrs Odling-Smee and Riley to forward his case.

2. I understand that you requested, through Sir Terence Burns, defensive briefing on these points. The attached has been agreed within MP, and with Sir Terence Burns.

J. W. Grice

J W GRICE

Bill Martin on Autumn Statement: Defensive Briefing

The unchanged net worth principle should be used as the definition of unchanged fiscal policy on which Autumn Statement should be based.

i. Absolutely confused suggestion. Any definition of unchanged macro-economic policies is bound to be arbitrary in some degree. Important point is that there be a sensible convention for "unchanged policies" from which a common understanding of underlying forecast assumptions can be drawn. Present convention that macro-economic policies will be as in current MTFS serves purpose well. Has been used for all previous AS; & is ~~clearly~~ superior to previous convention of unchanged tax rates & allowances.

Reason had to [illegible] forecasters not in a position to anticipate the Budget judgement.

ii. Unchanged net worth convention ludicrous. Sensible to take asset sales, North Sea revenues into account but completely inappropriate to make mechanical calculations - and impractical as guide to short-term policy stance. Odling-Smee/Riley and others who have seriously studied this issue recognise this.

Odling-Smee/Riley paper sets out new and more appropriate basis for fiscal policy. PSBR should be set to leave unchanged net worth of public sector.

Quote

i. Paper referred to makes it clear that views expressed are personal and not government policy. Represents discussion in an academic forum of one of the principles which academic literature suggests should guide fiscal policy. Right that Treasury economists should take part in professional discussions on personal basis.

ii. Paper suggests the unchanged net worth principle generates useful analytic framework for considering PSBR in medium to long term. Fully recognises practical difficulties of implementing any such principle. Does not rule out possibility of changing net worth if there are other reasons for a different mix of fiscal and monetary policy. Does not claim net worth principle incorporates all relevant factors (eg short-term fiscal mix objectives).

<u>The unchanged net worth principle implies adjusting PSBR targets over medium term for asset sales, North Sea revenues and for the level of public capital formation. Why does Chancellor dispute this?</u>

As 1984 MTFS* makes clear, the PSBR is set with full regard to the profile of asset sales, to North Sea revenues as well as to the composition of public expenditure. These are taken into account when setting the PSBR, as are other things such as the cyclical position (is it? of economy, developments abroad (eg US interest rates), short-term fiscal mix objectives, the accruals of inflation uplift on indexed gilts, etc.

[*1984 FSBR paragraph 2.17, attached]

A bit vaguer for public use, I think. This very [illegible] para from the MTFS was not repeated in 1985.

7½ 6½ 5½ 4½

1¾ 1¾ 1½ 1½

MGP

3¾ 3¼ 2¾ 2¼

SOE: 1¼ 1 ¾ ½

88A 2½ 2¼ 2 1¾

BACKGROUND NOTE

Odling-Smee and Riley gave an invited paper "Approaches to the PSBR" to a conference on Government Borrowing and Economic Policy on 3rd July 1985, organised by the National Institute. The paper was reproduced in the August 1985 National Institute Economic Review, with the other papers. Their paper makes clear that views expressed are personal and not necessarily those of the Treasury.

2. Their main points were:

a. public borrowing can be used to achieve desirable balance on consumption over time;

b. in the medium to long term, this balance would be held constant if borrowing was such as to leave public sector net worth unchanged. This means that factors like changes in the public capital stock, the present value of North Sea revenues and unfunded pension liabilities will be relevant to setting the PSBR;

c. such a principle generates a useful analytical framework but practical implementation is made difficult by severe measurement problems of net worth - especially valuing the capital stock;

d. in the short term a different PSBR response to fluctuations and disturbances may be appropriate depending on their source. But medium-term objectives always need to be borne in mind.

What is the rate of depreciation of the capital stock, in £bn p.a.? This requires (a) an estimate of the value of the capital stock and a prior on (b) a knowledge of the right depreciation rate (b). What are the orders of magnitude?

The PSBR path

2.16 Government policies have been directed to achieving a progressive reduction in public sector borrowing over the medium term. Fiscal restraint is essential to the achievement of lower inflation and interest rates. A further reduction in the PSBR over the medium term is required to be consistent with the monetary targets at acceptable interest rates.

2.17 The appropriate path of the PSBR from year to year reflects many considerations, including the cyclical position of the economy. The composition of public sector receipts and expenditure also has to be taken into account. The profile of public sector asset sales is an important aspect of this, since they are unlikely to make a large contribution to reducing interest rates. The higher level of asset sales over the next five years than in recent years points to an initial downward shift in the PSBR path. The pattern of North Sea oil revenues is also relevant: the likelihood that they may be near their peak in 1984–85 is a further reason for seeking to make rapid progress this year in reducing the PSBR.

PSBR projections

2.18 The PSBR for 1984–85 is forecast to be £7¼ billion, equivalent to 2¼ per cent of GDP, slightly below the figure assumed a year ago and in the Autumn Statement. The fiscal projections summarised in Table 2.6 show further small reductions in the PSBR as a proportion of GDP in subsequent years, to 1¾ per cent in 1987–88 and 1988–89. The figures after 1984–85 are illustrative, and decisions about the appropriate PSBR in particular years will be taken nearer the time. But the illustrative profile should be compatible with falling inflation and monetary growth, and interest rates declining in both nominal and real terms.

Assumptions

2.19 For the period to 1986–87, the fiscal projections in Tables 2.4–2.6 are based on the public expenditure plans shown in the Public Expenditure White Paper (Cmnd. 9143), updated where necessary to take account of Budget measures. Further details for 1983–84 and 1984–85 are given in Part 5. For 1987–88 and 1988–89, no public expenditure decisions have yet been taken and the projections assume that the public expenditure planning total remains unchanged in real terms. Similarly, no decisions on asset sales in 1987–88 and 1988–89 have been taken; they are assumed to remain at the levels in the White Paper for the previous three years. Real output is assumed to grow by 2¼ per cent a year on average over the five years. The general rate of inflation, as measured by the GDP deflator, which is put at about 5½ per cent in 1983–84, is projected to fall to under 5 per cent in 1984–85, and to 3 per cent by 1988–89. It is assumed that there is no major change in the effective exchange rate from year to year. These assumptions imply growth of money GDP falling from about 8 per cent in 1983–84 to 5 per cent by the end of the period.

Public expenditure

Public expenditure

2.20 Table 2.4 shows the relationship between the planning total for public expenditure and general government expenditure in national accounts terms (the definition of public expenditure lying behind the general government borrowing requirement).

2.21 Last month's Public Expenditure White Paper (Cmnd. 9143) set out in detail the government's plans on the level and make-up of public spending to 1986–87. On the assumptions on inflation in paragraph 2.19 above, these plans mean that public expenditure should remain broadly level in real terms for the next three years.

2.22 This stability is projected forward for a further two years, with the assumption that public expenditure in 1987–88 and 1988-89 will remain at its 1986–87 level in real terms. If the decisions which have still to be taken on the public expenditure totals for these years follow the assumed path, this should lead to a continuing fall in the share of the national product taken by public spending.

9/2416

71.31 p

FROM: A TURNBULL

DATE: 25 November 1985

CHANCELLOR

PSP

cc Sir P Middleton
Sir T Burns
Mr Scholar

TCSC BRIEFING

I attach the briefing notes Nos 2, 8, 10, 12, 14 and 16 which were promised for today in Mr Scholar's minute of 22 November. In addition there are notes on:

i) The information you requested on the slowderion in export growth and the figures underlying the output per head chart 1.6 - attached to Note 2.

ii) Briefing on manpower including recent correspondence between Ministers of State, Treasury and Mr Ralph Howell - Note 17.

iii) A table showing planning totals and their outturns with differences expressed as percentages - Note 18.

iv) A note matching passages from last week's transcript with the TCSC's questions - Note 19.

v) A note by MP setting out the information you requested on public sector current and capital transactions with and without depreciation - Note 20.

Could I make one gloss and one correction to Note 13 submitted on Friday. amended The figure for 1985-86 should read "£1,600" not "£1,500". You should take care when discussing next year's provision for gross capital expenditure of £3,250 million to compare it to this year's plans, not this year's spending which is estimated to be around £3,285 million. Mr Biffen, at PMs questions last week incorrectly stated that there will be greater spending next year - see attached.

AT

A TURNBULL

Mr. Kinnock: Has the right hon. Gentleman seen the parliamentary answer from his right hon. Friend the Secretary of State for the Environment, which makes it clear that there will be a further cut over the next year of at least £135 million in the Government's captial allocation for housing, housebuilding and house improvement? Does the right hon. Gentleman recall that just last week the Prime Minister rather glibly claimed in the Guildhall that she saw a process of renewal taking place throughout the country? Does he think a cut in housebuilding adds to or retards that process of renewal?

Mr. Biffen: I am sure that the right hon. Gentleman will take account of the fact that the prospects for housebuilding relate not only to the allocations but to the local authorities' access to their own capital receipts. When these are taken in totality, it is the view of my right hon. Friend the Secretary of State for the Environment that next year will show an increase over this year.

Mr. Kinnock: Does that mean that the right hon. Gentleman at least, thinks that local authorities should be permitted to use more than 20 per cent. of the money raised by a variety of means that they want to dedicate to housing? Is he satisfied with the fact that we have the lowest housebuilding starts of any year since the war; that 250,000 building workers are unemployed and that young and old people are in desperate need of houses? If he is concerned about those things, will he use his influence to persuade the Government to change their policy, make those allocations, and allow local authorities to spend more on creating jobs and homes?

Mr. Biffen: It is the avowed policy of my right hon. Friend the Secretary of State for the Environment that decisions on allocations are taken in the context of the local authorities' access to capital receipts. There will be greater spending next year.

50/70

FROM: ROBERT CULPIN

DATE: 25 NOVEMBER 1985

CHANCELLOR

cc Chief Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr Turnbull
Miss O'Mara
Mr Aaronson
Mr H Davies

OPENING STATEMENT FOR TCSC

I have, as promised, shortened and slightly revised the draft. It would take 3 or 4 minutes to deliver - it is about 460 words.

Rc

ROBERT CULPIN

003/24

pmp

Cl

FROM: S N WOOD
DATE: 26 NOVEMBER 1985

You already have a note from Philip - this was done for PetE

PS/SIR PETER MIDDLETON

cc: PS/Chancellor
Sir G Littler
Sir T Burns
Mr Cassell
Mr Peretz
Mr Turnbull
Mr Scholar
Mr Kelly
Mr Walsh
Mr Ilett

RL
26/11

TCSC

You asked how the markets have moved since the G5 Plaza agreement, and how the sterling markets have moved since the Autumn statement.

2. I attach a set of tables. These show UK money market rates and gilt market indicators immediately before and after the Plaza agreement and the Autumn statement, and now; and overseas 3-month interest rates, taken from EA's regular tables updated from today's FT, immediately after Plaza and yesterday. I also attach EF's table on exchange rate changes since Plaza, which shows how the major currencies have appreciated against the dollar, and how sterling has moved.

3. On interest rates, the main development internationally is the tightening of Japan's interest rates. Domestically, the Plaza agreement had only short-lived effects in reducing UK market rates. (Base rates have of course remained at 11½.) The gilts market has been consistently a little better since the Autumn statement; the boost following Plaza was short-lived.

SNWood

S N WOOD

TABLE 1 : STERLING MONEY MARKETS AND GILTS

A. Money markets

	1 month	3 month	12 month
September 20	11. 1/2	11.17/32	11. 3/16
September 23	11. 7/16	11. 5/16	10.15/16
November 11	11.19/32	11. 5/8	11. 7/16
November 12	11. 3/8	11. 9/16	11. 7/32
November 25	11. 5/8	11. 1/2	11. 7/32
November 26 (noon)	11.19/32	11. 9/16	11. 1/4

B. Gilts

	FT Government Securities Index	20 year par yield
September 20	83.4	10.43
September 23	84.0	10.40
November 11	83.3	10.43
November 12	83.3	10.43
November 25	83.9	10.39
November 26 (noon)	83.8	NA

8.8

TABLE 2 : WORLD MONEY MARKETS

3.2

1.7

3 month interest rates in major OECD economics

	Sept 23	Real	Nov 25	
US	7.85	4.71	7.91	
Japan	6.31	6.27	7.97	
Germany	4.68	3.00	4.80	1.8
France	9.50	3.81	8.81	5
Italy	14.06	5.58	14.38	
UK	11.53	6.16	11.56	

EXCHANGE RATES

	(Pre Plaza) 20/9/85	Oct Average	(day before Autumn Statement) 11/11/85	(latest close) 25/11/85
£ ERI	82.0	80.4	79.6	80.6
$/£	1.3675	1.422	1.4196	1.4635
DM/£	3.9063	3.758	3.7286	3.7499
DM/$	2.8565	2.643	2.6265	2.5623
YEN/$	240.85	214.60	205.90	200.60

RR3.63

FROM: MRS R LOMAX

DATE: 26 November 1985

Pmx

cc PS/Chief Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Mr Turnbull
Miss O'Mara
Mr Pratt
Mr Cropper
Mr Lord
Mr H Davies

MR CULPIN

CHANCELLOR'S TCSC APPEARANCE: OPENING STATEMENT

I attach a final draft of the Chancellor's opening statement for use at his appearance before the TCSC this afternoon.

2. The Chancellor has decided to drop the prepared statement on privatisation. He will speak off the cuff, so there will be no hand out for the press on this subject.

RL.

MRS R LOMAX

CHANCELLOR'S OPENING STATEMENT TO TCSC, 26 NOVEMBER

This year's Autumn Statement is the fourth in the series. It sets National Insurance rates for the next financial year, and fulfils the Treasury's statutory duty to publish an economic forecast; but its main function is of course to give the results of the annual survey of public expenditure.

This year we have provided more detail than ever before. We have given a Departmental breakdown of likely spending in the current year. And we have shown forward plans for three years ahead, instead of just one. These changes respond to suggestions made by the Committee, and I am glad to see that they have been welcomed.

I know that the Committee is less happy about another change, which is the omission of a forecast "fiscal adjustment". But I believe this is no real loss. The fiscal adjustment was simply the difference between an early and inevitably uncertain forecast, on which no decisions were based, and a conventional assumption. It added nothing to understanding or evaluation of the public expenditure plans which, as I say, are the main focus of the Autumn Statement - nor did it either represent or foreshadow any policy decision.

For the Autumn Statement is <u>not</u> a preview of the Budget. It cannot report decisions on tax because I have not taken them. And the decisions on expenditure - which <u>are</u> genuine decisions - though important in themselves, represent only one side of the public sector's accounts, and thus inevitably carry no implication for the stance of fiscal policy either next year or beyond. To describe the Statement as reflationary or deflationary is thus, even in Keynesian terms, a logical absurdity.

I shall, as always, make my decisions on fiscal and monetary policy in the Budget. And they will be decisions to sustain the conditions which have brought us the prize of relatively non-inflationary growth.

The record speaks for itself. We have held to a prudent fiscal policy, and reduced the PSBR from 5¼ per cent of GDP to a forecast 2¼ per cent this year. We have the lowest borrowing requirement, in relation to our national income, for 14 years: lower even than in 1981-82, when my predecessor with great courage presented a very tough Budget indeed. We have maintained monetary conditions tight enough to bring inflation down from double figures to 5½ per cent, with the firm prospect of a further substantial fall next year. We have resisted every temptation to seek short-term advantage in ways that would have undermined the long-term strength of the economy.

The Autumn Statement confirms that, even if you exclude the proceeds of privatisation, we plan to keep public expenditure broadly constant in real terms. With a growing economy, this should permit a gradual reduction in the burden of taxation. But the timing and size of any reductions are uncertain, and must depend on the judgements that I have to make at Budget-time each year.

The Autumn Statement shows expenditure under control and the economy set for a fifth successive year of relatively non-inflationary growth, and into the sixth. That is the prospect, and I shall do my best to answer your questions on it today.

Ch.

Robert would no doubt be grateful for early comments on the 2 potential press handouts (the opening statement & the piece on privatisation). The former has been done by Robert himself; the latter by Howard (without help from Terry, who is judging a CIPFA competition all day today). I attach – in the press folder – the earlier versions for comparison.

Will you want to [illegible]

With Romans / Middlehurst
Turnbull* before the off —
say 4ish? or earlier?
(*plus Culpan)

There is an extremely useful crosswalk from Margaret between the Committee's weekly questions, with reference to the Annex's transcript of AT, by question. The full transcript is in the other pink folder.

Other new contributions are listed on A Turnbull's amendment — though. I have put all the material into what I hope is a logical order, so follows any index not AT's numbering.

RE. 25/11

VR62

28/11/85

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4

TCSC QUESTIONS TO THE CHANCELLOR: FORECAST

Question 1. The government has said that changes in cost competitiveness do not affect exports very much. Does this mean that the government has little to fear about the effect of increases in domestic costs on the balance of payments?

This is not what the government has said. Paragraph 1.20 of the Autumn Statement said "...experience of the past five years suggests that export volumes have not been very responsive to price and cost changes."

See below

In addition Sir T Burns told the Committee on 18 November (page 12 of transcript) that "Competitiveness is a bit worse but it only accounts for about 1 per cent or so of the slower growth" in 1986 [ie of the slow down from 7 per cent growth in in exports in 1985 to 2 per cent in 1986]. The main point here is that changes in competitiveness are not the main reason for the slow down in export growth. The main concern about increases in domestic costs is their potential effect on employment.

What are the other factors? (and what are they are [illegible])

Question 2. If that is so, is it not worth increasing the PSBR, in order to stimulate employment, if there is little to fear from any consequent rise in domestic inflation?

The premise of this question is quite wrong.

Question 3. Moreover, does this not undermine the case that moderation in real wage increases help employment?

No, there are many reasons, in addition to better competitiveness, why lower wage increases will help employment. These reasons were spelt out in a Treasury paper on "The Relationship between Employment and Wages" published in January 1985.

(Summary) to come.

hpe83a

Q4. How is it possible to reconcile the forecast that there will be a further recovery in profits with the statement that companies are going to find it difficult to raise prices and are being squeezed by rising labour costs?

[Autumn Statement references:

Para 1.30. "With companies finding it increasingly difficult to raise prices ... there may not be much change in the general level of pay settlements in the current pay round."

Para 1.31. "The behaviour of competitors' prices means that profit margins are unlikely to go on rising at the same rate as in the first half of 1985."

Chart 1.4 shows an estimated rise in the rate of return of non North Sea ICCs from 6½ per cent in 1984 to about 8 per cent in 1985, and para 1.39 says that the profit share and rate of return are expected in 1985 to be at their highest level since 1973.

Para 1.41. "For 1986, the strength of the recovery in profits, the buoyancy of the stock market and the generally healthy state of company liquidity all point to a further rise in business investment."]

Points to make.

No forecast is made in the Autumn Statement of whether there will be a further rcovery in company profits next year (the reference in paragraph 1.41 is to the effects on investment next year of the recovery that has already happened). Nor does the Autumn Statement say that firms are being squeezed by rising labour costs.

As the Autumn Statement says, it will be more difficult for companies to raise prices from now on. This is confirmed by the October CBI survey, which shows the balance of firms expecting to raise prices is the lowest since 1968.

Further increases in profits will, therefore, be dependent on firms holding down the growth in costs: they won't simply be able to pass on higher costs to their customers.

Q5. What assumptions does the forecast make about the effect of the Government's supply side policies in increasing labour market flexibility.

Points to make

Forecast is for a continuation of the growth in employment seen since 1983: much of this growth will be in self-employment - most flexible area of the labour market.

But the persistent inappropriately high level of pay settlements in manufacturing and other industries indicates the deep-seated nature of the problems the Government faces in its reforms of the UK labour market.

n45sd

EXPORT FORECAST (Non-oil Goods)

Reason for slowdown in growth rate between 1985 and 1986 - export performance in late 1984/early 1985 better than would have been expected from growth of world trade and changes in cost competitiveness. Forecast assumes that while current unexpectedly high level of exports will be broadly maintained there will be no further unexpected increase of this sort.

See also T Burns transcript above.

Summary

	Growth in exports	Due to: World Trade	Relative costs & prices	Trend loss of share	Unexpected
1984	9½	7½	¾	-1	2¼
1985	7½	4½	1	-1	3
1986	2-3	4½	-¾	-1	0

Note 2

FROM: S J DAVIES

DATE: 25 NOVEMBER 1985

MRS LOMAX

cc: Sir Peter Middleton
Sir Terence Burns
Mr Evans o/r
Mr Scholar
Mr Culpin
Mr Mowl
Miss O'Mara

ERRORS IN INFLATION AND GDP FORECASTS BY LBS, NIESR, AND THE TREASURY

I attach two tables setting out the recent record of forecasts of inflation and GDP by LBS, NIESR and the Treasury. The forecasts covered are those made in the autumn of 1980 and subsequent years, up to and including forecasts published in the last month.

2. Taking this period as a whole the record can be summarised as:

Inflation

LBS		NIESR		Treasury	
Absolute Error	Bias	Absolute Error	Bias	Absolute Error	Bias
1.7	1.2	1.3	1.2	1.2	0.3

All forecasters showed a tendency to overpredict inflation (ie bias is positive): bias was greater in the case of the National Institute and the LBS, but even the Treasury shows some small tendency to overpredict inflation. (In the last three years, however, the Treasury has underpredicted inflation on average, while the National Institute's forecast in particular has continued to show a large positive bias.)

	GDP				
LBS		NIESR		Treasury	
Absolute Error	Bias	Absolute Error	Bias	Absolute Error	Bias
0.7	-0.2	1.1	-0.7	0.7	-0.5

All three forecasters tended to underforecast growth (ie bias is negative). The National Institute's forecasts for 1983 and 1984 were particularly pessimistic: 1983 growth was underforecast by 2 percentage points, and the 1984 growth forecast was 1 percentage point too low.

3. I also attach material on two further points raised by the Chancellor this morning - the contribution of factors other than competitiveness to the decline in export growth, and figures on manufacturing productivity.

SJD

S J DAVIES

n49sd

GDP FORECASTS

Per cent change year-on-year	Forecasts made in each autumn for year ahead						Average Errors 1981-85	
	1981	1982	1983	1984	1985	1986	(Absolute error regardless of sign)	(Bias)
(i) GDP (Average measure)								
HM Treasury	- 1½	1	1½	3	3½	3		
Outturn	-1.6	2	3.3	2.4	3.7	-		
(ii) GDP (Output measure)								
NIESR	-0.8	0.6	1.0	2.0	3.3	1.9		
LBS	-0.6	1.7	2.0	2.4	3.1	2.4		
Outturn	-1.8	1.9	3.0	3.0	3½			
Errors HMT	0.1	-1.0	-1.8	0.6	-0.2		0.7	-0.5
LBS	1.2	-0.2	-1.0	-0.6	-0.4		0.7	-0.2
NIESR	1.0	-1.3	-2.0	-1.0	-0.2		1.1	-0.7
Average bias	0.7	-0.8	-1.6	-0.3	-0.3			-0.5

INFLATION FORECASTS

Per cent changes	1981	1982	1983	1984	1985	1986	Average Errors 1981-1985 (Absolute error, regardless of sign)	(Bias)
	Forecasts made in each autumn for year ahead							
(i) RPI, fourth quarter								
HM Treasury	11	10	5	4½	4½	3¾		
NIESR	11.7	10.7*	5.8*	6.8	6.5	3.0		
Outturn	11.9	6.2 (8.6*)	5.0 (4.6*)	4.8	5.5			
* Annual average								
(ii) Consumers' expenditure deflator, fourth quarter								
LBS	9.9	10.4	6.7	6.0	5.0	5.0		
Outturn	11.2	6.7	4.7	5.1	4.4			
Errors: HMT	-0.9	3.8	0	-0.3	-1.0		1.2	0.3
LBS	-1.3	3.7	2.0	0.9	0.6		1.7	1.2
NIESR	-0.2	2.1	1.2	2.0	1.0		1.3	1.2
Average bias	-0.8	3.2	1.1	0.9	0.2			0.9

n49sd

Output per head of the employed labour force

(Manufacturing sector only)

	Index 1980=100	% change on previous year
1973	100.1	8.7
1974	98.6	- 1.5
1975	96.0	- 2.7
1976	101.1	5.3
1977	102.7	1.6
1978	103.5	0.8
1979	104.1	0.6
1980	100.0	- 3.9
1981	103.5	3.5
1982	109.6	5.9
1983	118.0	7.6
1984	124.0	5.1
1985(1)	127.7	3.0

	Annual Average Percentage changes	(Rounded to nearest ¼, as in Autumn Statement)
1973-79	0.65	¾
1979-85(1)	3.46	3½

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(1) 1985 figure is partly estimated.

n49sd

MANUFACTURING EXPORTS(1)

	Index 1980=100	% change on previous year
1973	85	14.9
1974	91	6.9
1975	88	- 3.1
1976	95	8.4
1977	101	6.2
1978	103	1.6
1979	101	- 1.4
1980	100	- 0.5
1981	97	- 2.7
1982	98	0.8
1983	96	- 1.4
1984	107	11.2
1985(2)	115	8.2

Annual Average

1973-79	3 %
1979-85(2)	2¼%

(1) Excluding erratics.

(2) partly forecast.

n55sd

CONFIDENTIAL

TABLE 2 : Money GDP at Market Prices (% change)

	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89
1979 Spring Internal	13.0	13.0	13.2	13.1	15.5	–	–	–	–	–
1979 FSBR	16.2	14.3	13.6	14.4	–	–	–	–	–	–
1980 Winter Internal	17.2	15.3	11.6	9.5	10.4	–	–	–	–	–
1980 MTFS	17.5	17.1	12.0	9.6	10.7	–	–	–	–	–
1981 Winter Internal	–	13.3	10.0	10.0	11.0	11.6	–	–	–	–
1981 MTFS	–	13.0	10.5	9.6	9.7	9.9	–	–	–	–
1982 Winter Internal	–	–	10.4	10.5	9.5	10.6	–	–	–	–
1982 MTFS	–	–	10.5	9.7	9.7	9.6	–	–	–	–
1983 Winter Internal	–	–	–	7.9	8.7	9.3	–	–	–	–
1983 MTFS	–	–	–	8.3	7.9	8.5	7.6	6.6	–	–
1984 Winter Internal	–	–	–	–	8.3	8.1	6.7	6.0	5.3	4.7
1984 MTFS	–	–	–	–	8.0	7.9	6.8	6.1	5.6	5.2
1985 Winter Internal	–	–	–	–	–	6.3	8.4	7.5	4.9	5.4
1985 MTFS	–	–	–	–	–	6.8	8.4	6.6	5.7	5.0
LATEST OUTTURN and Autumn Statement Projection	~~[illegible]~~ 19.8	~~[illegible]~~ 14.0	~~[illegible]~~ 10.1	~~[illegible]~~ 9.4	~~[illegible]~~ 7.8	~~[illegible]~~ 7.3	– 8.7	–	–	–

PSBR: MTFS Paths and Outturn

% of GDP

	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89
1980 MTFS	4 3/4	3 3/4	3	2 1/4	1 1/2					
1981 MTFS			4 1/4	3 1/4	2					
1982 MTFS				3 1/2	2 3/4	2				
1983 MTFS					2 3/4	2 1/2	2			
1984 MTFS						2 1/4	2	2	1 3/4	1 3/4
1985 MTFS							2	2	1 3/4	1 3/4
Outturn and AS Forecast	4.8	5.4	3.3	3.1	3.2	3.1	2.2			

PSBR: MTFS Projections and Outturn

£ billion

	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89
1980 MTFS	9.1	8.5	7.4	6.3	4.6					
1981 MTFS		13.5	10.6	8.9	6.0					
1982 MTFS			10.6	9.5	8.4	6.7				
1983 MTFS				7.5	8.2	8.0	7.0			
1984 MTFS					10.0	7.2	7.0	7.0	6.8	7.2
1985 MTFS						10.5	7.1	7.5	7.0	7.3
Outturn and AS Forecast	10.0	12.7	8.6	8.9	9.7	10.2	8.0			

TCSC ENQUIRY INTO THE AUTUMN STATEMENT

The Committee's advisers will brief the Committee to ask the following questions.

Fiscal adjustment forecast/revenue forecasts

- How is the Committee expected to assess the Government's strategy, when the Government is withholding the critical information?
- If there is a fiscal ajdustment, it is included in the forecast. This must mean that the forecast assumes changes in taxation. In what sense, therefore, is the forecast really based on a "no policy change" assumption?

policy = MTFS

- What proportion of the expected increase in real disposable income is attributable to assumed tax reductions?

Forecast

reference req'd.

(see MoM's note with quote by question below)

- The Government have said that changes in cost competitiveness do not affect exports very much. Does this mean that the Government has little to fear about the effect of increases in domestic costs on the balance of payments?

non sequitur

- If that is so, is it not worth increasing the PSBR, in order to stimulate employment, if there is little to fear from any consequent rise in domestic inflation?
- Moreover, does this not undermine the case that moderation in real wage increases help employment?

no.

prices are now cost determined, [illegible] import prices.

- How is it possible to reconcile the forecast that there will be a further recovery in profits with the statement that companies are going to find it difficult to raise prices and are being squeezed by rising labour costs?
- What assumptions does the forecast make about the effect of the Government's supply side policies in increasing labour market flexibility?

Public expenditure

- Last year the Committee criticised the way that the Government determines its overall public expenditure priorities. Has anything changed in the planning process this year? (The fact that some of the biggest increases are in demand-led, not discretionary programmes suggests that priorities have been forced on the Government, rather than the Government determining priorities.)

Prudent reserves; realistic assumptions

- What confidence can the Committee have that the planning total will be held either in the current year or in future years?
- What confidence can the Committee have that the growth, in real terms, in the planning total has come to an end?

- The Government forecasts that the entire Reserve will be spent in the current year. How much of this is due to policy changes, how much to unrealistic forecasting (eg of social security or local authority spending)?

Local authorities collection [illegible]

- Given that Revenue forecasts for the current year have been scaled down since the Budget, would it not be sensible to aim to avoid spending the entire Reserve, so as to ensure that the original PSBR target is hit?
- What is the split between capital and current expenditure?
- Will the extra £2½ billion raised by asset sales be spent on current or capital expenditure?
- Why are local authorities overspending disproportionately and why should the Committee believe that overspending will be less next year?
- Why is there no "unallocated" figure for local authorities in the plans?

Monetary and fiscal policy

- Can the Chancellor now say more about how monetary conditions are being assessed?
- Is there an exchange rate target?
- If, next year, the Government sticks to the PSBR figure set out in this year's MTFS, will this not signify an easing of fiscal policy because of the effects of asset sales? How credible is the Government's determination to maintain its fiscal stance?
- Does the Odling-Smee/Riley paper on factors to be taken into account in settling the PSBR represent Government policy?

no.

PRIVATISATION

The privatisation programme has been an enormous success. 12 major companies have been transferred to the private sector, and they are all better for it. It has also captured the imagination of the electorate.

Perhaps that is why the Opposition have begun to try so hard to discredit the policy, with a variety of extraordinary and quite baseless charges.

Four criticisms have been advanced. Let me say a word or two on each.

First, there is the charge that we are using privatisation receipts to massage the figures on expenditure and borrowing.

I hope that I have now laid that canard to rest for good. The PSBR is, of course, defined following international conventions, conventions which my Labour predecessors accepted. But to ensure that no-one is misled, this year's Autumn Statement shows the numbers with, and without, privatisation receipts.

Second, I am accused of engineering a dangerous reflation , behind a smokescreen of massaged numbers.

It is not much of a smokescreen, as I have shown. And behind it we can see that even if privatisation receipts were counted as an addition to borrowing this year's PSBR would - at 2.9 per cent - be the lowest percentage of GDP since 1971-72. And the share of GDP accounted for by public expenditure still falls consistently to 1988-89.

In any event the Labour party, with its commitment to a massive expansion of spending and borrowing, would be wise to be careful before charging this Government with fiscal irresponsibility. When Mr Hattersley borrows the arguments of a Daily Telegraph leader on the subject, I wonder whether he is quite serious.

<u>Third,</u> the Opposition claim that privatisation is in some way a threat to public finances in the long term - that there will be a fiscal crisis at some indeterminate future date.

This is obvious nonsense. Privatisation reduces the amount the government needs to borrow, and therefore future interest payments. And of course privatised companies pay tax - the more tax the more successful they are.

The <u>fourth</u>, and most desperate, charge is that we shall soon run out of assets, and will have nothing left for an encore.

In fact the privatisation programme has a long way to go yet. There are certainly enough companies in the public sector which would benefit from transfer to private ownership to see us through to the end of the next Parliament at least.

These four criticisms, then, are of no weight whatsoever. The truth is that the policy is successful, popular and makes sound economic sense. In the Autumn Statement context it is one part of the total fiscal picture. It is a significant part of that picture, I agree, but it is quite wrong to argue that further reductions in tax are either the justification for the policy, or the principal consequence of it.

I will reach my judgment on the appropriate fiscal stance at the usual time, and in the normal way.

(Sir T Burns' draft)

Privatisation

1. The Opposition originally opposed privatisation on grounds of political dogma; they prefer state owned activity to private enterprise. But now even Opposition can no longer deny the success of privatisation and have come to realise that it has the overhwelming support of public opinion.

2. As a way of diverting attention from the success of privatisation they advance the bogus charge of fiscal irresponsibility. This may seem extraordinary coming from a party that has supported every claim for higher public expenditure and persistently argue for a huge increase in borrowing.

3. The RHG seeks to make 2 points:

- that in the process of privatisation we are massaging the figures for expenditure and borrowing so that they look much better than they really are;

- and that we are doing long term damage to public finances. He argues there will be a fiscal crisis when the scope for asset sales runs out - requiring either higher taxes or cuts in spending.

4. Look us examine these charges in turn. I totally reject the charge of massaging the figures. The full figures are available for everyone. If anyone wishes to adjust public expenditure or borrowing figures for privatisation receipts they can do so quite easily.

5. As I explained to RHF (Higgins) yesterday the definition of the PSBR is based upon international convention. It has not been changed to accomodate privatisation. It is the same definition used by the last Labour Government when it still supported

nationalisation - and when they chose to sell BP shares. Because they used this technique to dig themselves out of a fiscal hole they wrongly assume others are up to the same tricks - or "wheezes" as I believe Lord Lever used to describe them.

6. It is interesting as a means of exposition to take the extreme example where privatisation receipts are added to borrowing and do not count as an offset to public spending. This is the convention supported by RHF (Higgins):

- this year public expenditure as a percentage of GDP, would be 45 per cent instead of 44 per cent;

- the reduction in the share of public expenditure from its level 3 years ago would be only 2 per cent instead of 2 1/2 per cent;

- by 1988-89 the share of public expenditure instead of being 41 per cent would be 42 per cent;

7. If the House is not overwhelmed by these differences I am not surprised. And the effect on public borrowing is of a similar order of magnitude;

- if privatisation receipts were counted as an addition to borrowing this year's PSBR would now be estimated at £10 1/2 billion; 2.9 per cent of GDP rather than the actual estimated figure of 2.2 percent. This compares with 9 per cent under Labour in 1975-76. You might wonder why they are making so much fuss;

- and at 2.9 per cent of GDP it would be less than the registered outturn for last year (3.1 per cent);

- and even on this basis where privatisation receipts count as an addition to borrowing the PSBR this year looks like being the lowest percentage since 1971-72;

8. Compare that with the plans and promises of the Opposition. Most of the time they complain that the PSBR is too low. We now find them masquerading in the appantly virtuous role of the protector of the public finances. Which position do they really take? Do they want the PSBR to be higher or lower?

9. I have repeatedly stated that we take full account of privatisation receipts when judging the appropriate PSBR. That will continue to the the approach I will adopt.

10. So the charge of long term damage to the public finances is equally absurd. Privatisation reduces the PSBR, the amount of outstanding government debt and future interest payments. And remember that once privatised those companies and shareholders will pay taxes; and as their performance improves with privatisation the more tax they will pay.

10. It is even implied by the Opposition that privatisation is an inferior form of financing to gilt edged stock -(or even forcing pension funds to lend to the Government through the National Investment Bank). This too is obvious nonsense. The variety and choice of securities offered has strengthened confidence and attracted new investors. Because of that I am in no doubt that privatisation receipts are a superior form of funding to normal gilt edged stock. The extreme case I presented above where they are simply counted as an addition to borrowing is therefore unduly cautious. The pressure on markets from privatisation receipts is significantly less than an equivalent amount of extra asset sales.

11. Finally the Opposition have raised the bogus issue of what happens when the scope for privatisation runs out?

- as I have explained, even excluding privatisation receipts public expenditure will decline as a proportion of output. This means that over time there will be downward pressure on the PSBR. In turn this leaves room for tax cuts. The prospect of tax cuts does not depend upon privatisation receipts but on continuing to control public expenditure as proposed in the Autumn Statement.

- in the absence of the privatisation receipts I have no doubt that the PSBR would have been higher; but as I have stressed even that figure is at a responsible level. Hence if the privatisation receipts were to fall the PSBR would clearly be sustainable;

12. But above all I can assure the House that there is no immediate prospect of privatisation receipts coming to an end. There are still plenty of companies in the public sector that we are eager to see in the private sector - enough to last through the next Parliament at least.

7/2416

Note 8

CONTROL OF PUBLIC EXPENDITURE

1. Two major factors behind the rise in public expenditure since 1978-79 have been the rise in unemployment and the need to increase defence expenditure. Over be next three years the increased costs of these two programmes will not be repeated.

   i) Since 1978-79 the defence programme in real forms has risen by 29 per cent. This is equivalent to an extra £4 billion on the defence programme.

   ii) Since 1978-79 social security benefits going to the unemployed have increased from £1.4 billion to £6.5 billion, equivalent an increase of £4 billion at current (1985-86) prices.

2. These two factors between them added approximately £8 billion out of the £11 billion increase in the planning total between 1978-79 and 1985-86.

3. See Note 12 on better control of local authority expenditure, current and capital.

Note 8
(public expenditure
control)

	1978-79	1985-86	
Cash			
Defence (including Falklands)	7,497	18,053	
Social Security to unemployed	1,340	6,540	
Planning total (£ billion)	65.7	134.2	
GDP deflator 1985-86=100	53.3	100	
1985-86 Prices			
Defence	14,066	18,053	+3,987
Social Security for unemployed	2,513	6,540	+4,026
Planning total	123.3	134.2	+10.9

A Turnbull

Note 18

PUBLIC EXPENDITURE PLANNING TOTAL

£ billion, unless indicated

	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86
PLANS	91.2	104.4	114.7	119.6	126.4	134.2
OUTTURN	92.7	104.6	113.4	120.3	129.7	134.2
CHANGE (outturn compared with plans)	+ 1.5	+ 0.2	- 1.3	+ 0.7	+ 3.3	-
PERCENTAGE CHANGE (")	+ 1.6%	+ 0.2%	- 1.1%	+ 0.6%	+ 2.6%	-
YEAR ON YEAR INCREASE, PER CENT	-	+12.8%	+ 8.4%	+ 6.1%	+ 7.8%	+ 3.5%
<u>Excluding strike costs</u>						
OUTTURN					127.1	133.0*
CHANGE (outturn compared with plan)					+ 0.7	- 1.2*
PERCENTAGE CHANGE (")					+ 0.6%	- 0.9%
YEAR ON YEAR INCREASE, PER CENT					+ 5.7%	+ 4.6%

3 9
2 0 avge { 0.42
0.42

* coal strike cost in 1985-86 shown as £1.2bn, consistently with AS ("nearly £1¼bn"), recent data suggest cost may be closer to £1.1bn.

<u>Source</u>: GEP3: figures shown will be those to be included in Table 2.1 of 1986 PEWP (subject to further small changes), ie "plans" for previous years have been adjusted for subsequent classification changes.

TABLE 2.1

PUBLIC EXPENDITURE(1) PLANS AND OUTTURNS

£ billion

	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89
March 1980 White Paper (CMND 7841) (2)	91.2	101.0	106.4	112.4					
March 1981 White Paper (CMND 8175) (2) (3)	92.8	104.4	109.9	113.6					
March 1982 White Paper (CMND 8494) (3)	93.0	105.8	114.7	120.7	127.6				
February 1983 White Paper (CMND 8789)	92.7	104.7	113.0	119.6	126.4	132.3			
February 1984 White Paper (CMND 9143)	92.7	104.7	113.4	120.4	126.4	132.1	136.7		
January 1985 White Paper (Cmnd 9428)	92.7	104.7	113.4	120.3	128.1 +3.3	132.1	136.7	141.5	
March 1985 Budget (FSBR)	92.7	104.7	113.4	120.3	129.7	134.2	139.0	143.9	
This White Paper	92.7	104.6	113.4	120.2	129.4	134.2	139.1	143.9	148.7

1980/1 – 1984/5 avge +0.75%.
(wd have been +0.35% [illegible] coal strike)

(1) Public expenditure planning total as defined in this White Paper
(2) Converted into cash as explained on page 103 of Cmnd 8494 Vol.2
(3) Including changes announced in the March Budget Statement.

Outturns & Estimated Outturns

Plans

7

PUBLIC EXPENDITURE IN REAL TERMS

		Percentage changes
	1982-83/1978-79	1986-87/1982-83
Planning total	5.5	2.4
Planning total & SSAs	6.0	5.4
General Govt expenditure	8.5	3.2
General Govt expenditure and SSAs	8.9	5.8

RESERVES

(i) The inclusion of a Reserve within the planning total is a proper part of expenditure control. It should not be seen as a pot of gold which is available for departments to spend and against which they may freely make bids. Rather it is a provision which experience indicates needs to be set aside to meet genuinely unforeseen contingencies such as revised estimates for demand-led programmes like social security or export credit; or higher than planned expenditure in local government which is not directly under the control of central government. It is also available to finance policy changes and new initiatives.

(ii) The fact that the Reserve is, in the event, fully spent is not a sign that expenditure is not under control since in these circumstances the planning total would be held. It is rather a sign of prudent and realistic planning.

(iii) The Reserves set out in the Autumn Statement are larger than in any previous White Paper.

(iv) Since 1984-85, the Reserve has covered not just policy changes and new initiatives but estimating changes as well. This was part of an effort to focus attention on the planning total as a whole; and, as part of that, to improve monitoring and forecasting of expenditure in-year.

CONTINGENCY RESERVE AND THE RESERVE

	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89
March 1982 White Paper Cmnd 8494	2,250	4,000	6,000				
February 1983 White Paper Cmnd 8789		1,500	3,000*	3,000*			
February 1984 White Paper° Cmnd 9143			2,750	3,750	4,750		
January 1985 White Paper Cmnd 9428				3,000	4,000	5,000	
March 1985 Budget				5,000	6,000	7,000	
November 1985 Autumn Statement					4,500	6,250	8,000

* Described as provisional

° First White Paper with new Reserve.

Note 10

OVERSPENDING ON PLANS BY SPENDING AUTHORITY

The table below shows outturn expenditure against plans by local authorities, capital and current, and central government.

The table shows:

(i) LA current spending has consistently exceeded plans, by well over 5% in most years. The absolute amounts are substantial. (These figures include all current spending, including housing benefit, not only RSG relevant).

(ii) LA capital spending has, in relation to plans, fluctuated widely; however, in absolute terms the LA capital overspend of recent years has been less than current overspend.

(iii) Central government overspending, in contrast, has been relatively modest. The last two years' figures are affected by the coal strike (the table includes CG grants etc to NIs).

£ billion, unless indicated

LA Current	**1981-82**	**1982-83**	**1983-84**	**1984-85**	**1985-86**
Plans	21.3	23.3	26.8	27.9	30.1
Outturn	23.3	25.6	28.7	30.4	31.4
Change	+ 2.0	+ 2.3	+ 1.9	+ 2.5	+ 1.3
Percentage change	+ 9.3	+ 9.7	+ 7.2	+ 8.9	+ 4.3
LA Capital					
Plans	4.2	4.2	3.9	3.7	3.2
Outturn	3.4	3.7	4.6	4.5	3.8
Change	− 0.8	− 0.5	+ 0.7	+ 0.9*	+ 0.6
Percentage change	− 19.2	− 12.9	+ 16.8	+ 23.5	19.3
Central Government					
Plans	76.6	83.7	88.4	93.7	99.8
Outturn	77.2	84.0	88.0	96.6	102.6
Change	+ 0.6	+ 0.2*	− 0.4	+ 2.9	+ 2.8
Percentage change	+ 0.7	+ 0.3	− 0.5	+ 3.1	+ 2.8

* rounding differences

Source: GEP3 ("Plans" have been adjusted for classification changes, but some errors may remain).

Excluding CG grants etc to NIs, the percentage change would be about 2.0% in 1984-85 and 2.2% in 1985-86.

CAPITAL SPENDING AND INFRASTRUCTURE: SPEAKING NOTE

[Before answering the specific question] let me say generally that I feel nothing to be ashamed of in this Government's record on capital spending and the infrastructure. In some areas, notably housing, we have deliberately and for good reason switched the emphasis in provision from the public to the private sector. Even so, total public capital spending in real terms has been broadly maintained since we came to office; and at a substantial level - about £22 billion last year. Public sector repair and maintenance expenditure, which is relevant in this context, has risen in real terms and adds approaching £5 billion to this figure.

DESPITE HOUSING POLICY

[In some sectors there have been substantial increases; spending on national roads is up by nearly 30 per cent in real terms since 1979, and capital spending in the NHS by the same amount; BGC's investment has risen by 2 per cent in real terms, the electricity industry's by 10 per cent and investment in water and sewerage will increase 5 per cent this year.]

But impressive though our record is, it is not really what counts. There is no 'target' or 'right' level of capital spending in aggregate. We should instead look at proposals on their merits; and where projects are shown to be worthwhile, and are best done within the public rather than the private sector, we should make every effort to find room for them in our spending plans. That is what we have done since we came to office, and what we did in the last Public Expenditure Survey.

In the course of the Survey, I have reviewed the case made by many people in this House, the NEDC and elsewhere for increased capital investment in some sectors. In looking at the evidence I have taken into account the wider economic and social effects of the spending and - to pick up a point often made about maintenance and renovation projects - the future cost of doing nothing now. In the light of this evidence I and my colleagues have thought it right to make additions to some capital programmes, within our general objectives for public spending.

You are already aware of the main areas where capital provision has been added: they include housing (renovals?) (£200 million in 1986-87), national and local authority roads (over £50 million in 1986-87) and prisons (some £10 million in 1986-87). In some areas there will be increased maintenance expenditure, notably local authority roads. It is too early to give details of the total provision for capital spending. As well as the major increases I have mentioned, departments will internally want to make adjustments to their plans. The numbers have to be processed and will be published in the customary tables in the White Paper.

But as I have indicated, I do not think that the total will be all that illuminating. <u>Where</u> we are spending the money and our priorities for spending it will be more important; and when looking at the figures, we should remember that substantial chunks of current expenditure - investment in training on R&D as well as repair and maintenance of buildings - can represent investment in our future just as much as that expenditure the statisticians choose to label 'capital'.

Note 12

Why are local authorities overspending disproportionately, and why should the Committee believe that overspending will be less next year?

A. We have to remember that local authority expenditure is the result of independent decisions by over 400 local authorities, subject to Government influence and sometimes control, but with considerable flexibility on both capital and current expenditure. Controlling it is not quite the same thing as controlling expenditure by a Government department.

Local authority capital expenditure is forecast to be substantially above plans in 1985-86 - the Autumn Statement gave a figure of £600m but explained that the position remains uncertain. This is happening because local authorities have more spending power in the current year, and are using more of it, than the plans allow for. The arrangements for 1986-87 take proper account of all the spending power available to local authorities from their receipts and other sources, and the allocations which the Government makes to local authorities are being set in a way which is designed to bring spending into line with the increased level of provision.

As regards current expenditure, the present target and holdback arrangements will not apply in 1986-87, but will be replaced by strong pressures to deter overspending in the mechanisms for distributing the Rate Support Grant. And of course rate-capping will apply to 32 authorities with expenditure totalling £3½bn, including the new joint boards in metropolitan areas.

Note 14

Q. Why is there no unallocated figure in the plans?

A. Unallocated sums were shown in the plans for local authority current expenditure in some recent years. They represented the difference between the total of targets and the total of GREs ie an allowance for the probability that certain local authorities would spend in excess of the plans for certain services. With the abolition of targets, there is no "unallocated margin" in the plans for 1986-87, and no decisions have been taken on provision for the two later years; but the possibility of overspending by some authorities on some services has been taken into account in setting the size of the Reserve for all three years.

Note 16

CHANGE IN UPRATING DATE

Line to take

"The change in the uprating date from November to April is not being made to save money. It is being made for sensible operational reasons. The main consideration is that local authority rent and rates change in April and under the new arrangements housing benefit will need to be recalculated only once a year. At present, local authorities have to make one change in April and another in November.

2. To smooth the transition and avoid a sixteen month gap between upratings, it was decided to bring forward the November 1986 uprating to ~~April~~ July. The size of that uprating will depend entirely on the actual movement in the RPI.

Producing two 8 month uprating periods

3. We can scarcely be accused of manipulating uprating dates when claimants have just received a 7 per cent uprating based on a short-lived peak in the rate of inflation earlier this year."

4. On Friday, Mr Newton answered a PQ on the cost of a November 1986 uprating in the following terms:

> "On the assumption in the Chancellor's Autumn Statement that the movement in prices over the eight months to January 1986 would be of the order of 1 per cent, the July 1986 uprating will add some £270 million to benefit expenditure by the end of the financial year 1986-87. An estimate of expenditure had the uprating taken place in November instead will not be available until the retail prices index for May 1985 is published."

Not for use

Compared with retaining the November sequence, the proposed sequence saves £ million

1986-87	1987-88	1988-89
215	588	525

A sequence of November '86 and April '87 leaves too little time to complete the second uprating. As it is operationally impossible it cannot be costed.

Note 17

POINTS TO MAKE

Public Sector Manpower

Treasury have agreed the TCSC's request to provide a public sector manpower table in the next Public Expenditures White Paper. This will be for past years, it will not include forecasts. Impossible to provide forward projections for all manpower outside direct control of Government.

Why no Foward Projections?

Up to local authorities to decide, within limits of expenditure, what staffing levels they can afford. Government departments may make assumptions about future trends for eg: education. But it would be inappropriately prescriptive for Government to set figures in White Paper as targets. In any case final decisions on local authority current expenditures are still to be taken so not possible to offer forecasts for those years.

What are Figures of Manpower to Date

Wait for White Paper. Figures in last years White Paper showed fall for average non-trading employment in local authorities of 74,000 from 1979-80 to 1984-85 (average 1984-85 figure 2,041,000), a fall of 3.6 per cent. /Mid-year figures to mid 1984 quoted to Mr Howell in a PQ are different but showed a similar fall (mid 1979 2,997,000; mid 1984 2,884,000 a fall of 3.8 per cent). Latest count to Q1 1985 shows a fall of only 3 per cent because local authority totals have increased/.

Disappointing Reduction in LA Manpower?

Compared with Civil Service reductions of 18 per cent, yes: this is a disappointing figure. But the Government's ~~can~~ control is of ~~the~~ expenditure by local authorities, not their manpower. And within that total there have been increases in police support and probation services, and health services.

Education Manpower

Next White Paper will show past figures for staff employed by local education authorities; university lecturers and lecturers employed by local authorities. It will show projections for teaching staff for 1986-87, (because of DES responsibility for teachers supply) but not for non-teaching staff, which are fully for local authorities to provide. Recent correspondence between Mr Howell and Minister of State, Treasury attached.

20/11/85 PWV.

DEPRECIATION

The depreciation figure for 1985-86 given in the tables has been obtained by extrapolating the figures in the CSO Blue Book, table 11.5. The Blue Book figures are constructed by the CSO from investment data using the perpetual inventory method. 5 assets, each with different asset lives, are distinguished in the calculation.

Using the CSO figures for the public sector capital stock, the aggregate depreciation rate is about 2 per cent per annum. Taken at face value, this means that assets are assumed on average to depreciate fully in around 50 years.

The assumptions about asset lives are subject to considerable uncertainty, though we have no reason to think they are biased one way or the other. The possibility that the net capital stock figures may be overstated in the accounts, which has been mentioned internally in the past, has no clear cut implication for the depreciation figures. A lower stock may mean either <u>less</u> depreciation now, or that the stock is depreciating <u>faster</u> than assumed. Overall, however, the figures are subject to major uncertainty.

No estimates are available for depreciation of defence capital. It is therefore <u>not</u> included in the figures presented in the tables. This will tend to bias up, perhaps substantially, the figure for net capital formation in table 3A, which is defined as <u>gross</u> defence capital formation plus the standard definition of net capital formation.

TABLE 3

FIGURES FOR PUBLIC SECTOR TRANSACTIONS: 1985-86, £ billion

CURRENT TRANSACTIONS

Current expenditure on goods and services	73.9	
Subsidies	5.5	
Current grants	48.4	
Debt interest	18.5	
Unallocated Reserve	5.0	
Depreciation	10.7	
Total current expenditure		162.0
Taxes on income	52.9	
Taxes on expenditure	55.8	
NICs, etc	24.6	
Gross trading surplus	7.6	
Rent and oil royalties	6.2	
Other	7.4	
Total current receipts		154.6
Current Surplus		-7.4

CAPITAL TRANSACTIONS

Net domestic fixed capital formation	1.1	
Increase in stocks	0.4	
Capital grants (net)	2.8	
Taxes on capital (-)	-1.9	
Net lending	+0.1	
Cash expenditure on company securities(1)	-2.6	
Miscellaneous	-0.2	
Total capital expenditure		-0.3
Borrowing Requirement		7.1

(1)Includes special sales of assets

TABLE 3A

FIGURES FOR PUBLIC SECTOR TRANSACTIONS: 1985-86, £ billion

CURRENT TRANSACTIONS

Current expenditure on goods and services(2)	68.5	
Subsidies	5.5	
Current grants	48.4	
Debt interest	18.5	
Unallocated Reserve	5.0	
Depreciation	10.7	
Total current expenditure		156.6
Taxes on income	52.9	
Taxes on expenditure	55.8	
Taxes on capital	1.9	
NICs, etc	24.6	
Gross trading surplus	7.6	
Rent and oil royalties	6.2	
Other	7.4	
Total current receipts		156.5
Current Surplus		-0.1

CAPITAL TRANSACTIONS

Net domestic fixed capital formation(3)	6.5	
Increase in stocks	0.4	
Capital grants (net)	2.8	
Net lending	+0.1	
Cash expenditure on company securities(1)	-2.6	
Miscellaneous	-0.2	
Total capital expenditure		7.0
Borrowing Requirement		7.1

(1) Includes special sales of assets
(2) Excludes defence capital expenditure
(3) Includes gross defence capital expenditure

TABLE 3': BASED ON AUTUMN STATEMENT

FIGURES FOR PUBLIC SECTOR TRANSACTIONS: 1985-86, £ billion

CURRENT TRANSACTIONS

Current expenditure on goods and services	74.7	
Subsidies	7.2	
Current grants	49.4	
Debt interest	18.5	
Depreciation	10.7	
Total current expenditure		160.4
Taxes on income	51.7	
Taxes on expenditure	56.4	
NICs, etc	24.3	
Gross trading surplus	7.7	
Rent and oil royalties	5.5	
Other	7.2	
Total current receipts		152.8
Current Surplus		-7.6

CAPITAL TRANSACTIONS

Net domestic fixed capital formation	2.3	
Increase in stocks	0.7	
Capital grants (net)	2.8	
Taxes on capital (-)	-2.1	
Net lending	-0.2	
Cash expenditure on company securities(1)	-2.6	
Miscellaneous	-0.4	
Total capital expenditure		0.5
Borrowing Requirement		8.0

(1) Includes special sales of assets

TABLE 3A': BASED ON AUTUMN STATEMENT

FIGURES FOR PUBLIC SECTOR TRANSACTIONS: 1985-86, £ billion

CURRENT TRANSACTIONS

Current expenditure on goods and services(2)	68.9	
Subsidies	7.2	
Current grants	49.4	
Debt interest	18.5	
Depreciation	10.7	
Total current expenditure		154.6
Taxes on income	51.7	
Taxes on expenditure	56.4	
Taxes on capital	2.1	
NICs, etc	24.3	
Gross trading surplus	7.7	
Rent and oil royalties	5.5	
Other	7.2	
Total current receipts		154.9
Current Surplus		+0.3

CAPITAL TRANSACTIONS

Net domestic fixed capital formation(3)	8.1	
Increase in stocks	0.7	
Capital grants (net)	2.8	
Net lending	-0.2	
Cash expenditure on company securities(1)	-2.6	
Miscellaneous	-0.4	
Total capital expenditure		8.4
Borrowing Requirement		8.0

(1) Includes special sales of assets
(2) Excludes defence capital expenditure
(3) Includes gross defence capital expenditure

TABLE 4

ALTERNATIVE DEFINITIONS OF CURRENT AND CAPITAL ACCOUNTS, 1981-82 to 1985-86

	1981-82	1982-83	1983-84	1984-85	1985-86 FSBR	1985-86 AS
Table 1 Basis						
Current surplus	6.2	5.7	3.8	2.3	3.3	3.1
Capital expenditure (net)	14.8	14.6	13.5	12.5	10.4	11.1
PSBR	8.6	8.9	9.7	10.2	7.1	8.0
Table 2 Basis						
Current surplus	11.4	11.1	9.9	9.2	10.6	11.0
Capital expenditure (net)	20.0	20.0	19.6	19.4	17.7	19.0
PSBR	8.6	8.9	9.7	10.2	7.1	8.0
Table 3 Basis						
Current surplus	-4.1	-4.9	-7.3	-8.9	-7.4	-7.6
Capital expenditure (net)	4.5	4.0	2.4	1.3	-0.3	0.5
PSBR	8.6	8.9	9.7	10.2	7.1	8.0
Table 3A Basis						
Current surplus	1.1	0.5	-1.2	-2.0	-0.1	0.3
Capital expenditure (net)	9.7	9.4	8.5	8.2	7.0	8.4
PSBR	8.6	8.9	9.7	10.2	7.1	8.0

b/f 30/11 ~~for~~ Rachel

Immediate

cc Mrs Lomax
Sir P Middleton
Sir T Burns
Mr Odling-Smee
Mr Pratt o/r

Mr HP Evans

Pl cd you get a submission to the Chancellor on this curiously worded question by tomorrow evening?

MCS 28/11

COMMITTEE OFFICE
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TREASURY AND CIVIL SERVICE COMMITTEE

28 November 1985

Richard Pratt Esq
HM Treasury
Parliament Street
SW1P 3AG

Dear Richard

I am writing to confirm formally the request which I made to you by telephone yesterday morning. Members of the Committee would be grateful if the Treasury could provide them with further explanation of the comments made at Q31 of the first day's evidence on the Autumn Statement. This reply, given by Sir Terence Burns, conveyed the Treasury conclusion that changes in cost price competitiveness may not be so closely related to exports as had previously been thought. The Committee would be very grateful for a brief account of the analysis which underlies this conclusion.

As you know, the Committee are under some pressure to conclude their report on the Autumn Statement, and are likely to be considering a text on Monday. I would be very grateful if your reply could reach me not later than midday on Monday.

Yours sincerely
Bill

W R MCKAY
Clerk to the Committee

CC → CHANCELLOR.
CHIEF SECRETARY.
SIR. P. MIDDLETON.
SIR. T. BURNS.
MR. F.E.R. BUTLER
MR. CASSELL.
MR. M.P. EVANS.
MR. ODLING-SMEE.
MR. TURNBULL.
MR. CULPIN.
MR. CROPPER.
MR. M.J. DAVIES.
MR. PRATT.

PMG

H M Treasury

Parliament Street London SW1P 3AG

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M C SCHOLAR

Under Secretary

W R McKay Esq
Clerk to the
Treasury & Civil Service Committee
Committee Office
House of Commons
LONDON SW1A 0AA

28 November 1985

Dear Bill.

AUTUMN STATEMENT

Thank you for your letter of 19 November.

As requested I attach both the supplementary notes which were asked for during the oral evidence and responses to the further questions set out in the attachment to your letter.

Yours sincerely

Michael Scholar

M C SCHOLAR

NOTE BY HM TREASURY

The Committee have asked for a note on some points which were raised at its meeting on 18 November.

(i) Expenditure on housing

Gross capital expenditure on housing in the current plans for 1986-87 is £3,250 million. This is an increase of £200 million, or 6.5 per cent, on the plans for 1985-86. This represents an increase of 1.9 per cent after allowing for inflation of 4½ per cent, as measured by the GDP deflator.

The Government has indicated that priority should be given within the total for capital expenditure to renovation of the local authority housing stock. Assuming local authorities continue the recent trend of spending less on new building and on improvement grants, expenditure on renovation can increase more than capital expenditure on housing generally.

(ii) Expenditure on Health and Personal Social Services

The Committee asked about the priority being given to spending on health. The priority the Government attaches to a programme is only imperfectly measured by the money put into it. Account needs to be taken of the underlying demands on a service which may have been falling, as in education; or rising, as with social security. Improvements in technology and working methods can sometimes reduce the costs of providing a service (eg advances in surgical techniques which permit patients to be treated within one day at hospitals). Ultimately, however, it is not the inputs to a service which matter but the output which is delivered. It is important, therefore, to take account of the scope for releasing resources within a service by increased efficiency. This is clearly relevant to the health service, as the Chancellor made clear in his oral statement. So far as expenditure alone is concerned, priority is best illustrated by the trends in provision for a service over a number of years.

The table below shows DHSS spending on health and personal social services as a proportion of the planning total in the Autumn Statement. This shows that spending on this programme is rising as a proportion of the planning total.

% Planning Total

1985-86	1986-87	1987-88	1988-89
12.4	12.7	12.8	12.9

iii) Costs of the coal strike

The Committee may also like to have for the record the Government's estimate of the effects of the coal strike on public expenditure and the PSBR.

		£ billion
	1984-85	1985-86
Nationalised industries' external finance (Coal Board, Electricity Industry, British Rail, British Steel)	2.5	1*
Other public expenditure (police, social security, miners' redundancy payments**)	0.1	nearly ¼
Total public expenditure costs°	2.6	nearly 1¼
Tax and national insurance	0.2	-
Total PSBR costs	2.8	nearly 1¼

* Includes cost of coal restocking

** Takes account of timing effects on miners' redundancies

° Expenditure costs in both years were included in the estimated outturn of the planning total shown in the Autumn Statement, and in 1985-86 will be met from the Reserve.

The Committee also asked for replies to a number of other questions. These are set out below.

1. The December 1983 version of the Treasury model included a retentions rate effect in the private sector earnings equation which represented an increase in nominal average earnings of 0.5 per cent if take-home pay was to be raised permanently by 1 per cent. Is this effect still operative in the current version of the model?

A. The private sector earnings equation in the version of the Treasury model released in January 1985 is shown on the attached page. That in the December 1983 version is shown in Barber J (ed.) H M Treasury Macro-economic Model: Supplement to the 1982 Technical Manual Treasury Working Paper No 31 June 1984, where the variables in the present equation are also defined with the exception of:

1023	NNSGDPO	Non-North Sea GDP (output measure)
1010	GDPO	GDP (output measure)

2. Is this effect largely responsible for the reduction of inflation as a result of tax cuts? How does this compare with simulations on other quarterly models, like those in the London Business School and the National Institute?

A. The mechanisms that cause inflation to change in tax cut simulations on the Treasury and other models can be studied by examination of the models and by performing comparable simulations. The Parliamentary Unit has access to the Treasury, London Business School and National Institute models among others.

3. The simulations referred to above also show that the effects on unemployment differ. Increasing Government expenditure by £2¼ billion would reduce unemployment by at least 150,000 after 4 years, while an equivalent cut in income tax taking 2 per cent off the basic rate reduces unemployment by 50,000 at most, according to Davies and Metcalf (Simon and Coates, 1985). What is the outcome in terms of unemployment of similar exercises with the Treasury model?

A. As indicated in the answer to question 2, the Parliamentary Unit can carry out simulations of the effects of changes in government expenditure and income taxation on the Treasury and other models. The supply-side response of the economy is not well developed in most macro-economic models, and so such simulations provide little information about longer-term developments.

4. A recent study by Professors Layard and Nickell suggests that the 'natural rate' of male unemployment in the UK in 1980-83 grew from 8.6 per cent in 1975-79 to 11.2 per cent in 1980-83. Is this evidence consistent with the implied natural rate in the Treasury Model?

A. The Treasury has not carried out any calculations of what the implied natural rate in the Treasury model might be.

5. The shortfall on oil revenue is mainly attributable to a higher sterling/dollar exchange rate than assumed in the Budget forecast (paragraph 1.57). Is the sterling-dollar rate assumed for 1986 the average since March as for the trade-weighted index?

A. Part 1 of the Autumn Statement follows the usual practice of making an explicit assumption about the sterling index. The forecast for 1986 assumes (paragraph 1.16) not much change in the sterling index from the average level between March and November. This is also consistent with an assumption of no major change in the sterling/dollar rate, but from more recent levels: there has been a fall in the dollar against nearly all other currencies between March and November. Some decline in oil prices is allowed for - as indicated by the futures market (paragraphs 1.13 and 1.22).

PRIVATE SECTOR EARNINGS, TREASURY MODEL 1985

```
                                                                                        9   1
Ln(*ERPR/R    ) = .243 Ln( - CCGE - .CLAE + 475.345 Y NNSGDPO/GDPO) +   S g (a Ln( - CCGE - .CLAE + Y - YOG)) +
          407                                                         1=1      1
  407                10           601     701      10028    1008 1023 1010                  601    701      1008 2131


                          407    412                            407     403    406    1317     4054
                         *ERPR NWFP                            *ERPR (WFP + OCR + :YPNIR + NIS)
 -.133 g ((1 - .5) Ln(----------) + .5 Ln(----------------------------------------------------)) +
                          WFP PR                      (4071 + 1 (4070 - 4070) R     - 4070) WFP PPGDP
 22               26                    26                                    407
                          403 501                           98001 98026                  98026 403 411


                                          2                                4   1
 -.00002926 (28 + T) + -1.0829 + .03 g Ln(*ECG + *ELA) +   S g (b [1 - g ]Ln(PPGDP)) +
                                                          1=0          1
 23                         24        25       607    706                           411


 4  1                      4   1
 S g (c [1 - g ]Ln(PR)) +  S g (d [1 - g ]Ln(NWFP/WFP)) +
1=0         1             1=0          1
                    501                        412   403


 4  1
 S g (e [1 - g ]Ln((WFP + OCR + :YPNIR + NIS)/WFP)) + g Ln(*ERPR/(4071 + 1 (4070 - 4070) R     - 4070))
1=0         1                                                                          407
                    403    406    1317      4054 403          407           98001 98026                98026
```

a	11- 19	b	48- 52	c	53- 57	d	58- 62	e	67- 71
		0	.0750	0	.0750	0	-.0250	0	-.0750
1	-.2430	1	.0850	1	.0850	1	-.0283	1	-.0850
2	.0810	2	.1038	2	.1038	2	-.0346	2	-.1038
3	.0520	3	.1231	3	.1231	3	-.0410	3	-.1231
4	.0000	4	.1131	4	.1131	4	-.0380	4	-.1131
5	.0000								
6	.0000	SUM	.5000	SUM	.5000	SUM	-.1669	SUM	-.5000
7	.0000								
8	.0000								
9	.0000								
SUM	-.1100								

CONFIDENTIAL

FROM: D N WALTERS
DATE: 29 NOVEMBER 1985

CHANCELLOR OF THE EXCHEQUER
SIR PETER MIDDLETON
SIR TERENCE BURNS
MR CASSELL
MR EVANS
MR TURNBULL
MR ODLING-SMEE
MR PERETZ

cc Mr Scholar

TCSC'S DRAFT REPORT ON THE AUTUMN STATEMENT

I attach a copy of the TCSC's draft report on the Autumn Statement. This has been sent to give us an opportunity to correct any factual inaccuracies. Our views are sought by lunchtime on Monday and in order for me to meet that deadline I would be grateful for your comments (including nil returns) by preferably close this evening or at latest 10.00am on Monday.

2. I should also stress the draft has been sent to us on a confidential basis and it should not be revealed that we have it.

PSC note my marginal comments passim. Also DCLP. Also note Scholar's. N

D N Walters

D N WALTERS

VP85

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

29 November 1985

John Browne MP
House of Commons
London SW1A OAA

Dear John

Many thanks for ringing my private secretary recently from Washington to report on your meeting with Jim Baker. It was good to hear that you had met him in such a bullish mood.

I gather you put to him the thought that successful co-ordination on exchange rates could lead to co-ordination on interest rate reductions. I fully appreciate the problems that high interest rates can cause. We keep a close eye on US rates and I have no intention of keeping our own rates higher for a moment longer than is absolutely necessary. But far greater damage could result for our economy if inflation were allowed to take hold again and, as you know, we are committed to ensuring this does not happen. So short-term interest rates will be held at whatever level is needed to maintain the monetary conditions that will continue to bring down inflation. Since the last Budget, of course, base rates have fallen by 2½ per cent.

Like Jim Baker, I will bear your idea carefully in mind.

Yours
Nigel

NIGEL LAWSON

copy attached
D
5/12

Have we yet vouchsafed a draft pro reply? ✓
Letter

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

TREASURY AND CIVIL SERVICE COMMITTEE

29 November 1985

Rt Hon N Lawson MP
House of Commons

Dear Chancellor.

I am writing on behalf of the Treasury and Civil Service Committee to thank you very much for agreeing to come, together with senior officials, to give evidence to us on Tuesday 26 November.

I know that Members of the Committee found the exchanges both interesting and stimulating, and we look forward to the preparation of our report on the Autumn Statement. I very much hope that, as in former years, sufficient time will be allowed to us to publish the report before the day arranged for the debate on the Autumn Statement in the House.

As ever
Terence

RT HON TERENCE L HIGGINS MP
Chairman

CONFIDENTIAL

p.f.

FROM: D N WALTERS
DATE: 29 NOVEMBER 1985

CHANCELLOR OF THE EXCHEQUER
SIR PETER MIDDLETON
SIR TERENCE BURNS
MR CASSELL
MR EVANS
MR TURNBULL
MR ODLING-SMEE
MR PERETZ

cc Mr Scholar

Rachel

TCSC'S DRAFT REPORT ON THE AUTUMN STATEMENT

I attach a copy of the TCSC's draft report on the Autumn Statement. This has been sent to give us an opportunity to correct any factual inaccuracies. Our views are sought by lunchtime on Monday and in order for me to meet that deadline I would be grateful for your comments (including nil returns) by preferably close this evening or at latest 10.00am on Monday.

2. I should also stress the draft has been sent to us on a confidential basis and it should not be revealed that we have it.

D N Walters

cc as above pages 12, and 19-24

D N WALTERS

Mr Walters

Some amendments from para 32 onwards. The conclusion of para 24 seems like a non sequitur. The argument in paras 39 & 40 is so bad one is inclined to leave the Committee to their own devices and leave the Treasury with some easy ripostes

A Turnbull

2/12

584/11

Economic Prospects

24 .The Autumn Statement expects real economic growth of 3% in 1986/87. ½% of this growth is expected to be due to the continuing recovery from the coal strike. The composition of demand is forecast to shift away from exports and investment towards domestic consumption. Domestic consumption is forecast to increase by 4%, encouraged by increased real earnings, increased employment[28] and the effects of the unspecified fiscal adjustment. Investment is forecast to rise by 3½%. The current account balance is expected to improve by £1 billion. A deterioration in the balance of manufacturing trade is forecast to be more than offset by the effects of improved terms of trade on the costs of inputs and an improved invisibles balance.[29] The worsening of the balance of manufacturing trade is ascribed principally to a slowdown in world trade growth and the "longstanding trend" (para 1.21) of import penetration in industrial countries generally rather than the further decline in UK cost competitiveness likely to occur next year. Retail price inflation is expected to fall to 3.75% by the fourth quarter of 1984 while domestic costs (as given by the GDP deflator) are expected to rise by 4½%. Unemployment and the effective exchange rate are assumed to remain at about existing levels. The PSBR is again likely to overrun, by £1 billion, in 1985/86. Next year's PSBR is assumed unchanged from the Financial Statement, because the £2½ billion increase in special asset sales is treated as negative expenditure.

√ oddly puts

28. Q15
29. Table 1.2

The Planning Totals

32 .The Autumn Statement contains a significant innovation. A new series of Tables, Table 2.2 and Tables 2.2A-D provide details of the estimated outturns for 1985-86 for both the planning total and individual spending departments. The same tables also contain projections of departmental spending for the next three financial years.

(i) The Plans for 1985/86.

33 .Para 2.02 of the Autumn Statement makes the claim that, "the estimated outturn for 1985-86 is £134.2 billion - as in the FSBR" ~~In fact however forecast expenditure for the current financial year will match the planning total only by fully deploying the Reserve of £5 billion.~~ This forecast implies that the Reserve will be fully utilised. Tables 2.2A, 2.2B and 2.2C in the Statement ~~indicate~~ will account for that £3 billion of the Reserve ~~has been allocated to central government~~ for that other departmental spending[1]; for £1.05 billion to local authorities' relevant current expenditure and £900 million to the Nationalised Industries, mainly for to meet further costs associated with the Miners Strike, the total cost of which is now estimated to stand at £3.75 billion.[31] Central government programmes which ~~have received extra funding~~ are expected to spend above plan including Social Security (+ £1.2 billion), IBAP and other CAP expenditure (+ £450 millions), ~~Transport~~ DOE-Housing (+ £400 millions), and the Exports Credits Guarantee Department. (+ £210 millions).

This is what the Reserve is for

"not really 'allocated' - and it's a forecast

Para 33 still written around view that Reserve has already been fully committed and allocated

---

31. Q49

1 this includes local authority capital spending and local authority current spending not classified as "relevant")

We sought to establish whether

Committee should reach its conclusions after hearing evidence not before.

34 . Despite the additional information given in the Autumn Statement it is, nonetheless, difficult to determine the extent to which expenditure is being contained within the limits established by the Public Expenditure White Paper. Table 2.2, which provides details of the estimated programme outturns for 198~~4~~5-8~~5~~6 ~~gives the distinct impression~~ implied that the Reserve has been fully committed with just under six months of the financial year to run and that further claims on the Reserve could not be accommodated without breaching the Planning Total. In evidence however both the Chancellor and officials claimed that this wasn't the case.[32] We were told that,

"We maintain a system whereby ~~divisions or~~ departments notify divisions in the Treasury and they in turn notify the General Expenditure Division of what they think the claims will be which arise during the course of the year. We keep a record of these and that helps us to produce our forecast of what is likely to happen by the end of the year. During the course of the year a number of concrete decisions are taken, for example an EFL of a nationalised industry may be changed. That will be announced, there may be a cash limit increase agreed and announced. ~~In that sense~~ Those are the changes which are positively committed and decided, but at this stage of the year the largest part represents not changes that ~~are~~ have been formally announced but changes that we think will arise by the end of the year."[33]

(ii) The Plans For Years to 1988-89.

---

32. QQ203-206
33. Q20~~6~~4

35 .The section of the Autumn Statement which deals with planned changes in future expenditure makes familiar reading. The overspend of past years will be compensated for by restraint in future years. Thus expenditure is planned to remain constant in real terms to 1988-89.[34] As a proportion of GDP, public expenditure will decline from 43% in 1986-87 to 41% in 1988-89.

36 .Examination of Table 2.2 in the Statement shows that for 1986-87 the additional proceeds of £2½ billion from asset sales, together with the allocation of part of the Reserve to Departmental programmes, mean that an additional £4 billion has been added to spending programmes since the 1985 Budget. As Table 3 shows, the familiar growth profile of public expenditure promises to be maintained.

Table 3 Public Expenditure Growth, Past and Future

Index Numbers, 1979=100.

1988-89 missing

		1979-80	1983-84	1984-85	1985-86	1986-87	1987-88
1	Planning Total	100	107.0	110.3	108.7	107.8	107.7
2	Planning Total and Special Asset Sales	100	106.5	110.7	109.3	110.1	109.9
3	Planning Total excl. all asset sales	100	107.1	111.8	110.4	111.0	110.6

---

34. Q117

4	Planning Total excl. asset sales + net interest	100	108.6	113.9	112.7	113.4	113.1
5	Total Expenditure adj to consistent basis*	100	110.1	115.7	114.7	115.4	115.1

SOURCE: Appendix 4

* includes corrections for the progressive reduction in the national insurance surcharge, and the changes in the accounting of housing and sickness benefits.

I make it 2.3%

so adjusted

37 .Since 1979-80 public expenditure in real terms so adjusted has increased by nearly 15%, or by almost 2½% a year. {If spending ~~is~~ were to be contained within the published planning total for 1986-87, there would be a break in this trend. We considered how likely it was that this would be achieved. ~~this trend will continue, although the rate of increase may be stemmed.~~}

Table does not show this. On table contrary. It shows on whatever basis you take next three years flat at about 1985-86 level. Should read as amended

38 .The Chancellor told us that ~~next year~~ over the next three years circumstances were likely to be more favourable to public expenditure control

"There are two things which I think will be helpful and those are that we have had to carry the cost up until now of a steadily rising defence programme in real terms, that phase has come to an end, and we also have had to carry the cost of a considerable increase in unemployment and that phase of the sharp increase in unemployment has come to an end. Those two sources of pressure on public expenditure produce totals which are quite important, together they account for the lion's share of the increase in public expenditure in real terms since we have been in office."35

39. We are however sceptical about the extent to which expenditure will remain constant in real terms. Table 2 sets out the planned growth by programme relative to the past rates of change. It shows that in most cases expenditure in future will increase at a slower rate or decline at a faster rate than over the past three years. This intended transformation is particularly marked for Defence, Energy, Other environmental services (in 1986-87 especially), ~~Education~~ and Social Security. Indeed in the case of Social Security, a programme which has shown a growth rate of over 4% a year since 1982-83, is planned to remain virtually constant in real terms from now on.36 This seems to rely to a large extent on the outcome of the Fowler review.

Of course. Govt has larger following NATO commitment

Nothing surprising in this if finances of coal industry are improved

This reflects fact that a major on spending on local authority capital in Wales in 1985-86

meaningless.

40. These doubts carry over to local authorities' spending. The expenditure projections show that the Government is expecting current spending by authorities to fall by almost 10% in real terms between 1985-86 and 1988-89 and by almost 4% in 1986-87. This compares with growth of 1 to 2% a year which has been experienced over the past six years.37

Committee have not read paras 2.36 & 2.37. It is made clear that current spending in 1987-88 and 1988-89 is entered at 1986-87 cash levels. These are ~~This comparison~~ not firm plans as Govt has not taken decisions. Size of ~~contingency~~ Reserve takes this into account

35. Q195
36. Appendix 4
37. Appendix 4

'24

Not checked
Committee on [illegible] for [illegible].

Table 2 **Real Public Expenditure Growth Rates by Programme, Past and Planned.**

	Average % change per year		
	1982-83 to 1985-86	1985-86 to 1986-87	1986-87 to 1988-89
Defence	3.3	-2.6	-1.9
ODA	1.0	1.1	-0.6
EEC Contributions	5.2	-22.2	-17.1
Trade and industry, excl. nat. inds. ext. finance	-19.4	-4.3	-10.4
Energy, excl. nat. inds.	21.7	-4.3	-2.3
Employment	6.9	9.0	-0.2
Transport, excl. nat. inds.	-5.3	3.2	-1.6
Housing	-4.0	-2.5	-0.9
Other environmental services, excl. nat. inds.	-0.2	-10.5	-2.5
Law and order	3.7	0.4	-1.5
Education and science	-0.5	-4.8	-2.6
Arts and libraries	0.8	-0.2	-1.2
Health and personal social services	1.8	1.5	0.6
Social security*	4.3	-0.1	0.3
Civil superannuation	4.6	7.5	5.5
Scotland, excl. nat. inds.	0.9	-2.2	-1.6
Wales, excl. nat. inds.	0.8	-0.2	-1.5
Northern Ireland	2.4	0.6	0
Addition from Reserve		3.2+	2.3+
Planning total, excl. special asset sales	1.5	0.7	0

* Adjusted for change in accounting of housing and sickness benefits.

\+ This is expressed in relation to base year expenditure and is hence the additional growth of total expenditure that the reserve makes possible.

Source : Appendix 4.

pmp.

2564/57

CONFIDENTIAL

From: D L C PERETZ
Date: 29 November 1985

MR WALTERS

cc Chancellor
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Evans
Mr Turnbull
Mr Odling-Smee

I agree [illegible] [illegible] [illegible] changes to (a), (b) & (d). [illegible]

TCSC'S DRAFT REPORT ON THE AUTUMN STATEMENT

You asked for comments.

2. I think there are several points that could be made about paragraphs 17 and 18 (in the Monetary Policy Section) without departing too far from the constraint of sticking to correcting factual inaccuracies.

(a) The Mansion House Speech did not say that £M3 had been "demoted" as a monetary target; nor was it "vague on the details of future monetary policy". What the Chancellor said was that "to try to bring [£M3] back within the range - which, with the benefit of hindsight, was clearly set too low - would imply a tightening of policy which the evidence of other indicators of financial conditions tells us is not warranted. I shall as usual be considering what target to set for £M3 for 1986-87 at the time of the next Budget. In the meantime we shall continue to monitor £M3 ...".

(b) More generally, the Mansion House Speech contained a full description of how monetary policy is being operated.

(c) It is ridiculous to suggest, as the draft report seems to, that the Government should be indicating the level of interest rates required "to keep the exchange rate at a level consistent with lower inflation". But that is perhaps not a matter of factual accuracy.

(d) It does not represent a "major change from the economic policy as it was originally explained ... when the Government took office" (paragraph 18). As the Chancellor said in the Mansion House Speech "there is, essentially, nothing new in this approach to the conduct of monetary policy." The footnote to paragraph 18 refers to the 1980 Green Paper on Monetary Control. As the Chancellor pointed out in the Mansion House Speech that Green Paper explicitly stated that to assess underlying monetary conditions properly, account has to be taken of the evidence of all the various monetary indicators. "No single statistical measure of the money supply can be expected fully to encapsulate monetary conditions".

D L C PERETZ

10.

PWP.

cc CHANCELLOR.
SIR. P. MIDDLETON.
SIR. T. BURNS.
MR. TURNBULL.

H M Treasury

Parliament Street London SW1P 3AG

Switchboard 01-233 3000
Direct Dialling 01-233 ....

S Barrett Esq
Treasury & Civil Service
 Select Committee
St Stephen's House
St Stephen's Parade
LONDON SW1

2 December 1985

Dear Steve,

AUTUMN STATEMENT ENQUIRY

.. I attach a corrected version of the transcript of the evidence given by the Chancellor and Treasury officials on Tuesday 26 November.

Yours sincerely

Richard

RICHARD PRATT

SP/003

CONFIDENTIAL

FROM: MRS R LOMAX
DATE: 2 DECEMBER 1985

MR WALTERS

cc Sir P Middleton
Sir T Burns
Mr Cassell
Mr Evans
Mr Scholar
Mr Turnbull
Mr Odling-Smee
Mr Peretz

TCSC'S DRAFT REPORT ON THE AUTUMN STATEMENT

The Chancellor has seen the TCSC's draft report on the Autumn Statement, attached to your minute of 29 November. He has also seen Mr Peretz's note and agrees that we should insist on the changes noted on his paragraphs 2a, 2b and 2d.

2. The Chancellor also has the following comments:-

- Paragraph 10 - The Chancellor has commented that the first paragraph (the references to 'announcement' and 'commitment') are not consistent with the text of the gracious speech. He has noted that the second sentence condemns the TCSC out of their own mouths - since it carries the clear (and incorrect) implication that the fiscal adjustment is an indication of the Government's 'policy intentions'.

- Paragraph 12 - The final sentence is constitutionally bizarre.

- Paragraph 15 - Final sentence. The Chancellor has asked what 'we agree with the conclusion' means (that they agree with themselves? or with whom?)

- Paragraph 18 - The Chancellor thinks the reference in the first sentence to 'a major change' is rubbish, as Mr Peretz observes. There are quotations from the

Chancellor's previous speeches in this year's Mansion House speech; the 1981 Zurich speech is also relevant as is the 1980 Green Paper on Monetary Control.

- Paragraph 23 - Footnote 19. The Chancellor has commented that the final two sentences are a somewhat incomplete and very muddled account of the Odling-Smee and Riley working paper.

- Paragraph 26 Whose view is referred to in the second sentence? And what squeeze in profitability are they talking about in the third indent? (A similar point arises on paragraph 28).

- Paragraph 30 - The Chancellor has observed that these quotations need checking against the corrected transcript (especially the final sentence of the second set of remarks attributed to him).

- Paragraph 36, table 3 - The Chancellor would be grateful if you could arrange for all these figures to be checked.

- Paragraph 38 - Again these quotations need checking against the corrected transcript.

- Paragraph 39 - Would you please arrange for the figures in the penultimate sentence to be carefully checked.

- Paragraph 40 - Second sentence; The Chancellor thinks the Autumn Statement figures for Local Authority current spending from 1985-86 to 1988-89 are subject to an important qualification, recorded in a footnote.

2-3-86

RL

RACHEL LOMAX

Rmp

FROM: M C SCHOLAR
DATE: 4 December 1985

MR H P EVANS

cc: Chancellor of the Exchequer
Chief Secretary
Sir P Middleton
Sir T Burns
Mr Odling-Smee
Mr Sedgwick
Mr C W Kelly
Mr Melliss
Mr Mowl
Mr Riley
Mr Barrell
Mr Bredenkamp
Mr Pratt

C./ It may be worth using this in some way next week.

Rs 4/12

TCSC REPORT ON THE AUTUMN STATEMENT

In the course of discussions yesterday about the arrangements for the Economic Secretary's appearance before the TCSC on 9 December (to give evidence on Seoul, Baker, debt etc), Mr Higgins told me that he was sorry that the Committee had not had time to take account of our supplementary note on the responsiveness of exports to price and cost changes. He had tried to think of a way of getting round this and referring to it in their report, but there seemed to be no alternative but to publish our note later, at the same time as the Government's reply to the Committee's recommendations.

2. It will be worth bearing this in mind when we prepare briefing for the debate on the Autumn Statement next week: presumably the Committee's final report will say that they did not find persuasive the evidence given by Treasury witnesses on this point.

MCS

M C SCHOLAR

pvp

From: **JOHN BROWNE,** MSc, MBA, MP

HOUSE OF COMMONS
LONDON SW1A 0AA

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
H M Treasury
Treasury Chambers
Parliament Street
London SW1

5th December 1985

C/ To note.

RS 9/12

Dear Nigel,

Thank you for your letter of 29th November which I received this morning.

Contrary to the majority of Members on the Treasury Committee, I strongly agree with your use of the Fiscal Adjustment. I also totally agree with your use of interest rates as an anti-inflationary measure. I realise that part of this anti-inflationary aspect is to maintain a strong exchange rate. Again, I totally support this, particularly as it forces business men to concentrate upon the non-price limits of the marketing mix. However, I wonder if it is possible, when the market is ready to accept a downward move in interest rates, to organise a concerted approach so that relative real rates of interest remain unchanged and currency stability is enhanced.

I know that you have kindly said you would bear my idea in mind. Please do not bother to reply to this letter as I know how busy you are.

By the way, many, many congratulations on the way in which you answered at the last Treasury Committee meeting. It really was outstanding, at least in my view.

Yours ever

John.

JOHN BROWNE

CH/EXCHEQUER
REC. -9 DEC 1985
ACTION
COPIES TO

9/12

CONFIDENTIAL

FROM: R PRATT
DATE: 5 DECEMBER 1985

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Sir Geoffrey Littler
Mr Butler
Mr Cassell
Mr Anson
Mr Scholar or
Mr Evans
Mr Odling-Smee
Mr Turnbull
Mr Peretz
Mr Culpin
Miss O'Mara
Mr H J Davies

Thanks. A more unimpressive report. Sir TB will wish to take [illegible] [illegible] [illegible] [illegible] [illegible] Monday

It will be interesting to see how much of this is effectively used by members in the A.S. debate. Doubtless TCSC members will make all of these points between them.

RWO 5/12

TCSC REPORT ON THE AUTUMN STATEMENT

I attach the final proof of the TCSC report on the Autumn Statement. It will be published on Monday. We have received this proof in confidence and should not reveal that we have it.

2. The final version of the report has taken account of most of the comments that you and others made on their draft. However:

(i) Paragraphs 17 and 19 - asserting that the Mansion House speech represented a "major change", and arguing that it confirmed that £M3 had been demoted as a monetary target - remain more or less as drafted.

(ii) Paragraph 18 on the role of the exchange rate is new.

(iii) Paragraph 23 still asserts that the Autumn Statement forecast is assuming tax cuts.

(iv) Paragraphs 24 to 26 have been redrafted but they still assert the decisions announced in the Autumn Statement may amount to a relaxation of the fiscal stance.

(v) Paragraph 36 still misunderstands the nature of the Reserve - it asserts that money from the Reserve has been "allocated" to different expenditure heads.

Richard Pratt

RICHARD PRATT

13/2650

UNCLASSIFIED

pmsp. ~~b/f~~ 10/12

From: J P MCINTYRE
Date: 6 December 1985

6/xii

1. MR GRIMSTONE

2. CHIEF SECRETARY

cc
Chancellor
Financial Secretary
Sir Peter Middleton
Mr Butler
Mr Monck
Mr Moore
Mr Scholar
Mr Turnbull
Miss Peirson
Miss O'Mara
Mr Crompton

DEBATE ON AUTUMN STATEMENT : TONY BLAIR ON PRIVATISATION PROCEEDS

You asked for a note about Mr Blair's series of PQs on privatisation proceeds and for some draft text on the subject for your winding-up speech next Thursday.

2. Mr Blair's Questions have been aimed at establishing that the extent of "asset sales" has been, and is planned to be, much larger than indicated by the Special Sales of Assets figures in the Autumn Statement and the PEWP. This is the basis for Labour's argument that the Government's fiscal policy is unsustainable and that, when the assets run out, tax increases will be needed.

3. Mr Blair claimed in October that sales of assets had amounted to £62 billion in the six years from 1979-80 (see attached reports in FT and Guardian of 21 October at Annex A). Annex B shows how his figure of £17½ billion for 1984-85 was built up, notably by including North Sea oil and gas revenues.

4. On the same basis, and using published information from the Autumn Statement and elsewhere, Mr Blair may claim that the true proceeds from asset sales in this and the next 3 years will be £67.6 billion, see table at Annex C.

5. I attach at Annex D a draft passage for your winding-up speech which

(i) stresses the merits of the privatisation programme in its own right;

(ii) asserts that public spending and borrowing are under control;

(iii) distinguishes between SSA and other proceeds.

6. This has been agreed with GEP.

Paul McIntyre

J P MCINTYRE

Annex A

MP claims public asset disposals are understated

BY PETER RIDDELL, POLITICAL EDITOR

MORE than 13 per cent of public expenditure was last year financed from "unsustainable" sales of public sector assets and North Sea oil and gas revenues, Mr Tony Blair, a Labour Treasury spokesman, has claimed in a new analysis of the Government's accounts.

In a dossier released over the weekend compiled from official information, Mr Blair argues that the separate published figures for asset disposals substantially understate the amount which the Government is receiving in various ways from the asset sales programme.

For instance in 1984-85, in addition to just over £2bn identified in the special sales of assets programme, about £2.54bn was received from sales of land and buildings, primarily council housing. This item is officially treated as negative expenditure and deducated from programme totals.

Moreover, some £430m was raised by nationalised industries from the sales of their assets, such as Wytch Farm by British Gas. These figures are reflected in an adjustment of these industries' external financing limits.

In total, these assets sales amounted to just over £5bn in 1984-85 compared with just under £4bn in the previous financial year.

In addition, some £12.5bn was received from North Sea oil and gas revenues and from the Gas Levy. Together with asset sales this was equivalent to 13.1 per cent of public spending, up from 10.7 per cent in the previous year.

Mr Blair suggests the scale of true asset sales over the next two years could be colossal.

Mr Blair estimates that in the Government's first six years of office about £62bn was received from these two sources. "Because many assets, like British Telecom, have been sold for far less than they were worth, the deterioration in the underlying balance sheet for the public sector has been much worse. With North Sea revenues now facing decline, the Government will go on the rampage, stripping assets from wherever it can."

He describes this as "grotesque irresponsibility"

The Treasury's decision to treat one-off sales of public sector assets as negative items has been persistently questioned and criticised by the Treasury and Civil Service Committee of the Commons.

FT
21/10/85

'One-off sales' finance big public spending slice

By our Industrial Editor

More than 13 per cent of Britain's public expenditure last year was financed by "one-off" sales of nationally-owned assets and oil and gas reserves, according to a Labour MP, Mr Tony Blair.

Mr Blair, Labour's Treasury spokesman, said yesterday that the government obtained £17.5 billion from asset sales and North Sea production in 1984-5 — some 13.1 per cent of the £133 billion of public expenditure. He estimated that about £62 billion has been raised from public sector sales in the past six years.

In a dossier on public spending, Mr Blair says the government conceals the full extent of public asset sales.

He claims that the North Sea oil revenues and gas levy brought in £12.5 billion last year, asset sales through privatisation a further £2 billion, and sales of land and council houses £2. 5 billion. In addition, public corporations sold £430 million worth of assets which they kept in their businesses.

Mr Blair's dossier points out that the huge sums now being raised by the government come from "unsustainable sources" and that the level will rise further with the planned sale of British Gas for about £8 billion. This, he claims, will creat a "Tory slush fund for giving the voters pocket money before the election."

He adds: "For all its self-righteous pap about following the economics of the corner shop, this government has been behaving like a regular of the pawn shop. There has not been plunder on this scale since the dissolution of the monasteries."

Guardian
21/10/85

ANNEX B

ASSET SALES AND NORTH SEA REVENUES, 1984-85

	£ million
Special Sales of Assets	2,091
Privatisation proceeds retained by nationalised industries	419
Sales of Council Houses	1,455
Other Departments' sale of land and buildings	1,081
North Sea oil and gas revenues	12,000
Gas levy	504
	17,550

ANNEX C

Proceeds from "Asset Sales"

£ million

	1985-86	1986-87	1987-88	1988-89
SSA	2,500	4,750	4,750	4,750
Sales of Land and Buildings	2,616	2,380	2,190	[not published]
Proceeds retained by NIs*	296	76	59	[not published]
North Sea oil and gas revenues	13,500	11,500	9,500	8,500
Gas levy	520	-	-	-
	19,136	18,706	16,499	13,250

Published cumulative total 1985-86 to 1988-89: £67.6 billion

* excluding NCB

ANNEX D

Privatisation Proceeds

Opposition have said a great deal about proceeds from the privatisation programme. It is true that these proceeds will be large and that they will increase. But the fact is that we would have stepped up this programme whatever the outlook for financial policy. It is a programme which is justified in its own right:

(i) In reducing the size of the public sector;

(ii) In promoting efficiency;

(iii) In giving opportunities for employees and the public generally to buy shares.

2. The results of companies like Jaguar, Amersham, and National Freight show clearly that privatisation can bring major improvements in performance.

3. The increase in receipts planned for future years is a sign of confidence in a successful policy. And the British public is clearly showing its support for this policy. The number of individual shareholders has probably doubled, and over 300,000 employees of privatised companies now have a stake in their own firm. [Cable and Wireless is another great success story for privatisation. x investors have shown this week their enthusiasm for the Government's policy in opening up direct opportunities to invest in British industry.]

4. And this is happening not only in this country. We are setting an international trend. Japan, Canada, Italy, even the socialist Governments of France and Sweden are recognising that business is better run in the private sector.

5. Opposition say we are concealing the true extent of proceeds from privatisation. This is not the case. All the figures are published. But we see no sense in lumping together different categories of income and expenditure to come up with a figure for so-called "asset sales". Privatisation proceeds are not specifically related to programme expenditure and are therefore shown separately. Council house sales, on the other hand, are an integral part of

the management and control of programmes: council house receipts directly affect what local authorities can spend. As for North Sea revenues, these are fully taken into account in deciding fiscal policy as the Medium Term Financial Strategy makes clear. And the PSBR for 1985-86 excluding North Sea revenues is now projected to be £1 billion lower than estimated at Budget time.

6. Some Opposition members have short memories on these matters. The last Labour Government sold BP shares worth over £½ billion, and the proceeds were treated in just the same way, offsetting public expenditure.

7. The position is that public spending and borrowing are under firm control and will remain so. Even if privatisation proceeds are excluded, public spending will remain broadly flat in real terms. And the PSBR will decline as a proportion of GDP.

8. Fears are expressed about the state of public finances when the privatisation programme is complete. These fears are not justified. The programme is only just getting into full swing: we have some way to go. But, more important, far from making fiscal policy unsustainable in the longer term, privatisation is helping to create a more efficient and dynamic economy which can well support a sensible level of public spending, without excessive borrowing and taxation. It is reducing Government borrowing and therefore future interest payments. It is transferring businesses to the private sector where they will prosper. It is providing a great stimulus to share ownership by employees and the public, and the consequences of this for our economic performance could be far-reaching.

CHANCELLOR OF THE EXCHEQUER

Comments with TB + PL

Ch.

Next week's diary points to doing as much work on this over the weekend as you can. The waters have closed over your "free day" on Monday (if you scrap Pete & Terry at 3 I cannot find another hour before the Paris dinner: I've looked). Tues & Wed. are both busy. You are out every night. You have Cabinet on Thursday morning.

This isn't in bad shape — though there is too much

Specifically addressed
to the TCSC - including a section
on monetary policy which
won't go down well; the
privatisation section won't
help either. Subject to
Howard's amendments, the section
on the recent [illegible] [illegible]
interesting. As a point of
drafting, you might want to
make some references to the
Opposition amendment. There
might be a case for something
on the jobs front.

RL
6/12

FROM: H J DAVIES
DATE: 6 DECEMBER 1985

CHANCELLOR

cc PS/CST
Sir P Middleton
Sir T Burns
Mr Butler
Mr Monck
Mr Cassell
Mr Turnbull
Mr Scholar
Mr Peretz
Mr Robson
Mr Williams
Mr S J Davies
Miss O'Mara
Mr Culpin
Mr Aaronson
Mr Cropper
Mr Lord

Mr P Lilley MP

AUTUMN STATEMENT DEBATE SPEECH: 12 DECEMBER

I attach a draft of your speech in the Debate on the Autumn Statement.

2. I think it includes most of the material which you mentioned in our meeting on Tuesday morning. I am grateful to Sir T Burns for the material in the section on "The Economic Record". Mr Turnbull provided a major input to the early sections on the TCSC report and helpful contributions have come, too, from Messrs Peretz, Robson, Williams, Davies, Pickering and Miss O'Mara.

I gather Terry may have some [illegible] amendments on Monday

3. I would draw your attention to the following points:

i) The section on Monetary Policy is a late addition after I had read the TCSC report last night. It certainly needs more work than some of the other passages.

✓ is too long.

ii) I have not included criticism of the Treasury Committee's attitude to the forecast. It seemed to me that there was enough about the Treasury Committee report as it was.

Far too much.

iii) Mr Turnbull advises against using the point that the Committee complained when falling inflation produced higher real increases but had given it no credit for restraining expenditure when inflation was rising faster than expected. In the last Budget the planning total was raised by £2 billion in part to accommodate higher inflation, so we are vulnerable to the retort that when inflation decelerates Departments keep the money and when it accelerates we provide more.

iv) I have included something on gas, but I wonder whether you really need it. The second reading of the Bill is on 10 December.

v) I have omitted the House of Lords Report for the time being. Mr Kelly is in favour of letting sleeping dogs lie after the lack of media response to the debate in the Lords.

plenty of opportunities for you, [illegible] Brittan the EST to add your voices [illegible] hand the following week

vi) The Archbishop has been left for the Chief Secretary, as has fraud and the small business routine.

vii) There is nothing in on pay or interest rates at the moment. It could easily be added.

viii) Nor have I put in a passage explicitly about unemployment, though clearly there are quite a lot of references throughout.

See my comment too.

ix) I have some doubts about a few of the comparisons in the Economic Record part, particularly for use in the House. I wonder, for example, whether we want to say ourselves that growth has been lower in the last six years than in the previous six.

aim for something shorter?

4. I think that as drafted this would run for about 30 minutes.

HJD

H J DAVIES

VP87

CONFIDENTIAL

FROM: P WYNN OWEN
DATE: 6 December 1985

MR PRATT

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Butler
Mr Cassell
Mr Anson
Mr Scholar
Mr Evans
Mr Odling-Smee
Mr Turnbull
Mr Peretz
Mr Culpin
Miss O'Mara
Mr H J Davies

TCSC REPORT ON THE AUTUMN STATEMENT

The Chancellor has seen and was grateful for your minute of 5 December. He thinks the TCSC's report is most unimpressive. But he would like it to be taken into account by those drafting his speech. He trusts that the TCSC will have a messy press conference on Monday!

P WYNN OWEN

pst

Incorporated in Burns redraft

FROM: M C SCHOLAR
DATE: 9 December 1985

CHANCELLOR

cc: Chief Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Turnbull
Mr Culpin
Mr Pratt
Mr H J Davies

AUTUMN STATEMENT DEBATE SPEECH: 12 DECEMBER

You asked for comments on the draft attached to Mr Davis' minute of 6 December.

2. (i) On p.1, third para, I suggest we stick to our line of saying that unemployment has now stabilised, rather than that it is falling: amend to "Unemployment has now clearly stabilised; it has fallen by 2,000 on average in each of the last six months."

(ii) I do not think we should say without qualification (p.5, penultimate para) that "expenditure plans for the next year should not follow any variation in revenue forecasts." Substitute "slavishly be varied to follow" for "follow"?

(iii) The next paragraph on p.5 might better read: "We provided this, first, in a Green Paper on long term public expenditure and taxation in 1984. This showed the reductions in the tax burden which might be generated by different growth rates for public expenditure. It showed, too, that if the burden of taxation is to be reduced anything like adequately public expenditure has to be held broadly constant in real terms."

(iv) It doesn't seem quite right to say (p.12, second para) that the phase of rapid increases in unemployment has come to an end (it came to an end several years ago). Substitute, "Second, we are now expecting much slower growth in the social security programme. This reflects the changed situation in the labour market, as well as the outcome of the social security reviews."

(v) I suggest adding a fourth point on this page, as follows:
"Finally, on local authority expenditure, with tougher block grant pressures, rate-capping, and the scale of the efficiency gains which, on the Audit Commission's estimates, are available in this area, there should certainly be greater restraint in spending than in recent years."

MCS

M C SCHOLAR

1-50

FROM: R PRATT
DATE: 9 DECEMBER 1985

MR CULPIN

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Butler
Mr Anson
Mr Cassell
Mr Scholar
Mr Turnbull
Mr Odling-Smee
Mr Evans
Mr Peretz
Miss O'Mara
Mr M L Williams
Mr Gray
Mr Dyer

C, see X - No 10 have now requested briefing on TCSC report. Content for this to go to No 10?

RS 9/12

TCSC REPORT ON THE AUTUMN STATEMENT

... As I mentioned in my minute of 5 December, the TCSC report will be published today (9 December). You may find it helpful to have the attached note on the main conclusions of the report and a line to take. You should not, however, indicate that we have seen an advance copy of the Report.

X 2. I expect that No 10 will also require briefing for Prime Minister's Questions tomorrow and the attached may serve that purpose as well.

3. The attached is culled from existing material, but if copy addressees have any comments perhaps they could let me know by close today.

Richard Pratt

RICHARD PRATT

TCSC report on the Autumn Statement

Factual

The TCSC Report:

(i) Condemns absence of fiscal adjustment forecast and of updated revenue forecasts; recommends reintroduction, in future, of more revenue information (this is the only recommendation in the report), and says, without this forecast commentators cannot judge if revenue determines expenditure;

(ii) Argues that Mansion House represented 'major change' in monetary policy (involving switch from money supply to exchange rate) and says that more information should be given in Autumn Statement;

(iii) Asserts that, because of increased asset sales, Autumn Statement would represent easing of fiscal policy, if 1986-87 PSBR were to be unchanged from MTFS figure;

(iv) Considers Autumn Statement forecast optimistic particularly on growth;

(v) Asserts that 1985-86 Reserve is "fully allocated" with 6 months to run;

(vi) Argues that public expenditure profile is the familiar picture of past overspending and future restraint, and is sceptical of Government ability to hold expenditure constant in real terms.

Positive

(i) Autumn Statement presented forecast of continuing steady growth (3 per cent in 1986) with low inflation (below 4 per cent by the end of 1986); public expenditure plans broadly constant in real terms and declining as proportion of GDP.

(ii) More public expediture information provided than before - 3 years future plans instead of just 1, and a Departmental breakdown of forecast outturn for the current year.

(iii) Fiscal adjustment forecast dropped. In previous years, despite giving no useful new information, it was taken by some as indication of Government intentions. Last year's forecast, for example, contributed to sterling's difficulties. Important to avoid a repeat.

Defensive

(i) No fiscal adjustment forecast; no revenue projections. What about 'revenue determines expenditure'. Revenue projections and fiscal adjustment forecast, as published in previous Autumn Statements, were based on conventional assumptions, and gave no indication of Government decisions. 'Revenue determines expenditure' principle applied over longer term - ie as set out in 1984 Green Paper and translated into successive versions of MTFS. Does not depend on temporary fluctuations in 6 monthly updates of revenue forecasts.

(ii) Mansion House - 'major change'. More information should be provided in Autumn Statement. Mansion House speech not a major change. Always said that wide range of factors taken into account when assessing monetary conditions. Section on financial conditions in this year's Autumn Statement give as much information as in previous years.

(iii) Easing of fiscal policy? Chancellor told the Committee that no decision had yet been made on fiscal stance for 1986-87. Autumn Statement follows convention in assuming PSBR for 1986-87 unchanged from figure in 1985 MTFS. This convention carries no implications for fiscal stance. When making Budget judgement, Chancellor will consider all relevant factors, including asset sales and oil revenues.

(iv) Forecast optimistic? Report recognises Treasury record is good. Forecast is central - ie equal chance of better or worse outcome

(v) Reserve 'fully allocated' therefore likely public expenditure overrun? As was made quite clear to Committee, Reserve is not fully allocated. Only small proportion of Reserve is, as yet, formally committed. Treasury best guess is that Reserve will all be spent. Eventual outcome could be better or worse than this. Every effort made to avoid breaching Reserve.

(vi) Past overspending, future restraint? Public expenditure has been on a declining trend, as proportion of GDP since 1982-83. Previous factors putting upward pressure, not likely to do so in future - eg Defence, with end of 3 per cent annual real terms increase, Social Security, with no prospect of substantial increase in unemployment.

1920/10

FROM: ROBERT CULPIN
DATE: 10 DECEMBER 1985

Ch/ To keep in reserve for Thursday - either you or CST - second Commons debate on Tuesday too.

RC
10/12

CHANCELLOR

cc Economic Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Peretz
Mr Scholar
Miss O'Mara
Mr Aaronson
Mr Board
Mr H Davies

AUTUMN STATEMENT DEBATE SPEECH 12 DECEMBER

I have had a go at some Johnson Matthey paragraphs - attached. They might go after the privatisation section on page 17 of the present draft. If anything, they are probably too long.

2. We shall have to look at them in the light of Thursday's papers, which will be full of the Johnson Matthey accounts and Mr Walker's briefing.

3. They stress that you have acted swiftly and openly. If you wanted a backbencher to intervene, someone could make the point that an enquiry would take forever.

4. If you need to make room for Johnson Matthey references, I should cut out the stuff on Gas (pages 15-16) and say less about the fiscal adjustment, which has proved almost a non issue.

I agree

RC

ROBERT CULPIN

FINANCIAL INSTITUTIONS

Not only does the RHG want to seize back private companies. He also wants to collar pensioners' savings to let Lord Williams pick losers. The motto is: if it moves, control it. Or worse: get some quango to control it.

2. We have followed a quite different road. Within months of taking office, we got rid of exchange controls and controls on bank lending. They only denied people choices they should be free to make. We have ended hire purchase controls. We have just introduced a Bill to scrap unnecessary restrictions on building societies.

3. The result is a better service for savers and borrowers. There has been a huge increase in competition between the banks, the building societies and others. Look at last week's announcement on bank changes. People can get interest on their current accounts; they will soon get cheque cards from their building societies; they will be able to get all round insurance from either the banks or the building societies; and they can buy shares in the High Street. They are free to take their own money on holiday, and to build up their overseas investments.

4. The price of this freedom is, of course, that there have to be adequate safeguards. And the Government is

p.8

FROM: H J DAVIES
DATE: 10 DECEMBER 1985

CHANCELLOR

cc Sir P Middleton
Sir T Burns
Mr Scholar
Miss O'Mara

AUTUMN STATEMENT DEBATE: SPEECH

I attach a revised version. The principal changes are:

i) at the beginning, which is, post-OPEC, less bullish

ii) additions from Sir Terence on the forecast, and the prospect, together with his revision of one or two other sections, particularly monetary policy.

iii) some re-ordering, with capital spending pushed upwards.

iv) one or two drafting points from Mr Scholar and Miss O'Mara (though Miss O'Mara's marginalia have not been taken into account; many apply to passages now redrafted by Sir Terence).

2. I have not seen Mr Lilley's comments which I think you have. I have also separately submitted a piece on OPEC etc.

Jo Smith

pp H J DAVIES

Ch/ Steve Robson has cleared this. It's a great advance on what I dictated over the phone. Para 3 looks especially capable as it stands.

RL 10/12

pp

FROM: H J DAVIES
DATE: 10 DECEMBER 1985

MR ROBSON

cc PS/Chancellor
Sir T Burns
Mr Odling-Smee

AUTUMN STATEMENT DEBATE 12 DECEMBER: OPEC

The Chancellor has asked for a piece on the Government's attitude to this week's developments in the oil market which he might use in the House on Thursday. I was asked to draft and to clear it with you.

2. It would be helpful if, when you return, you phone comments to the Private Office, since I shall be out of the building early this evening.

HJD

H J DAVIES

The OPEC Meeting in Geneva which finished earlier this week has once again thrown the spotlight on the oil market and particularly on the prospect for oil prices. And many commentators have had an enjoyable time speculating on the implications for the Government's North Sea policy, for the exchange rate, and for my Budget next year.

Most of these commentators appear to be blessed with a clearer crystal ball than is available to Her Majesty's, or any other Government. In reality, the prospect is very uncertain.

But let me say three things. First, there is no question of a change in our policy towards North Sea development. We have maintained, and will continue to maintain, a free market. That clearly serves the nation's interests best in the long run.

Second, it is worth recalling that even now oil represents only 6% of GDP - and henceforth can be expected to be on a gently declining path.

Third, a fall in the oil price does, all other things being equal, bring about a reduction in tax revenue.

Of course all other things are not equal, and there will be some offsetting rises if lower energy prices boost growth in the economy.

But lower oil prices, and lower North Sea Oil tax revenues, will reduce the scope for reductions in the burden on other taxpayers. That is a fact of life we have to accept.

13
11/12

Mr Lomax
I've received this mid-morning. A few points marked.
MON
11/12

~~PWP.~~ D

FROM: H J DAVIES
DATE: 10 DECEMBER 1985

CHANCELLOR

cc Sir P Middleton
Sir T Burns
Mr Scholar
Miss O'Mara

AUTUMN STATEMENT DEBATE: SPEECH

I attach a revised version. The principal changes are:

i) at the beginning, which is, post-OPEC, less bullish

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2. I have not seen Mr Lilley's comments which I think you have. I have also separately submitted a piece on OPEC etc.

Jo Smith
pp H J DAVIES

27/2416

PwP

FROM: N BARKER
DATE: 11 December 1985

APS/CHIEF SECRETARY 12/2

cc APS/Chancellor
Mr M L Williams
Mr McDonald
Mr Peet
Ms Spencer
Mr Stredder

AUTUMN STATEMENT DEBATE WIND-UP

As requested I attach a brief on the Parliamentary Brief published by the Building Employers Conferation on 'The Autumn Statement - Implications for Construction'.

2. This is based primary on contributions from LG1, LG2 and ST2 and has been cleared with Mr Williams.

Nicholas Barker

N BARKER
GEP1

34/33/2413

BUILDING EMPLOYERS CONFEDERATION

PARLIAMENTARY BRIEF ON CONSTRUCTION IMPLICATIONS OF AUTUMN STATEMENT

1. **GENERAL**

1. **Government's general record good:** average annual construction expenditure on basic infrastructure higher in real terms than when it came to power. Government has deliberately switched emphasis in provision of housing from public to private sector. Even so, total public capital spending broadly maintained in real terms since 1979.

2. **No 'target' or 'correct' level of capital spending.** Must be judged case by case on merits, taking into account wider economic and social benefits (including supply-side benefits where relevant and future extra costs if investment delayed).

3. **Investment in whole economy:** total fixed investment in economy in 1984 was all-time high in real terms (£55 billion in current prices). Forecast to increase further in real terms by 4½ per cent in 1985 and 3½ per cent in 1986.

2. **HOUSING**

Factual

1. **Provision for gross capital expenditure increased by £130 million on Cmnd 9428 plans (not £60 million as BEC claim, para 3)** and £200 million over 1985-86 provision. [NOT FOR USE: but £120 million lower than 1985-86 forecast outturn to be published in 1986 PEWP].

2. **Increased provision for current expenditure in 1986-87 (para 3)** due to revised economic assumptions. Increase in current expenditure on renovation assumed to be broadly in line with inflation.

Positive

1. **Provision for capital expenditure on housing £200 million up** on provision for current year.

2. **Government considers priority now is renovation of the local authority stock.** A switch from lower priority expenditure should also provide scope

f[illegible] increasing expenditure on renovation. In addition, more than £1 billion current expenditure a year on repairs & maintenance.

Defensive

1. **Increase on 1985-86 expected outturn much smaller. (para 4)** Government cannot be expected to plan from a base of overspending. [NB total overspend on LA Capital now estimated at £750 million].

2. **Not all increase in current for building work. (para 3)** Increase in current intended to take account of revised economic assumptions. But open to local authorities to fund higher level of current expenditure on repairs and maintenance from increasing rents.

3. **Level of capital receipts (para 4).** Although sales numbers falling, receipts holding up well because greater proportion of sales finance by private sector mortgages.

4. **Housing Corporation programme constant in cash terms, so falling in real terms (para 4).** Government intends shift away from new provision towards renovation.

5. **Local authority allocations reduced. Government should explain how gap is made up (para 5).** Level of spending assumed consistent with expected use by local authorities of all the spending power available to them. Spending justified by accummulated capital receipts and non-prescribed expenditure not expected to double [if pressed: increase assumed closer to 40%].

6. **Increase in renovation expenditure insufficient to meet £900 million a year annual increase in backlog identified by Audit Commission.** Audit commission figure refers to recent years when many hitherto unexpected problems come to light. No guide to future. Additional sums provided for renovations will enable LA's to make start on dealing with backlog.

3. **NHS CAPITAL PLANS**

Factual

1. **Will remain steady in real terms** after proceeds of sales of land and building (para 7).

2. **Programme of land and building sales should proceed rapidly in 1986 (para 8).**

Positive

1. **21 per cent real terms increase since 1978-79.** Last labour Government made substantial cuts (para 7).

Defensive

1. **Maintenance and repair spending** running at £300 - 400 million annually. Backlog estimate of £2 billion is exaggerated (para 9).

2. **Receipts accrue to DHAs initially** but can be redistributed within Regions, since Regions determine capital allocations (para 8).

4. **Total LA CAPITAL**

Positive

1. **Plans for net GB spending in 1986-87** have been increased by nearly £200m, and rising in later years.

2. **Gross planned spending of nearly £6bn (GB)** is a siginificant programme of public capital works.

Defensive

1. **1986-87 plans are a large increase on 1985-86 plans (£600m)** Continuing problem of overspending in 1985-86 most unwelcome - Government proposals for new control system to be set out in Green Paper on Local Government finance.

VR86

Changes on pp 8, 1, 5, 6, 7, 9, 10, 12, 13, 14, 15, 16, 17, 18.

FROM: MRS LOMAX
DATE: 12 December 1985

MISS O'MARA

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr FER Butler
Sir G Littler
Mr Cassell
Mr Peretz
Mr Scholar
Mr Turnbull
Mr Culpin
Mr Cropper
Mr Lord
Mr H Davies

Ch/
Checked (and corrected) by Margaret.
Word count: - 3126
ie about 23 mins
We'll have this run out on speech paper, with any further corrections
Pete's contribution below.

AUTUMN STATEMENT DEBATE: CHANCELLOR'S SPEECH

RL 12/12

I attach a redraft of the Chancellor's speech for this afternoon. There is one passage missing which is to be supplied by Sir Peter Middleton.

2. Could you please check through carefully for factual accuracy and let me have any comments as soon as possible.

RL.

RACHEL LOMAX

From: SIR PETER MIDDLETON
Date: 12 December 1985

CHANCELLOR

cc Sir T Burns
Mr Cassell
Mr Peretz
Mr Culpin
Mr H Davies

I attach a piece which might best come on page 5. You may not like the Biblical tone but it can easily be turned into English.

K F Murphy
(private secretary)

pp P E MIDDLETON

Ce/
I'll have this typed into the speech. [illegible] let me have changes asap. (Don't like [illegible] much)

R
12/12

Against this uncertain background the continuing framework of our financial strategy is a great source of strength. If anyone is unclear about the aims and direction of our ~~monetary~~ financial strategy, let him read the Budget Speech. If any one suspects a change in the operation of the strategy, let him see what we have done. If anyone is in any doubts about the success of the strategy, let him look at the results.

Quote or paraphrase Speech?

2. Our strategy will continue to be to maintain steady downward pressure on inflation as we have in the past. There has certainly been no change in the way we take account of the exchange rate in judging monetary conditions where Select Committees and other footnote watchers have an inexhaustible appetite for detecting major switches in the stance of policy. [It is almost as popular as trying to spot Halleys comet.] I have resisted - rightly - the pressure from those who see "windows" and "gaps" in which it is suggested we should make opportunistic reductions in interest rates.

3. So far as the results are concerned, they are impressive. I am confident that inflation will continue to subside. No one seriously doubts it. The Government will stick to its strategy to ensure that it happens. And - as the Prime Minister said - we shall take no action, on taxes or on interest rates, to put this paramount objective at risk.

FROM: R A L LORD

DATE: 12 DECEMBER 1985

cc. PS/Chancellor
Mr F E R Butler
Mr Anson
Mr Turnbull
Mr Cropper
Mr Davies

CHIEF SECRETARY

AUTUMN STATEMENT DEBATE: WIND-UP

I attach some material which you may care to draw on for your speech tonight. It:

a. picks up a quote from Terry Davis' speech last year

b. includes a Hattersley quote which accords ill with Davis

c. makes some value for money comparisons with Labour.

R A L LORD

When the Hon. Member for Birmingham Hodge Hill made the closing speech for the Opposition in this same debate a year ago he correctly observed that our plans made no allowance for any increase in public spending in real terms. "That is a source of satisfaction to the Chancellor," he said, "but to the Labour party it is a confession of failure." (OR 6 Dec. 1984. Col. 584).

A year later our plans again provide for public spending to remain level in real terms. I ask the Hon. Member what level of public expenditure the Labour Party would regard as a success, I am prepared to give way.

If the Hon. Gentleman is too coy to give the country a straight answer let me remind members of Labour's plans at the last general election. The sum total of electoral bribes offered by members opposite at that time amounted to a staggering £40bn. addition to public expenditure.

Since then there have been several further epidemics of electionitis among Opposition members. Higher spending has been promised on rural areas, higher spending has been promised on urban areas. Labour would renationalise companies transferred by this Government to free enterprise, they would set up new public corporations in parts of the economy where there were none before.

Student grants would be substantially increased, sixth formers would be given pocket money on the rates. They would abolish private medicine and private education putting the entire burden on the taxpayer. They would spend on the roads, spend on the railways, spend on the ports.

Of course the Government also has its spending priorities. And they are priorities which command the support of the electorate. Protection from ill-health, protection from crime and protecton from the country's enemies overseas. But we on this side of the House are honest enough to make it clear that the sum of the parts must be something which the nation can afford.

"The Labour Party is always wanting to bake plum pies before we have picked the plums." Not my words, but those of the Rt Hon Member for Birmingham Sparkbrook, quoted in Lord Barnett's book on the Treasury. (p.142).

The prudent approach to controlling public spending means not only sticking to totals which the nation can afford. It also means making sure that the taxpayer's money is spent as effectively as possible.

Value for money is almost inaudible in the Labour Party's rhetoric. But it is through better value for money that we can best obtain the improvements in services which we all want to see while at the same time sticking to totals we can afford.

Much the best way to get better value is through competition. Encouraged by the Government the NHS is now saving £28m. a year as a result of putting some services out to a competitive tender. That is £28m. more for kidney machines and heart transplants.

What is Labour's policy ? Labour is committed to ending competitive tendering in the NHS.

It's the same story in local government services. Since 1978 the real cost of refuse collection has fallen by 25% because of the Government's encouragement of contracting out and the pressures which competition brings on councils.

But not always on Labour councils. Lambeth ratepayers pay exactly twice as much per head for their refuse service as neighbouring Wandsworth.

Or take manpower. Under the last Labour Government the number of civil servants required to administer every million pounds of public spending in real terms rose steadily. Under the present Government it has fallen every year.

That is not a confession of failure. That is the very best form of public spending success.

2-36

Detailed Comments on A.S. Speech (from Peter Lilley)

1.	Page 1, para 3	Has male unemp. fallen by 3,000 per month?
2.	Page 1, para 4	Delete "winter of 79/80" and replace by "late 79". (To avoid echoes of "discontent")
3.	Page 2	Delete first line. Replace by "while easing slightly against DM and Yen."
4.	Page 2, para 2	Replace "yields" by "long term interest rates".
5	Page 2, para 7	Amend as in text.
6.	Page 5, last para	Second sentence is ambiguous. Can be omitted. Indeed, I would omit the whole para. The telling argument is that revenue is determined before spending round, rather than at the end. This could possibly be highlighted more clearly.
7.	Page 6, para 4	Replace "as I see did 2 members"... by "as I gather did at least 3 members"... This is legitimate since Beaumont-Dark declared this view in the Chamber but was away for the TCSC internal vote on the fiscal adjustment.
8.	Page 7, para 1	Delete "Rev Moon" and replace by "Ayatollah".
9.	Pages 7/8, final sentence	Delete "announced in the Budget" and replace by "before the current target period ends". Insert thereafter. "We remain determined to ensure that growth in the money supply, judged in the light of all relevant factors, is not excessive". Then para 2 on p8 could be deleted.
10.	Page 9, para 3	After "efficiency", insert "good for personal freedom".
11	Page 9, para 4	Replace "wrong" by "mistaken".
12.	Page 13, last para	Don't call the Daily Telegraph an "enemy".
13.	Pages 15/16	Omit the defensive stuff on BG/privatisation.
14	Page 18, para 5	It is giving hostage to fortune to admit Labour's six years had more growth. Either omit or say "at this point in the first 6 year period the reported growth was x%. This was subsequently revised upwards, in the normal way, to 9%. The currently reported growth for the second 6 years is about 7½%. Given the normal upward revision the final measure of growth in the Tory years is likely to surpass that under Labour." On the whole I would omit and go straight to the ex-oil comparison.
15.	Page 19, para 3	Replace first sentence (beginning "And during ...") by "Moreover, our non-oil economy has accelerated over a period when most other countries' economies have slowed down."

16.	Page 19, para 3	Last sentence "In the previous ..... 10% adrift". I don't understand!
17.	Page 19, last para	Omit "I do not dispute this."
18.	Page 20, first para	Omit entirely.
19.	Page 20, third para	Omit Replace by: "It is somewhat puzzling that some people are trying to denigrate the performance of our manufacturing industry when: - last year it achieved its highest growth in output for a decade - manufactured exports are now running 14% higher in real terms than when Labour left office." Possibly that should go on page 21 at the end of the manufacturing section.
20.	Page 22, para 1	At end add "and from new build to repair and renovation".
21.	Page 22, para 2	Include the figure 22% for rise in repair and maintenance.

General Comments

1. Given the extensive defensive/anti-Labour stuff, it might be wise to end by saying something positive - eg repeating the opening success story theme.

Insert. Possibly on page 15 or 21.

The RHG has espoused the view that receipts from privatisation should be invested in public sector capital spending projects. Well, in a sense, they are - since even at their expected annual level of £4¾ billion receipts from privatisation are absorbed many times over by the £22 billion spent annually on public sector capital works.

But maybe the RHG was putting forward a more sophisticated doctrine :- that any increase in privatisation revenues should automatically result in an increase in public sector capital spending? If so, would he likewise cut capital spending by an amount equal to the cost of renationalising privatised firms?

FROM: MRS R LOMAX

DATE: 12 December

PS/CHIEF SECRETARY

cc: PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Peretz
Mr Culpin
Mr Hall
Mr Board
Mr H Davies

AUTUMN STATEMENT DEBATE: JMB

The Chancellor has substantially shortened the passage on JMB provided by Mr Culpin. In the light of this morning's papers, he does not now plan to use it, but he thinks the Chief Secretary might find it useful for his wind-up.

RL

RACHEL LOMAX