FILE NUMBER

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FILE TITLE

TREASURY CIVIL SERVICE COMMITTEE

FILE BEGINS 27/11/1984

ENDS 28/11/1984

From: M J C FAULKNER
Date: 28 NOVEMBER 1984

MR PERETZ

cc: CST
FST
MST
EST
Mr Bailey
Mr Anson
Mr Battishill
Mr Gilmore
Mr Ridley
Mr Scholar
Mr Folger
Miss Dales

CHANCELLOR'S TCSC APPEARANCE - AUTUMN STATEMENT - STUDENT AWARDS

.... We spoke. I attach briefing - essentially what we gave the Chancellor for the Cabinet discussion of public expenditure, with two additional defensive points. It has been agreed with DES. There is now no difficulty about using any of this material in public.

MF

M J C Faulkner

STUDENT AWARDS

Factual

1. In 1983 Survey main changes agreed were:

- minimum award halved to £205

- upper end of the paren tal contribution scale steepened

- value of maintenance award to be increased by 1 per cent less than assumed inflation over Survey period.

2. Further changes now proposed are:

- minimum award to be abolished

- further steepening of parental contribution scale

- parental contribution scale to be extended to tuition fees element of award in addition to maintenance element (will affect only highest earners)

- upper limit of £4,000 to parental contribution, to protect parents with more than one student child.

3. Table A attached sets out the old and new contribution scales.

4. Table B shows the effects of the changes on parental contributions. Note that income bands:

a) relate to 'residual income'. This is typically about 10 per cent below gross taxable income because of allowances for mortgage interest, life insurance premiums, dependants etc

b) relate to income in the financial year preceding the academic year concerned (eg financial 1984-85 for academic 1985-86)

Positive

1. Present arrangements still amongst most generous in the world. Healthy to reduce students' dependence on state funding. This should improve their motivation and commitment, not the reverse.

2. Student award savings will release more resources for increases in science budget, universities' equipment grant etc. These could not otherwise be afforded.

3. Changes targeted on those who can best afford to pay.

Defensive

1. Minimum award regressive and anomalous. Only one-sixth of students' parents likely to lose from its abolition.

2. At top of the scale, contributions will be no more than many parents have already chosen to pay in school fees.

3. No changes entailed for the 30 per cent or so of students' parents on residual incomes below £10,300.

4. Parents can make their contributions by deed of covenant attracting tax relief. Over 70 per cent already do so. (Use with caution. Corollary is that much of the saving will be offset by 'tax expenditure'. Rationale for this relief can be questioned.)

5. Nonsense to suggest that asking the wealthiest parents to contribute towards the tuition fee heralds some move to introduce charging into other sectors of the education system.

6. Government's position on possibility of student loans remains as stated by Sir Keith Joseph before the election:

> "We remain interested in finding means of widening access to higher education without excessive cost to the taxpayer, and in this context will continue to examine the whole system of student support. Student loans may have some part to play in this, but we would introduce any reforms, whether or not involving loans, only after widespread consultation. The first step would be the issuing of a consultative paper."

Permanent Secretary
H M TREASURY

The process has resulted
in substantial changes
in the pattern of expenditure
in line with Government policy

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

1½ m applications

last night

phoning more to-day

still coming

no fall off

Permanent Secretary
H M TREASURY

Bids come up all the
time for extra expenditure
And compensating savings
are looked for

A lot depends on the
extent of the bids

He's not complaining
about the nature
of cabinet government.
He just doesn't like
the results.

TCSC 28th NOVEMBER: CHANCELLOR'S OPENING STATEMENT

The Committee has ~~, no doubt~~ already, studied the revised expenditure plans for 1985-86 outlined in the Autumn Statement. The results of this year's PX Survey, summarised in just five pages of the statement, represent the outcome of the usual detailed review of all programmes. Since 1979 the Government has brought about a substantial re-ordering of priorities within public expenditure programmes. This year's review has, as usual, led to decisions to increase provision in some areas, and some hard decisions to reduce it elsewhere.

As indicated in the Statement, we now expect that, ~~given the exceptional factor of the coal strike~~, public spending in 1984-85 will be some £1½ billion above the planned level. This has led us, in the review of the 1985-86 position, to pay ~~particular~~ Even greater regard to the realism of the plans and to the adequacy of the Reserve provision.

Of course, ~~none~~ no-one can be sure what will be needed to cover unforeseen developments. But we have taken a number of steps to ensure the realism of the 1985-86 figures. On local authority expenditure, we have increased provision by nearly £1 billion, matched by much tougher penalties for overspending and the

The second reason for the continued rise of unemployment is that the labour force has grown by more than expected. This has particularly been the case for women in part-time employment. This is a trend that we have seen for many years but it has continued at a rapid pace during the period of recovery.

I have argued on a number of occasions that the level of unemployment would have been improved if real wages had grown at a less rapid pace. ~~Over the years of recovery real wages have grown by an amount similar to the overall growth of output. If real wages had grown less rapidly the level of output would have been higher. And the ratio of employment to output would have been higher reflecting a changing mix of products and a different mix of labour and capital.~~ I hope to publish some further analysis of this important topic in the not too distant future.

Many commentators continue to refer to the years since 1981 as a period of weak recovery. But a closer examination of the figures shows that the pace of recovery of output has been far from weak. If we are ~~correct~~ right about the rate of growth ~~in~~ for 1985 then the growth of output over the four years cumulatively will have been almost 12 per cent. This is very respectable by past standards. It more than matches the growth of output during the previous recovery period 1975-79. On the basis of annual data the highest four-year growth figure since the war was for 1962-66 when 15 per cent growth was registered. The only four year period since then which has seen growth clearly faster than 12 per cent was the ~~years~~ period 1969-73.

Unfortunately growth during this recovery period has still not been fast enough to bring down unemployment. During the recovery period unemployment has tended to turn out higher than we assumed or expected. It is important to recognise the reasons why unemployment has turned out higher than expected.

The first reason for this is that on average the growth of output has been matched by equivalent growth in productivity. Productivity growth has been faster than expected, particularly after the disappointing performance in the 1970s.

It is not an occasion for a general restatement or updating of economic strategy which is primarily for the Budget. But I would emphasise that the overall objectives and strategy remain unchanged. The objectives are to continue to bring down inflation and create the conditions that will enable progress to be made in bringing down unemployment.

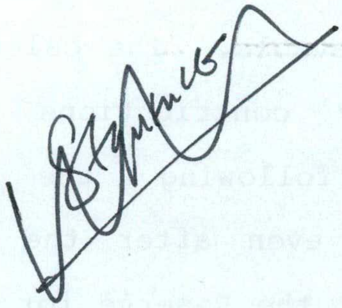
We continue to make better progress on inflation than most commentators have expected and I expect this downward pressure to continue over the next year. Although our forecasters are not expecting much of a change in the inflation rate over the 12 months, this would still mean a significant period when inflation has been below 5 per cent. Because expectations are now adjusting to this lower rate it should provide the basis for the further downward movement of inflation that policy is designed to achieve.

The framework of policy remains as set out in the MTFS with target ranges for both Sterling M3 and MO and an illustrative path for the PSBR. So far this year both monetary aggregates are within the target range and although the PSBR is now expected to be above the level planned it will still represent the lowest proportion of GDP for more than ~~10 years.~~ a decade.

introduction of rate-capping. ~~This means that the plans for local authority current spending are both realistic and achievable.~~ The calculation of our European Community contributions is now more securely based following the Fontainebleau settlement. And, even after the normal annual process of reducing the Reserve for the year ahead as the plans are firmed up, we have provided for a figure of £3 billion, £¼ billion more than the provision for 1984-85 in the last White Paper.

All these adjustments, up and down, have once again been carried out within an unchanged public expenditure planning total. ~~Ever since the introduction of cash planning, we have held the aggregate plans within the cash totals set in earlier White Papers. That we have done again, with a planning total for 1985-86 of £132 billion.~~ In real terms this is the same level as that planned for 1984-85, and below the expected outturn, implying a further reduction in the ratio of public expenditure to GDP.

As last year the Autumn Statement brings together a number of announcements which fall to be made at this time of year. In particular it allows the public spending plans for the year ahead to be set in the context of a fresh economic forecast.



FROM: A M W BATTISHILL
DATE: 27 November 1984

CHANCELLOR OF THE EXCHEQUER

cc Sir P Middleton
Sir T Burns
Mr Bailey
Mr Scholar
Mr H P Evans

TCSC BRIEFING

This minute covers briefing for your appearance tomorrow before the Treasury Committee.

2. Immediately below at Flag A are some notes for the brief opening statement you wish to make. Those on the economy have been prepared by Sir T Burns and those on public spending by Mr Scholar. PE will provide a short piece on BT tomorrow.

3. There then follow briefs on a number of issues mentioned at your meeting this morning or which came up with officials yesterday. They are at Flag B:

(a) debt interest: the revisions since the Budget;

(b) public investment;

(c) the planning total figures: NIS, VAT and corporation tax;

(d) local authority current expenditure;

(e) housing receipts;

(f) housing benefit - the Guardian story about joint tenancies;

(g) the water industry.

4. Also attached at Flag C are some notes on EC budget discipline (with the text of the inter-governmental agreement) just in case Mr Budgen returns to the charge.

5. Lastly, at Flag D, is a list of the questions we understand the Committee may wish to put to you tomorrow. Many of them cover very familiar ground on which you are unlikely to want any extra briefing. But we have asked for a line to take on those marked with an asterisk - though I am afraid it will not be possible to cover all these until the morning. Those that are available are at Flag E.

6. I understand you already have a copy of the transcript of officials' evidence; and GE will be letting Mr Peretz have direct drafts of the notes we undertook to provide at yesterday's hearing. Mr Peretz also has a copy of a note for the Committee written by Mr Terry Ward on which we have been asked to check the figures.

You have these already.

AMW

A M W BATTISHILL

DEBT INTEREST

ANALYSIS OF REVISIONS TO DEBT INTEREST FORECASTS

The general government debt interest forecasts published in the Autumn Statement were £16 billion for 1984-85 and £16½ billion for 1985-86, respectively some £½ billion and £1 billion higher than the forecasts in the 1984 Budget. Officials were closely questioned on the reasons for the revised forecasts when they appeared before the TCSC on Monday 26 November. Mr Wainwright had previously raised the subject with the Chancellor in the House - see attached extract from Hansard, col 782. The TCSC Chairman indicated that the Committee will return to this subject when they see the Chancellor on Wednesday 28 November.

2. Table 1 shows the short and long term interest rate assumptions used in the 1984 Budget and 1984 Autumn Statement.

Table 1: Interest rate assumptions (annual averages)

	1984-85	1985-86
Long term rates		
1984 Budget	9.3	8.7
1984 Autumn Statement	10.8	10.3
1985 White Paper	10.8	10.0
Latest (26 November)	10.3	..
Short term rates		
1984 Budget	8.7	7.8
1984 Autumn Statement	10.3	9.8
1985 White Paper	10.3	9.0
Latest (26 November)	9.8	..

3. Table 2 shows the corresponding revisions to general government debt interest forecasts, and also breaks down the revision into the amounts due to higher interest rates, higher borrowing and estimating changes.

Table 2: General government debt interest revisions (£million)

	1984-85	1985-86
Total change	500	1000
of which due to:-		
Interest rates	250	650
Increased borrowing	50	100
Assessment changes	200	250

4. Based on these figures (which should not be quoted) the suggested line to take on the revisions is:

"Over half the revision is due to a profile of interest rates somewhat higher than expected at the time of the Budget. A little is due to higher borrowing and the remainder is due to the normal reassessment process that occurs in the light of later outurns."

5. If pressed to divulge actual interest rates being assumed, line to take:

"Not the practice to divulge interest rate forecasts as they are market sensitive. But as I said in the House on 15 November [column 782], I now see the prospect of interest rates falling from their present levels."

6. If pressed on poor record of debt interest forecasts over the past, the suggested line to take is below. [Note: the average error on corresponding forecasts over the last ten years is about 10 per cent. This year's change - £1billion on £15½billion - represents 6½ per cent.]

"As outside forecasters will appreciate, debt interest is by its nature difficult to forecast and obviously very sensitive to interest rates, which in turn are not easy to predict. [This year's revisions are not high by historical standards, but officials are constantly reviewing modelling procedures to see if any improvements can be made."

7. Max Wilkinson (FT, 27 November) suggests that the latest forecasts imply that on average interest rates in the two years 1984 and 1986 would be about one to two percentage points higher than was hoped at the Budget. There seems no reason to deny that these figures are of the right order, without confirming precise numbers.

PSF Division
27 November 1984

HANSARD Tuesday, 15th November 1984
(cols. 782-3)

HANSARD EXTRACT

Public Debt

2. **Mr. Wainwright** asked the Chancellor of the Exchequer to what extent the trend of public debt interest is higher than his forecast of March.

The Chancellor of the Exchequer (Mr. Nigel Lawson): "The Autumn Statement 1984" gives estimated figures for debt interest in 1984-85 and 1985-86 which are respectively about £½ billion and £1 billion above previous estimates.

Mr. Wainwright: As the Chancellor of the Exchequer has referred not only to the autumn uprating of the current debt estimate, but to the estimate for 1985-86, which is stretching a long way ahead, how does he explain his recent statement that the prospect is of further interest rate cuts? Will the right hon. Gentleman say something about interest rates to reassure British industry?

Mr. Lawson: I can deal with the hon. Gentleman's puzzlement quite simply. The increase in the estimates to which I referred is an increase over what was envisaged at the the time of the last Budget. When I say that I now see a prospect of interest rates falling, I am talking about falling from their present levels. I am glad to say that that prospect remains as a result of this Government's policies.

Sir William Clark: Does not my right hon. Friend agree that as the national debt increases year by year because of overspending, interest charges will obviously increase as far as revenue is concerned? As the interest payments on the national debt are now more than £45 million per day, would not it be folly to increase our public expenditure now?

Mr. Lawson: My hon. Friend is quite right. It would be folly to increase public expenditure now and that is why the Government have no intention of doing so. It is a quite remarkable fact that, despite the miners' strike and the events in the United States, where interest rates have risen sharply, the level of interest rates in Britain is no higher than it was at the time of the last general election, and is set to go lower.

TCSC enquiry into the Autumn Statement

PUBLIC INV'

Public investment

1. Public expenditure plans for 1985-86: some decisions yet to be taken on breakdown between capital and current spending. Full details in next White Paper.

2. Important to understand definitions. Capital spending by the public sector, including investment by nationalised industries, defence spending on equipment such as ships, tanks, aircraft, but excluding sales of council houses and other assets, amounts to over £20 billion. (For details see attached table from February 1984 EPR, taken from Cmnd 9143, table 1.13).

3. Capital spending in real terms (ie cash deflated by GDP deflator) roughly constant in recent years, up to and including 1984-85. [Warning: figures not yet finalised for 1985-86, but fall in real terms likely.]

4. For purposes of Industry Act Forecast, assumptions made about likely split of expenditure plans into capital and current. Table 1.10 in Autumn Statement shows rise of 3 per cent in fixed investment for whole economy in 1985: paragraph 1.42 shows private sector investment rising faster, and implication is that public investment will show a small fall. Note that definition of public investment included in total investment in table 1.10 is on national accounts basis, much narrower than 1984 White Paper table 1.13 (ie table attached).

5. [Not published; for use if pressed] Industry Act Forecast includes a figure of a fall of 3 per cent in public investment - in national accounts terms - in 1985. (This excludes the effects of changes in council house sales; and is not affected by the privatisation of BT.) This is accounted for by a fall in local authority investment, following the likely spending this year: see paragraph 1.43 of AS.

Table 3 — Public sector capital spending

£ million cash

	1978-79 outturn	1979-80 outturn	1980-81 outturn	1981-82 outturn	1982-83 outturn	1983-84 estimated outturn	1984-85 plans
Goods and services							
General government and some public corporations							
Expenditure on dwellings	2,101	2,395	2,302	1,943	2,204	2,212	2,227
New construction other than dwellings	2,556	3,165	3,766	3,912	4,340	4,302	4,524
Purchases (net) of vehicles, plant and machinery	629	736	877	902	1,056	1,140	1,132
Defence expenditure*							
Construction	46	205	283	271	395	456	528
Equipment	1,779	2,211	2,905	3,445	3,800	4,554	5,200
Nationalised industries and other public corporations†							
Expenditure on dwellings		2	3	2	3	5	3
New construction other than dwellings	4,734	1,929	2,352	2,489	2,694	2,930	2,838
Purchases (net) of vehicles, plant and machinery		3,564	3,962	4,388	4,240	4,743	4,647
Total goods and services	11,845	14,207	16,450	17,352	18,732	20,342	21,099
Cost terms (base year 1982-83)	19,250	19,760	19,275	18,504	18,732	19,373	19,137
Capital grants to private sector							
General government and some public corporations	1,552	1,619	1,936	2,019	2,638	2,988	2,749
Nationalised industries and other public corporations†	9	12	12	14	14	24	25
Total capital grants to private sector	1,561	1,631	1,948	2,033	2,652	3,012	2,774
Total goods and services plus capital grants to the private sector	13,406	15,838	18,398	19,385	21,384	23,354	23,873
Cost terms (base year 1982-83)	21,787	22,029	21,558	20,672	21,384	22,242	21,654
Net lending							
General government and some public corporations							
Net lending to private sector §	244	658	920	1,356	1,103	89	983
Net lending and investment abroad	267	−319	−521	−270	−97	47	192

*NATO definition of defence capital expenditure.

†Several points on the nationalised industries figures need to be noted:— (a) they are not included in the planning total, (b) they include the planned capital spending in 1984-85 of British Telecom and British Airways but no figures are available for Enterprise Oil, (c) British Telecom changed the accounting treatment of certain fixed assets in 1983-84, (d) the 1978-79 figure includes net expenditure on land and existing buildings.

§Includes cash expenditure on company securities.

PLANNING TOTAL.

Q.1 Why did you reduce the planning total in the FSBR to take account of the abolition of NIS? (We said at the time that if we had not done so departments would have had extra cash to spend on other things.)

PLANNING TOTAL FIG'S

A.1 NIS was no longer a liability on programmes, so programme totals and the planning total were reduced accordingly. NIS has not, of course, been added back to individual programmes.

Q.2 So why now add NIS back into the total, to bring it up from £131.6 billion to £132.0 billion?

A.2 We have not done so. The new planning total of £132.0 billion - which is somewhat below the Cmnd 9143 figure, and further below the Cmnd 8789 figure of £132.2 billion - is higher than the FSBR figure of £131.6 billion (corrected for classification changes to £131.7 billion) by less than the NIS adjustment of around £450 million. We have stuck to the White Paper cash total; and, although it is true that we are not now deducting NIS from that figure, neither are we adding to it, either for 1985-86 or subsequent years, to take account of the Corporation and Value Added Tax changes in the Budget which together increased the pressures on public expenditure programmes by over £200 million in 1985-86. [Note: the "over £200 million" consists of around £190 million for VAT and about £40 million for Corporation Tax.]

L.A. CURRENT

LOCAL AUTHORITY CURRENT: REALISM

1. Addition of £950 million to provision (compared with addition of only £600 million at this time last year) requires average 3 per cent cut on local authorities' budgets (in cost terms). Government is directly tackling problems of high spenders through rate capping etc - exercising direct control over £3 billion+ of local authority expenditure through rate capping; and the 18 rate-capped authorities account for over 80 per cent of overspending in 1984-85.

2. The targets set for authorities in the provisional settlement reflect their past spending. Most authorities spending below GRE are allowed increases over 1984-85 adjusted budgets of 4½ per cent. Other authorities have been given much more realistic targets than last year (the largest cut sought last year was 6 per cent over budget; this year it is 1½ per cent).

3. The Government has backed this up with a much more severe penalty regime. Last year an authority only lost 2p in the £ in grant for the first one per cent overspend and 4p for the second percentage point. Inevitably a large number of authorities decided to overspend by 2 percentage points. This year the first percentage point in overspend will cost 7p in lost grant, the second 8p.

4. The Government is backing this up with a virtual cash standstill on adjusted Aggregate Exchequer Grant (has to be adjusted to take account of reduced LA responsibilities eg LRT, some non-advanced further education). Again, this will increase the pressure on authorities to spend in line with provision.

5. Although the pay assumption does not formally apply to local authorities, pay, which accounts for ⅔ of local authorities' net current expenditure, is crucial in determining the level of services local authorities can provide for their provision.

Manpower is also important. Local authorities have only cut manpower by 4 per cent or so since June 1979 - and the downward trend was temporarily reversed last year. All this despite eg school rolls declining (and education accounts for about half LA current).

HOUSING RECEIPTS

Q. On what basis have council house sales been assumed to increase (by £430 million) in 1985-86?

A. 1. The assumption made about housing capital receipts in Cmnd 9143 for the two later years of the Survey was inevitably somewhat broadbrush. Only in September this year could a detailed forecast of receipts in 1985-86 from council house sales be made once information about applications had been received from local authorities.

2. Three factors have tended to increase the receipts forecast. First the Housing and Building Control Act 1984 will have full effect for the first time. This reduces from three to two years the length of time needed to qualify for "right to buy" discounts and increases the maximum discount. Second, on the basis of recent experience the proportion of sales financed by private sector mortgages is expected to be rather higher than previously assumed.

HOUSING RECEIPTS

3. Third, prices rose quite sharply in 1983-84 and the early part of 1984-85. But there is always a margin of uncertainty in the figures. In the recent past receipts have tended to be under rather than over forecast.

4. Nevertheless, numbers of sales are in fact assumed to fall slightly compared to 1984-85. What we are assuming is that receipts from sales will increase in 1985-86 both compared to 1984-85 and to our previous forecast. These depend on the proportion of sales financed privately, the average discounted price and the number of homes sold.

FROM: MISS G NOBLE

DATE: 27 November 1984

MR SCHOLAR

cc Mr Battishill
Ms Seammen
Mr Hall

TCSC QUESTION ON HOUSING BENEFIT

I attach a short piece of briefing on the story in the Guardian last week about joint tenancies and housing benefit.

G Noble

G N NOBLE

JOINT TENANCIES, A NEW LOOPHOLE IN THE HOUSING BENEFIT SCHEME LEADING TO £190 MILLION OF ADDITIONAL EXPENDITURE?

Background

Last week's Guardian reported that a possible new loophole in the housing benefit scheme had been identified which could lead to expenditure of up to £190 million. If a working non-dependent is living in a household where the head of the house is claiming housing benefit, the non-dependent is assumed to be contributing £8.20 towards the households' housing costs and that amount is deducted from the housing benefit calculations. The Guardian claimed that an increasing number of such households were arranging joint tenancies. In such cases, the housing costs are divided between the tenants and a separate housing benefit calculation carried out for each. If the non-dependent has a low enough income the family may qualify for more housing benefit.

2. DHSS say that the estimate of £190 million is incorrect even on the assumptions used. A potential spend of £80 million would be more accurate on the assumptions used and actual exploitation of this loophole is likely to be far less because of the other implications of taking joint tenancies. Many landlords, including local authorities, will be reluctant to award joint tenancies because it extends the security of tenure to additional persons. DHSS are taking the problem seriously, however. They are still assessing the scale of the problem and the real potential for abuse, and considering what action, if any, needs to be taken to block the loophole. Any regulations will need to be carefully drafted, however, so they do not discriminate against legitimate shared tenancies.

HOUSING BENEFIT

Line to take

3. There are significant broader implications for both the tenant and landlord in switching to joint tenancies and the figures quoted in the Guardian look grossly overstated. However, I understand the Secretary of State for Social

Services is looking into the problem to assess the potential for abuse and is considering what action if any needs to be taken.

Footnote

4. An earlier loophole in the housing benefit scheme identified by the National Union of Miners - that strikers living with close relatives could claim they were paying rent and thereby claim board and lodgings payments - is being closed. The Secretary of State for Social Services announced that this loophole was to be closed on the day of the Autumn Statement (it was included in the DHSS Press Notice, though few commentators noticed it). Draft regulations have been submitted to SSAC and to the local authorities for consultation, and they will be laid in the house shortly,

WATER.

1. The Select Committee may raise the question of increases in water charges, following publicity about a letter of complaint from the CBI to Patrick Jenkin, the sponsor Minister. I have not seen a copy of the letter, but according to press reports (attached) it makes the following points.

2. Industry is facing rises of up to 50 per cent in real terms over the next three years, to be debt free after that, and a reduction in capital investment. This will be a major blow to industry's costs.

3. None of these "facts" is correct.

(a) charges will rise somewhat above the rate of inflation but how much will depend on efficiency savings in the industry. 12 per cent (cash) rises will be the average in 1985-86 but industrial charges will rise less than the average - 10-11 per cent perhaps. In the following two years the increases shall be slightly less.

(b) investment is increasing, not decreasing, funded by the rising charges. About 10 per cent cash increase from 1984-85 to 1985-86, to enable more work to be done on eg underground mains and sewers, and on anti-pollution work. (£778m in 1984-85, £846m in 1985-86.) The CBI should welcome this extra infrastructure investment.

(c) Debt The EFL is declining (£284m in 1984-85, £203m in 1985-86) but the industry will be a long way from debt free in two years. Only one authority (Thames) will be close, as it has a negative EFL.

WATER

4. Other points

(i) Water has been too cheap. The industry has a very low profitability, and only earns 1 per cent (before interest) on its net current cost assets. The norm for nationalised industries is 5 per cent. The government has set targets of 1.4 per cent, 1.7 per cent and 1.9 per cent for the next three years, to move towards more economic pricing. (Assets are valued at their net current value to the business - estimated net replacement cost, about £30 billion.)

(ii) Not a sensible comparison to criticize increasing water 'rates' as inconsistent with rate-capping local authorities. Water services in England and Wales are provided by the water industry. Water charges are a charge for water, not a rate or a tax. Nothing to do with controlling the spending of profligate local authorities.

(iii) Domestic users are mainly at present charged on the basis of the rateable value of their houses, but industry is all metered - charged according to what they use. Government just launched a study of extending metering to all domestic users as well.

(iv) Effect on inflation, industrial costs etc should be small. Each 1 per cent charge in water charges raises RPI by only 0.01 per cent. Water is a small element of most industries' costs - some will feel the effect of these increases, but for most it should not be significant.

(v) It is not government policy to subsidize costs of utilities, as a way of subsidizing industry in general. Nationalised industries should be efficient and provide a good service but with minimum burden on the taxpayer. Until the water industry is earning 5 per cent on its net current cost assets, on a par with the private sector, there is in fact an implicit subsidy from the taxpayer - at present over £1 billion. (Assets £30 billion x (5% - 1% = 4%) = £1.2 billion.)

TCSC HEARING : BUDGET DISCIPLINE

The question and answer briefing set out below covers the main points of criticism on which the TCSC (particularly Mr Budgen) focussed when officials gave evidence on 19 November. My separate minute of today's date reports that the Foreign Affairs Council has so far failed to adopt the budgetary discipline conclusions because of disagreement as to whether any concession should be offered to the European Parliament. The Foreign Affairs Council will make a further effort to reach agreement tomorrow. The question and answer briefing suggests what you might say in the event that the Foreign Affairs Council fails to agree again. We will let you know before the TCSC hearing what the position is.

2. Annex A, the work of Miss Simpson, sets out the draft Conclusions of the Council on budgetary discipline in the form agreed at the 12 November ECOFIN Council and as presented to the House, together with an article by article commentary and a line to take on difficult points.

3. We suggest that you commend the budgetary discipline text to the TCSC not as an ideal outcome, which fully achieves the Government's negotiating targets, bu, as a vast improvement on the present position where there is n discipline at all. (The figures in Answer (c) below substantiate this). It has to be admitted that there <u>are</u> loopholes in the text - exceptions clauses etc. These can only be defended by reference to the need for some flexibility in controlling highly volatile agricultural spending. The essential points are that there will be a clear constraint on the agricultural price fixing decisions and that Finance Ministers will now have a substantial role to play.

Q+A Notes

BRIEFING TCSC, 28 NOVEMBER :

AUTUMN SURVEY : BUDGETARY DISCIPLINE

(a) Budgetary Discipline not legally binding; subordinate to Treaty requirements (Art. 39) to maintain farmers' income

The Government's objective was to get these rules incorporated into the Community's budgetary procedures and, once the text has been adopted, that will have been achieved; the Council will have bound itself to observe the rules in it governing both agricultural and non-agricultural expenditure.

2. As regards agriculture, Council will have committed itself to keep growth of expenditure below that of own resources base. That will be financial framework within which price fixing decisions are to be taken. The CAP objectives set out in Article 39 of the Treaty are in any case internally contradictory - references to both "fair standards of living" for agricultural producers and "reasonable prices for consumers". Nothing to say which of these two should have priority.

3. [If pressed on legal nature of the Conclusions]. Whether or not the text has legal force could in last resort only be decided by European Court. Hon Member greatly exaggerates significance of this point. Several apparently binding provisions of EC Treaty - eg freedom of services and removal of barriers to trade - have at best only been partially implemented. In contrast, both the 1980 agreement on UK refunds and the setting up of the EMS were agreed without any provision for them in the Treaty and on the basis of Council Conclusions and a Council Resolution respectively. What matters is that the Council is binding itself to observe this agreement.

(b) HMG surrendered veto over own resources increase, in return for budgetary discipline which can be overturned by qualified majority

4. UK did not "surrender veto". Fontainebleau agreement is a highly satisfactory deal; HMG agreed to propose to Parliament

increase in VAT ceiling to 1.4% in return for 66% abatements of our budgetary burden and the budgetary discipline rules governing agriculture. If no Fontainebleau agreement, no rebates, no abatements and no control of agricultural spending.

(c) But why qualified majority voting?

5. We wanted budgetary discipline incorporated in Community's budgetary procedure where qualified majority voting rule applies; hence qualified majority in this text.

6. So far as agricultural spending is concerned, Commission has bound itself to draw up its price fixing proposals in the light of the agricultural guideline. Provided it does so and sticks to its original proposals, Agriculture Council can only amend them by unanimity under Article 149 of Treaty. Moreover, if that seems likely to happen, the new rules require the Commission to summon a Joint Agriculture-ECOFIN Council to take final decisions.

(d) How can budgetary discipline be taken seriously when super-levy arrangements flouted by France, Italy etc?

7. Far too soon to conclude that super-levy will not be implemented. Commission has made it clear it will initiate action in European Court against recalcitrant Member States. Faint hearted/ to assume all is lost at first obstacle. Government has never pretended budget discipline easy or settled in a day. Hard decisions will be required on the CAP of which super-levy on milk only the first. The budgetary discipline text provides essential financial framework to ensure those decisions are taken.

(e) Agricultural Guideline far too generous. Will allow agricultural spending to grow in real terms.

8. Problem is that agricultural spending has risen far faster than own resources bases :-

	1984 on 1977	1984 on 1982	% inrease
(i) agricultural expenditure	168%	48%	
(ii) own resources base	75%	11%	

Now agreed that agricultural spending will rise less than own resource base. Our estimate is that this will give an increase of around 6% in 1986 on 1985 and lower increases thereafter - 4½-5%. That will be vast improvement compared with past. Zero growth simply unrealistic given large level of accumulated stocks.

(f) Foreign Affairs Council has not adopted budgetary discipline text. Government's negotiating triumph has vanished into thin air?

9. No. No disagreement in Foreign Affairs Council over substance of the text or the agricultural guideline. Sole point at issue is whether and how to associate the European Parliament with budgetary discipline - in a purely consultative role. Confident that this will be resolved speedily. No question of Government seeking House's approval of Inter-Governmental Agreement until text finally adopted.

TEXT OF INT-GOV AGREEMENT

Text

Whereas at its meetings on 19 and 20 March and 25 and 26 June 1984, the European Council reached agreement on a series of decisions and guidelines to ensure the relaunch of the Community and establish a solid basis for its further development during the present decade;

Whereas principles of budgetary and financial discipline are specifically laid down;

Whereas the European Council considered it essential that the rigorous rules which at present govern budgetary policy in each Member State shall also apply to the budget of the Communities, and stated that the level of expenditure will be fixed on the basis of available revenue, and that budgetary discipline will apply to all budgetary expenditure;

Whereas the European Council invited the Council of Ministers to adopt the measures necessary to guarantee the effective application of the principles as set out in its conclusions.

Commentary

Follows closely the Fontainebleau conclusions. Clearly therefore ties the budgetary discipline arrangements and the rest of the Fontainebleau package. No problems for the UK.

Text

Article 1

1. At the beginning of the budgetary procedure each year, the Council shall fix a reference framework, ie the maximum level of expenditure which it considers it must adopt to finance Community policies during the following financial year in accrodance with Articles 2 to 5 inclusive and Article 9.

2. In order to fix the reference framework, the Council shall act by qualified majority in accordance with Article 148(2), second indent of the EEC Treaty.

3. The relevant provisions of the financial guidelines concerning the Common Agricultural Policy, set out in the Annex to the Commission Communication of 6 March 1984, shall be implemented; these provisions are annexed to this conclusions.

Paragraph 2. The "qualified majority" is 45 votes (out of a total of 63) cast by at least 6 members. After enlargement will be 54/76.

Line to take Qualified majority voting is the normal rule for decisions which are part of the Community's budgetary procedure. (See separate note)

Paragraph 3 Firmly associates the Commission's proposals for control of agriculture spending with the Council's measures on budgetary discipline generally. The Commission has said it will make its agricultural proposals "in the light of" the guideline.

Commentary

Paragraph 1 empowers the Council (basically ECOFIN) to fix the reference framework. It now takes the form of a direct quotation from the Brussels/ Fontainebleau conclusions. (Articles 2 to 5 and Article 9 refers to the agricultural guideline and the maximum rate provision respectively.) The major weakness of the Article is the timing. "At the beginning of the budgetary procedure" is an indeterminate time, and could turn out to be as late as June. We had originally marked a specific date that clearly preceded the agricultural price fixing, but were unable to achieve this.

Line to take. The guideline, rather than the reference framework, is the right control on agricultural expenditure. As the Commission have made it clear that they will compare the estimated budgetary consequences of their price-fixing proposals with the guideline, the Council will also be able to compare their compatibility. Commission has said it will provide necessary figures "early in the year" to enable Council to fix reference framework. This must be done before the Commission presents the Preliminary Draft Budget.

Articles 1 and 6.1 embody the reference framework in the Community's budgetary procedures.

Text

Article 2

The Council shall ensure that the net expenditure relating to agricultural markets calculated in accordance with Article 4, will increase by less than the rate of growth of the own resources base. This development shall be assessed on comparable bases from one year to the next.

Account shall be taken of exceptional circumstances, in particular in connection with enlargement.

Line to take: It is a fact of life that agricultural expenditure will be subject to unforeseen market developments. In addition, the Community will be going through an important structural adjustment over the next few years - namely enlargement. These are both legitimate, and sensible, reasons for providing for some flexibility within the guideline. We shall, of course, scrutinise most carefully all attempts to invoke this provision. No agreement to anything except enlargement as "exceptional". Qualified majority needed to agree on exceptional circumstances.

Commentary

This commits the Council to keep the rate of growth of agricultural expenditure below that of the own resources base. It does not now fully reflect the Fontainebleau conclusions, because with the changed method of calculating the guideline, the reference to "three-yearly" basis has been discarded.

Line to take: Nothing sinister about the removal of
Simple cross-reference to Article 4.
the reference to three years./ The intention of the article is still quite clear. The agreed method of calculation of the guideline also automatically provides a three-year comparison - years 1984, 1985 and X.

The reference to exceptional circumstances and enlargement comes direct from the Fontainebleau conclusions. the Irish have added an entry in the minutes claiming that account, under this heading, should also be taken of the costs of stock disposal. The Council has also pledged itself to take into account its and the European Councils' previous decisions, especially relating to less developed areas. The flexibility available within the Article is therefore uncomfortably large and there will clearly be scope for considerable argument about the adjustment of the guideline. Fortunately, neither of the Council minutes entires should become public knowledge.

Text | Commentary

Article 3

The amounts to be taken into account for the application of Article 2 shall be:

The definitions of both the expenditure base and the own resources base for the guideline calculations. In both cases, they differ from those normally quoted by the exclusion of the sugar and isoglucose levies. The text corresponds to that of the Commission communication on budgetary discipline which was endorsed by all member states at Fontainebleau.

(a) as regards expenditure:

that chargeable to Section III, Part B, Titles 1 and 2 (EAGGF Guarantees) of the Budget. The claculation of agricultural expenditure for the purpose of the guideline referred to in Article 2 shall be this expenditure, reduced by the sum of amounts corresponding to the marketing of ACP sugar, refunds in connection with food aid and the payments by producers in respect of the sugar and isoglucose levies as well as the revenue from any future internal agricultural charges;

The final paragraph was inserted at the insistence of the UK , and is designed to ensure that increases in the own resources ceiling doe not permit a 'step' increase in the guideline. The effect will be to 'read back' the new VAT maximum rate into the figures for 1984 and 1985 so that the own resources factor will not be artifically inflated by a comparison between an own resources base calculated on 1% and one calculated on 1.4%

(b) as regards the own resources base:

the potential revenue on the basis of which Titles 1 and 2 of the Revenue side of the Budget are determined. The calculation of the Community's own resources base for the purposes of the guideline referred to in Article 2 shall be the total VAT base upon which the VAT rate for the year in question is calculated, the amount of financial contributions (if any) included in the Budget of the year, together with the own resources, other than those derived from VAT, set out in Revenue Title 1, less the sugar and isoglucose levies as well as the revenue from any future internal agricultural charges.

When the potential revenue from VAT is changed following an alteration in the VAT ceiling, the guideline provided for in Article 2 shall thereafter be calculated as if the new maximum VAT rate had been applied in all the years relevant to the calculation of the guideline.

The UK has inserted a statement in the minutes accepting this definition of agricultural expenditure only for the purposes of this exercise, and rejecting any implications it may have for the budgetary treatment of FEOGA guarantee expenditure or other purposes.

What difference does the "narrow definition" make? Why did UK agree?

(a) Will not make much difference (less than 10% of Budget) and omitted portion unlikely to grow faster than rest of FEOGA budget.

(b) This definition was proposed by Commission at Fontainebleau. UK accepted for use in this context only. Other member states wanted even narrower definition.

Article 4

The level of net expenditure relating to agricultural markets for a given financial year shall be calculated as follows:

(a) the level of expenditure, as defined in Article 3(a), shall be the average of the actual outturn expenditure for 1984. and the best estimate of the outturn for 1985.

(b) the own resources factor shall be established by dividing the forecast level of the own resources base for the financial year in question, as defined in Article 3(b), by the average own resources base for 1984 and 1985

(c) the level of expenditure for the financial year in question shall be determined by multiplying the amaounts obtained by the application of paragraphs (a) and (b), unless the Council acting by the majority defined in Article 1(2) decides otherwise;

(d) the method of calculation shall be re-examined in accordance with the Fontainebleau conclusions under the heading "budgetary imbalances" on the basis of the report to be presented by the Commission, one year before the 1.4% VAT ceiling is reached.

The method of calculating the agricultural guideline, and core of the agreement. It has been changed from previous versions in 3 significant ways:

(a) there is a fixed, rather than a moving reference period;

(b) the reference period itself is 2, rather than three years; and

(c) provision has been made for a review of the system.

In addition, it has made special transitional arrangements for 1986 unnecessary.

Line to take

1. The key matter in establishing the guideline was to eliminate "base drift" ie getting excess expenditure in any one year built into the system. This the present formula achieves.

2. The present formula, like the previous "original budgets", is based on one originally tabled by the UK. It is much more satisfactory than the previous one whould have been without "original" budgets, on which it became clear there was not going to be agreement.

3. Even with a 2 year base period, the formula gives a tight guideline. Total agricultural spending in 1986, on this basis, is expected to be some 6% more than in 1985, compared to increases averaging 16% between 1982 and 1985. Given the high level of stock disposals that will have to be financed, the 1986 figure will be a tight constraint.

4. The Fontainebleau conclusions always envisaged that there would be a review of the system. The Presidency on Monday accepted the Council Legal Services advice that this meant the mechanism continues to operate while expenditure remained within the 1.4% ceiling, which cannot be altered without our consent.

Text

Article 5

In the event of failure to respect the qualitative guideline referred to in Article 2, the Council shall, during the following two financial years, ensure that, barring aberrant developments, agricultural expenditure is brought back within the limits imposed by this guideline. In so doing, the Council shall concentrate its activity primarily on the production sectors responsible for the failure to adhere to the guideline.

Commentary

The clawback provisions, based on the Commission's proposals on the financial guideline. They are ambiguous, in that it is not clear whether they are intended to bring expenditure back to the original line, but starting from a higher base, or genuinely to claw back any excess expenditure. With the revised formula for calculating the guideline, the latter interpretation is the only one that makes any sense, as excess expenditure in any one year will not get built into the formula (after 1985). The formula, however, also have the advantage of making it more difficult to tinker with the guidelines, for example if excess expenditure on any one year leads to an effective very small increase (or even decrease) in expenditure the following year.

Line to take

This is an essential part of the package and one we fought hard to get included in the text. The guideline itself now provides for automatic avoidance of base drift. The effect of this Article will be that if, in any one year, expenditure does exceed the guideline, the Council will have to consider what measures are needed to offset any excess over the following 2 years. Clawback not automatic. Judgement will have to be made depending on cause of the expenditure overshoot. But strong presumption that clawback will be applied.

Text

Commentary

Article 6

1. The council shall, when exercising its powers as legislative authority or branch of the budgetary authority, ensure that the reference framework is respected.

2. At the request of a member of the Council or the Commission, the Council, acting by the majority laid down in Article 1(2), may amend the reference framework.

This article commits "the Council" ie individual spending Councils when taking decisions with financial implications, to respect the reference framework established by ECOFIN. It also permits the ECOFIN itself to amend the reference framework. This, although unwelcome, is in fact unavoidable. There are certain spending obligations of the Community for which provision will always have to be made and for which the reference framework will have to allow room.* The ECOFIN Council will not, of course, agree to expanding the reference framework without the most careful consideration of the reasons for which it is required. (See also Article 7).

* eg Supplementary Budget for agriculture.

Text

Articel 7

1. Except in the case of Decisions mentioned in paragraph 4, when the Council is on the point of adopting an act which appears likely to increase expenditure for a financial year beyond the reference framework applicable to that year, the adoption of that act shall, at the request of a member of the Council or the Commission, be suspended.

2. Within a period not exceeding one month, the Council, acting by the majority laid down in Article 1(2), shall determine whether the proposed act would, if adopted, lead to the reference framework being exceeded.

3. If the Council concludes that the proposed act would, if adopted, lead to the reference framework being exceeded, it shall reconsider the proposed act with a view to taking appropriate measures.

4. In the case of decisions affecting net expenditure relating to agricultural markets, the procedures laid down in paragraphs 5(c) and 6(b) of the Annex to the Commission's Communication of 6 March 1984 shall apply.

Commentary

This article provides for the ECOFIN Council (except under Article 7(4) to review spending proposals by other Councils which look likely to exceed the reference framework. It allows decisions on these projects to be delayed for a month, and provides for reconsideration if the financial consequences look unacceptable.

Articles (1) to (3) refer to non-agricultural spending. Article (4) refers to agricultural spending. The procedure to which it refers is one whereby if the Commission considers the Agriculture Council is likely to take decisions whose costs would breach Commission's original proposals. It will ask for the decision to be referred to a special Finance & Agriculture Council. It will also monitor expenditure throughout the year and ask for any potential overrun to be similarly referred. Although the original Commission proposals referred only to the price-fixing, the French, whose formulation this is, intend that in its present form it will apply to all agricultural spending.

The UK has secured an entry in the minutes which will enable an individual member state to trigger the review by formally asking the Commission to give its opinion on any potentially excessive exepnditure.

Text	Commentary
Article 8	
When the Council is on the point of adopting an act which has considerable financial implications for several years, the Council shall, before taking the final decision, formulate an opinion on whether the financial implications of the proposed act are compatible with the principles and guidelines governing the Community's budgetary policy.	This has much the same effect as Article 7, except it relates to the decisions with longer term financial consequences rather than those relating to a single year. Both this and Article 7 help fulfil a recommendation from the House of Lords Select Committee that Finance Ministers should generally be those involved in spending decisions. There can be no automatic formula for applying this Article, as by definition no reference framework will have been fixed nor will the maximum rate be known. Important thing is that for the first time ECOFIN will have the opportunity to give its views on whether the rate of growth of expenditure is likely to be excessive in relation to the finance likely to be available under the reference framework and maximum rate in future years.

Text	Commentary
Article 9	
1. The Council shall comply with the maximum rate provided for in Article 203(9) of the EEC Treaty throughout the budgetary procedure. 2. In order to achieve this: - when establishing the Draft Budget, the Council shall keep the increase in expenditure other than that necessarily resulting from the Treaties or from acts adopted in accordance therewith to a level no higher than half the maximum rate provided for in Article 203(9); - at the second reading, the Council shall adopt a position such that the maximum rate is not exceeded. 3. Paragraphs 1 and 2 of this Article are without prejudice to the provisions of Article 203 of the EEC Treaty, particularly those of the last sub-paragraph of paragraph 9.	This does not add much to the procedures the Council is already supposed to respect in making its budgetary decisions. The existing provisions were, however, more often dishonoured than not, and Fontainebleau specifically called on the Council to adopt measures to ensure that the maximum rate provisions were respected. The proviso in paragraph 3 is to permit the Council to accept increases in the maximum rate itself, as is provided for in the Treaty. The Council Legal Services and the Commission had refused to accept a text that did not include this proviso. Line to take Council is binding itself to observe more scrupulously a provision of the Treaty that it has always been subject to, but has not always honoured. This fulfils the third leg of the Fontainebleau remit.

Text	Commentary
Article 10	
On the assumption that the 1986 budget will be prepared on the basis of own resources being increased in that year, these Conclusions shall first apply to the exercise of the Council's powers in 1985 concerning expenditure in the financial year 1986.	This article will ensure that budgetary discipline and, especially, the agricultural guideline, should apply as from the beginning of 1986. It will therefore have to bite on the 1985 price fixing as that affects expenditure falling in 1986. It is an essentail article of budgetary discipline that is to be taken seriously as part of the Community's budgetary procedures. It is also consistent with budgetary discipline's position as part of the Fontainebleau package that it should come into operation at the same time as the rest of it. UK assistance played a large part in getting this starting date agreed.

1-48

LIKELY Q's

CHANCELLOR'S EVIDENCE TO THE TCSC

The following questions have been suggested by the Committee's Clerks in their advice to the Committee:

- Does the Treasury provide advice to Ministers collectively on spending priorities and, if so, how are they determined?
- Are Ministerial bilaterals concerned mainly with spending at the margin of programmes, or is the approach more zero based?
- Could the Committee be provided with a departmental breakdown of forecast outturn for 1984?
- Is it not fair to say that public expenditure plans are really rising: firstly because, within the planning total, increases have been offset by increased asset sales and the abolition of National Insurance Surcharge; secondly, because interest payments (which are rising) are not included in the planning total; and thirdly because many of the plans in the Autumn Statement are based on clearly optimistic assumptions, such as the 3 per cent pay assumption and the assumed real cut in local authority spending?
- If it is true that revenue determines expenditure, why do we not have firm medium term plans for taxation as well as expenditure?
- Forecast oil revenues for 1985-86 have increased by £2½ billion. Since this more than accounts for the prospective £1½ billion fiscal adjustment, and yet, is, in effect, a windfall gain, would it not be irresponsible to use this money either for tax cuts or to increase spending?
- If it is true that asset sales are taken into account when deciding the level of the PSBR, can we expect a lower PSBR in 1985-86 than the £7 billion set out in the MTFS?
- The Government has criticised the US budget deficit but if the US policy were to change, there may be a consequential effect on the sterling dollar exchange rate and on oil revenues - which might in turn affect the scope for tax cuts. Does the Chancellor really want to a change in US fiscal policy?
- Why has the level of debt interest risen?
- What is the effect on the RPI of the increased charges that have been necessary in certain departmental programmes in order to achieve "savings"?
- Although MO and sterling M3 are within the target ranges, M1 and PSL2 are growing faster. Why does the Chancellor believe that M0 and £M3 are better indicators and is he not worried about the other indicators?

* - The Chancellor said that if there were a 1 per cent reduction in real wages, there would be 200,000 jobs. How many of these would be for part-time women?
* - What is the Chancellor doing to bring down real wages?
* - The Autumn Statement shows a decline in the UK share of export markets. Does this not demonstrate declining cost competitiveness and if so, what is the Chancellor doing about it?
* - What is the effect on industry's costs of the increase in the gas and electricity negative EFL and the reduction in the water industry EFL?
* - How are nationalised industries EFLs decide - ie are different rates of return chosen for different industries.

ANSWER

TSY ADVICE TO MINS

Q. Does the Treasury provide advice to Minsiters collectively on spending priorities and how is that advice determined?

A. The Treasury has a natural focal role in planning, monitoring and controlling both total public spending and the individual programmes. It is the job of Treasury officials to advise the Chief Secretary and me on both aspects. Their advice on individual programmes reflects detailed assessments of the pressure for additional provision and the scope for savings, based on their regular discussions with officials in other Departments. It is for the Chief Secretary and for me to decide, on the basis of that advice, what proposals we put, and what responses we make, to individual spending Ministers and to the Cabinet.

ZERO BASED/ MARGIN?

Q. Are Ministerial bilateral discussions concerned with spending at the margin or are they more concerned with a zero-based approach to departmental spending?

A. Procedures for analysing spending on individual programmes follow no single set pattern. And nor should they. No one approach or technique has all the answers. Inevitably considerable attention is given to proposals for changes at a margin - whether a proposed new initiative, the ending of a particular function or revised estimates of the cost of executing present policies. But that does not preclude more fundamental reviews of total spending in particular areas. And the Government's record since 1979 shows that major shifts in priorities between different expenditure programmes have been achieved.

TCSC: 1984-85 PLANNING TOTAL: DEPARTMENTAL ANALYSIS OF ESTIMATED OUTTURN

/The TCSC asked why Table 2.1 of the AS, which shows 1984-95 plans by departments, did not also show an analysis of estimated outturn7.

DEPTS OUTTURN

<u>Line to Take</u>

1. The speed with which the Autumn Statement is produced and the substantial uncertainty of the figures means that it would not be possible to produce an accurate breakdown.

2. The prospective outturn for the planning total of "nearly £128 billion" is itself subject to considerable uncertainty; a breakdown by department would have to be based on partial information and, at this early stage of the year, would be highly unreliable.

3. Estimated outturn expenditure by programme will, however, be shown in the Public Expenditure White Paper. But, even those estimates will necessarily be uncertain, and may need to be supplemented by a global unallocated allowance for longfall or shortfall, reflecting the latest information just before the White Paper is published.

<u>If Pressed</u>

1. I will consider whether it might be possible next year to give some indication of the departmental breakdown of the prospective outturn in the Autumn Statement.

Q. Forecast oil revenues for 1985-86 have increased by £2½ billion. Since this more than accounts for the prospective £1½ billion fiscal adjustment, and yet is, in effect, a windfall gain, would it not be irresponsible to use this money either for tax cuts or increased spending.

Q. If it is true that asset sales are taken into account when deciding the level of the PSBR, can we expect a lower PSBR in 1985-86 than the £7 billion set out in the MTFS.

OIL REV'
ASSET SALES
+FISCAL ADJ.

A. The size of the fiscal adjustment and of the PSBR for 1985-86 will be announced at Budget time next year, and will take account of all relevant factors, including those mentioned here.

Q. The Government has criticised the US budget deficit, but if US policy were to change, there may be a consequential effect on the sterling/dollar exchange rate and on oil revenues - which might, in turn, affect the scope for tax cuts. Does the Chancellor really want a change in US fiscal policy?

A. Any change in US policy would have a large number of consequences. It is not sensible to pick out only one consequence and judge the desirability of the policy change solely by that criterion.

The Government's view on the US deficit is that it is unsustainable in the longer term and therefore will have to change. The sooner the change takes place, the better.

The Government would, of course, accept any effects on the prospective fiscal adjustment of the kind described, but there will be other effects of a reduction in the US deficit - such as that on the dollar oil price, and is by no means clear that the net effect on oil revenues would be negative. The Government will have to consider all the relevant factors, when making a judgement on the PSBR and fiscal adjustment at next year's Budget.

U.S. BUDGET DEFICIT

Q. What is the effect on the RPI of the increased charges that have been necessary in certain departmental progrmames in order to achieve savings?

A. I presume you are referring to the effect of increased charges by nationalised industries. These are a matter for the industries themselves and final decisions have not been made. No accurate estimate of the RPI can be made.

RPI EFFECT

Q. Although MO and £M3 are within target ranges, M1 and £M3 are growing faster. Why does the Chancellor believe that MO and £M3 are better indicators and, is he not worried about the other indicators?

A. M1 is clearly distorted by interest bearing sight deposits and there is no reason to be concerned by its growth.

PSL2 can be considered as a cross check to £M3, and the Government have looked carefully at the reasons for its growth.

In fact the growth in PSL2 is largely due to the growth in Building Society liabilities, and it is not surprising that these are growing rapidly at this stage in the development of Building Societies.

MO +
£M3

Q. The Chancellor has said that if there were a 1 per cent reduction in real wages, 200,000 jobs would be created. How many of these would be for part-time women?

A. There is no reason to suppose that the mix between full-time and part-time jobs that might be expected would be very different from the actual mix that occurred over the last decade or so.

"PART-
-TIME
WOMEN"

What is Chancellor of the Exchequer doing to bring down real wages?

Real wages will more readily adjust if the labour market works better, with fewer impediments to free supply of labour and to matching of supply and demand. The government has acted in several areas to help bring this about. Cannot expect them to give overnight results when operation of UK labour market has been gummed up for so long.

2. Measures which will bear on real wages include:

(i) trade union legislation (in particular preovisions for strike ballots and provisions on closed shops effective from 1 November) helps restore better balance in industrial relations. Reduces monopoly power of unions and safeguards rights of union members.

(ii) cut in the burden of income tax on earnings and changes in social security system (abolition of earnings related supplement to unemployment benefit) have brought a bigger gap between what people can earn in work and what they can receive out of work. Incentives are improved and supply of labour is less distorted by taxes and benefits. [Replacement ration "reduced even including employee NICs]

(iii) 1946 Fair Wages Resolution abolished. Allows government contractors to create more jobs, free of special minimum wage restrictions

(iv) pay determination in the public services now set with much more regard to market factors, less to so-called "comparability".

3. Other measures which will help to promote smoother labour market adjustment include:

(i) action to help geographical mobility (council house sales), end to conveyancing monopoly, encouragement for National Mobility Officers to help public sector tenants move)

(ii) training programmes to improve supply of skilled employees

(iii) action on occupational pensions to make it easier for people to move jobs.

LEVEL OF REAL WAGES

What will the increase in negative EFLs for gas and electricity and the smaller positive EFL for water do for industries' costs?

Prices are a matter for the industries to settle. Discussions will now take place within the industries on increases for 1985-86.

Supplementary points:

(i) Gas and electricity. Increases expected to be broadly in line with inflation. (No decisions yet taken on recovering costs of the coal strike including extra costs of maintaining electricity supplies).

Electricity prices to industry are generally in line with Continental competition, except for France with its high nuclear output. Recent outside evidence suggests UK gas prices are low by Continental standards.

Future of electricity load management scheme - this is a matter for the industry. The industry anticipate a scheme providing comparable benefits will continue in 1985-86.

(ii) Water. Expect the increases to be somewhat above the rate of inflation. How much will depend upon the efficiency savings the industry can achieve.

The increased charges will help to finance a much increased investment programme.

[If pressed: DOE has stated that increased charges are likely to be around 12%. But industrial charges will be less than domestic (possibly about 10-11%).]

GAS + ELECTRIC EFLS

By what criteria are nationalised industry EFLs decided?

EFLs are agreed by sponsor Ministers and the Treasury on an industry-by-industry basis. Several factors are taken into account, including the industry's medium-term financial target, the size of its investment programme, the scope for reducing costs and increasing efficiency, and the level of its prices.

[If pressed:

(i) The aggregate level of EFLs is influenced by macro-economic considerations and the overall public expenditure position.

(ii) For 1985-86 the liability of some industries to Corporation Tax has also been taken into account.]

HOW ARE NIS EFLS CHOSEN

SUPPLY
BRIEFING.

TERRY WARD NOTE

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TREASURY AND CIVIL SERVICE COMMITTEE

27th November 1984

Dear Terry

This is to confirm that the Committee would like the Treasury to examine the figures in the Table annexed to Mr Terry Ward's paper, a copy of which was sent to you earlier today. If you think any of his calculations are wrong, I would be obliged for early warning - since this might enable us to put a better version on the table at tomorrow's meeting of the Committee. You may find by then that there are some changes in the later parts of the text. This exercise, incidentally, should be deemed to subsume that referred to by Mr Townend towards the end of his questioning yesterday.

In hand

On the question of additional expenditure in 1984/85 attributable to the coal strike, the Committee would like to know how much of the projected total increase is directly attributable to that cause and how much of the additional provision required has been met out of the contingency reserve.

Revised draft tomorrow morning from GE.

Yours
Donald

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D.W. Limon

24/110

(d) Why not a £2 note?

A new note would take some time to design and bring to issue (18 months to 2 years); it would be costly, and in unit terms would probably cost more than £1 note.
When it issued, a £2 note would have a lower purchasing power than the 10/- note when it was withdrawn in 1970.

The place of a £2 note in the currency would not be easy to determine. Cash dispensers would not use them. A £2 note would be likely to change hands rather like a £1 note ie as if it were small change.

Not for use

If anything, the case is probably stronger for a £2 coin (which we do not plan for general circulation although there is to be a collector's piece).

CURRENCY

Looking at highest coin, lowest note ratios, there is virtually nothing between the £5 note and £1 coin now, and the 10/- note half-crown pre-decimalisation (5:1 and 4:1).

Experience overseas is not encouraging in trying to supplant a 1 unit with a 2 unit (particularly true in the USA, although USA is best not mentioned). The majority of western countries that have notes of 2 units have had them for many years. There are very few examples of a country which has created a note of 2 units on withdrawing from circulation a 1 unit note. Denmark and France are cases in point (10Kr replaced 5Kr, and 20FF replaced 10FF). In France although the 20FF has been in issue since 1981 we believe that the number of 20FF notes in circulation is only about 4% of total number of bank notes.

A The possibility has been considered. But apart from the additional cost [of designing and introducing a new note], a £2 note would tend to circulate much like the £1 note, and so be open to the same objections of wear and tear with treatment as small change. These are reasons for substituting a coin for a note, not from introducing a new note. To opt for £2 note would erode the savings gained from ending £1. [If pressed, perhaps two-thirds of saving would be lost.]

(a) Quality of paper

Background

Portals have suggested better paper as a solution to the state of the note - see attached Times letter. The paper they want to provide is chemically stronger than the paper they supply to Bank of England specifications. The Bank's paper has remained substantially unchanged in the degree of its toughness (resistance to tearing, effects of folding, screwing up etc) for many years, becoming slightly lighter as characteristics allowing lighter paper to be stronger have been incorporated.

Problems with Portal's suggestion

2. They are well aware of the arguments.

First, thicker paper does not necessarily last longer in practice. It depends on the type of treatment notes get. In the UK case, a major problem is soiling owing to pushing the note into pockets, overalls etc. Soiled notes no less objectionable than torn ones. This may be less of a problem in the US where more small transactions occur by credit transfer, notes are paid less in pay packets etc.

Second, the time periods often quoted are not comparable. We say the £1 note lasts 10 months. But that is in active circulation, and does not include time spent in bank vaults when it is not suffering wear and tear. The often quoted 18 month figure for note circulation elsewhere generally includes this idle time. The life of our own notes on this basis would be about 1 year

In any event, a coin is cheaper.

Third, the problem we have is that the appropriate place is pockets rather than wallets. The £1 unit has become small change, and will remain so regardless of whether it is made of thicker or thinner paper or indeed of metal. As such, its best form is a coin. Without a coin, we could not take advantage of the great convenience of goods - eg gas, electricity - and services - eg underground travel - which can be sold through coin machines.

An answer using these points is already in your Q and A briefing (copy attached).

Reference ....

SATURDAY 17/11/84.

THE TIMES

Paper pounds

9

From Mr Julian Sheffield

Sir, As producer of the paper for £1 notes, I can answer R. J. Phillips's letter in *The Times* of November 15.

We have developed a highly durable paper for bank notes which has been available for some time. US $1 bills are printed on this quality of paper and remain in good condition for an average of eighteen months. One could expect £1 notes to last as long.

Another letter raises the possibility of a £2 note. This would be a sensible compromise. No other country in the Western world has a gap as big as we will have between its top coin and bottom note. It is worth pointing out that if we have no £1 note, change from £5 for a £1.12 purchase will produce a minimum of nine coins.

Finally, the Chancellor has stated in his case for the £1 coin that it will last 40 years. I wonder how many coins in his pockets are 40 years old. Not many halfpennies, I suspect.

Yours faithfully,

JULIAN SHEFFIELD, Chairman,
Portals Ltd,
Overton Mill,
Overton,
Basingstoke, Hampshire.
November 16.

CODE 18-78

Paper from Existing Q + A.

Q. Why not better quality paper?

A. This is Portal's suggestion, not without a degree of self-interest as the Bank's paper supplier in pushing a more expensive product. It is based on the argument that US notes last longer. But the comparison is not straightforward and the life of the notes is calculated differently. The UK note has an actual circulation life on only 10 months (cf 18 months Portals say for USA).

Currency is used differently in the USA, while here it is used more for low/medium value transactions. The proportion of wage earners paid in cash is greater in the UK; as cash is used more frequently, our notes get tattier.

We cannot prove that better paper means a longer life. If notes, for example, did not tear quite so easily, the probability is that the notes would get dirtier.

Q. Why not plastic coatings like the Dutch?

A. Bank of England have been investigating use of plastic coating for 20 years. Problems are:

(1) difficulty in interpreting results

(2) translation of results into comparisons against cost, ie is extra cost matched by a higher note life.

The conclusion is that there is insufficient evidence that it lengthens note life when account is taken of cost.

Other countries have tried plastic coating from time to time. Many are believed to have since stopped using the process. Currently we know the Dutch and Swiss use plastic covered notes. One practical problem is that the plastic sometimes crazes and this attracts dirt, a problem shared with the paper note.

(b) Unemployment at Portals?

The Bank of England's Printing works which keeps in daily contact with Portals does not know of any redundancies which will follow from discontinuing the £1 note. The Bank's print order for notes have yet to be redetermined in the light of the £1 note's demise, and loss of orders for £1 paper may be compensated for to a certain extent by paper for other notes.

2. Portal's are also involved in overseas work and have a broadly based security printing business in the UK generally. Only about 20 per cent of their capacity is absorbed by Bank orders, although 40 per cent of that has been for the £1 note. The security printing industry is suffering from overcapacity at present. But other than in the short term the firm is not expected to have difficulty using the capacity profitably.

3. Portal's may complain that notice might have enabled them to plan rationally. Unfortunately the secret had to be closely kept as part of the Chancellor's Autumn Economic Statement. Even the Bank of England's printing works and staff of the Royal Mint were unaware until the afternoon of the announcement.

4. This question is clearly linked to that of a £2 note, which would go some way to filling the work gap as far as Portals are concerned.

Reply

5. Commercial relations between the Bank of England and its paper supplier are not perhaps a fitting subject for discussion in this House. I gather that the Bank of England's future demand for paper for existing denominations of note has yet to be determined in the light of the decision on the £1 note.

(c) Loss of overnight interest by clearing banks?

Background

Notes held by the clearing banks are partly paid for, eg in local branches and partly "held to order", ie held free of charge pending issue to branches. Banks can freely call on "hold to order" stocks or return surpluses to them. Holding notes to order is convenient to all parties from a security point of view because it prevents the physical movements of notes which would otherwise be necessary if banks were to minimise their holding costs. Bulk movements of coin are less realistic anyway, and the Government has always resisted extending "held to order" to cover them. The argument is that as the nation's coin handlers - with the benefits this brings them, banks should be prepared to stand the cost. When "held to order" arrangements were negotiated in 1980, the banks specifically agreed to exclude the £1 coin from them.

2. A form of "held to order" now operates for the £1 coin, but only for a limited period. To encourage the banks to preposition stocks around the country in the face of uncertain public demand, the £1 coin can be held without payment until it is issued. The arrangement will lapse on 31 January next, when all coins held by banks must be paid for.

3. The existence of "held to order" and "deferred payment" is not referred to publicly by agreement between the clearing banks and Bank owing to the concentrations of cash to which it draws attention. The answer is drafted to skirt this problem.

Suggested Answer

4. The switch from notes to coin does have a cost to the banks because they can return surplus banknotes to the Bank of England, whereas there is no such facility for returning coin to the Royal Mint. But coin has always been handled differently, and the cost is offset by the benefit to banks of the business which supplying cash to customers brings to them.

FROM : S WEBB

DATE : 28 NOVEMBER 1984

SAR 28.11

1. MR ROBSON

2. MR PERETZ

c.c. Mr Pratt

Mr Felgett

COAL DEFICIT GRANT

As requested, I attach a note for the Chancellor on the continued provision of grant to NCB during the strike. The debate on Monday 26 November after which two Conservative MPs voted against the Government, concerned an Order to increase the limit of deficit grant from £1200m to £2000m.

2. A note is also attached on reports in today's papers (e.g. p11 of FT) that studies by academic accountants suggest Cortonwood was profitable and NCB's accounts misleading. We are exploring further with the Department.

S WEBB

Why is Government paying Grant to NCB during the Strike?

NCB is technically insolvent. Grant is needed to allow it to pay those miners who continue to work and suppliers. The House provided in the 1983 Coal Act for £2000m of deficit grant to be paid over the three years 1983-84 to 1985-86. The fact that this was eaten up in the first 1½ years mainly reflects the damaging effect of the strike. But the need to provide the £2000m in the first place indicates the dire state of NCB' finances even before the strike.

How much Grant is due to the Strike?

About £800m up to the end of October, including amounts for 1983-84.

Independent accountants suggest Cortonwood profitable

I have not seen this report. Questions about individual pits are for the NCB. But we cannot get away from the fact that NCB's accounts - audited by a leading firm - showed losses of £650m last year even before the strike.

PS/Chancellor

You asked for the levels of UK base rates and US prime rates at the times of the 1979 and 1983 Elections.

They were

	Base Rate	Prime Rate
June 1979	9½%	11¾%
May 1983	10%	10½%
Now - Nov 28 1984	9½%	12 %

Bob Bowen

28/XI/84

INTEREST RATES AND EXCHANGE RATES: SINCE MARCH 1984 CUT IN BASE RATES

Closing Rates	Exchange Rates			Short Term Interest Rates (per cent)					Long Term Interest Rates	
	£ effective	£/$	DM/£	UK Base Rate	US Prime Rate	3 month £ inter-bank	3 month Eurodollar	Uncovered Differ-ential	UK 10 year Gilt	US long T-bond
						+NB: In these three columns, numbers to the right of the point are sixteenths.				
14 March (UK base rate cut)	81.1	1.47	3.76	8½-8¾	11	8.13	10.06	-1.09	10.28	12.29
9 May (UK base rates up)	80.0	1.38	3.84	9-9¼		9.07	11.10	-2.03	11.33	13.14
Mon 25 June (UK base rates	79.2	1.35	3.79	9-9¼*	13	9.07	12.03	-2.12	11.93	13.55
Tues 26 June realigned)	79.0	1.35	3.78	9¼**		9.08	12.01	-2.09	11.98	13.41
Fri 6 July (UK base rates up)	77.9	1.32	3.74	10		10.05	12.04	-1.15	12.00	13.66
Wed 11 July (UK base rates up)	77.6	1.31	3.72	12		11.14	11.14	0	12.40	13.28
Wed 8 August (UK base rates down)	78.7	1.31	3.82	11½		11.06	11.14	-0.08	12.00	12.81
Fri 10 August (UK base rates down)	78.5	1.31	3.80	11		10.09	11.13	-1.04	11.77	12.50
Fri 17 August (UK base rates down)	78.5	1.32	3.78	10½		10.08	11.14	-1.06	11.45	12.81
Mon 17 September	77.0	1.24	3.82			10.14	11.12	-0.14	11.40	12.38
Fri 5 October	76.2	1.23	3.77		12½	10.08	11.07	-0.15	11.29	12.44
Fri 19 October	74.0	1.19	3.67			10.12	10.04	+0.08	11.6	12.00
Tues 6 November (UK base rates down)	76.3	1.26	3.72	10	12	9.12	9.15	+0.03	10.29	11.56
Mon 19 November	76.0	1.248	3.735	10-9¾***		9.12	9.11	+0.01	10.76	11.69
Thur 22 November (UK base rates down)	75.1	1.229	3.688	9½		9.11	9.06	+0.05	10.92	11.31
Mon 26 November	74.2	1.200	3.76			9.13	9.03	+0.10	10.86	11.25
Tues 27 November	74.6	1.209	3.692			9.12	9.03	+0.09	10.86	11.31

* Lloyds base rate up
** National Westminster base rate up
***Barclays 9¾
\+ So for example 9.08 represents 9½; 10.12 is 10¾ per cent etc.