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Lawson

PART A

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PART A

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

e (TCSC)

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PO -CH /NL/~~00003~~ 0846

PART A

Begins: 1/2/85

Ends: 24/7/85 (CONTINUED)

DD: 25 years

5/9/95

1-24

FROM: R PRATT
DATE: 1 FEBRUARY 1985

1. MR BATTISHILL

2. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Anson
Mr Monck
Mr Cassell
Mr Scholar
Mr Burgner
Mr Evans
Mr Odling-Smee
Mr Gray
Mr Stibbard
Mr M L Williams

I am sorry we could not get this to you sooner.
It has been discussed, and agreed, with GEP and PE.

TCSC REPORT ON THE AUTUMN STATEMENT

I attach a draft response to the TCSC report on the Autumn Statement. Since the report was published on Thursday 6 December, the normal 2 month rule means that the last date for our response is Tuesday 5 February.

2. The report contained four recommendations:

(i) that there should be a reappraisal of the machinery for determining public expenditure priorities;

(ii) that debt interest should be included in the planning totals; that when taxation and administrative changes occur (eg NIS and housing and sickness benefits) the PEWP should maintain statistical consistency with the previous plans; asset sales should be treated as negative expenditure;

(iii) there should be a departmental split for the current year estimated outturn;

(iv) there should be a reappraisal of the relative rates of return for all nationalised industries.

3. In addition to these formal recommendations, the report also makes the following points:

(i) that the MTFS should be revised and updated at the time of the Autumn Statement;

(ii) that a comparison of plans against estimated outturn does not support the contention that "spending remains within target";

(iii) that the prospective fiscal adjustment depends on oil revenues and could be eliminated by a relatively small rise in the exchange rate.

Our normal practice is not to respond to comments which are not formal recommendations, unless there are good reasons for doing so. In this case, there seemed to be no reason for departing from our normal practice. The suggestion that the MTFS should be updated in the autumn is old hat and our response is on the record. We are unlikely to get much credit for challenging the Committee's comments based on a comparison of plans against estimated outturn. And the suggestion that the prospective fiscal adjustment might be eliminated by a relatively small rise in the exchange rate has been rather overtaken by events.

4. The response therefore covers just the four recommendations.

Public expenditure priorities

5. Because the response as a whole is not very forthcoming, the section on public expenditure priorites attempts to flatter the Committee a little by taking its recommendation seriously and giving a full account of how public expenditure priorities are determined. It also makes the point that priorities have indeed shifted quite substantially since 1978-79. In effect, however, the response rejects the Committee's recommendation that there should be a formal reappraisal of the machinery for determining public expenditure priorities.

Debt interest, asset sales etc

6. The Committee repeat the recommendations they made in their report on last year's Public Expenditure White Paper. No further argument is given beyond an assertion that the Treasury's earlier response to the Committee's recommendation amounts to little more than debating points. There seems little point in going over this ground again, and therefore the draft response on this occasion simply records that the Government holds to its earlier view.

Department breakdown of estimated outturn

7. It was only after careful consideration that Treasury Ministers decided, this year, to publish an estimated planning total outturn for the current year in the form in which it appeared in the Autumn Statement. A breakdown by departments would have been

awkward, given the policy not to reveal the details of the estimated cost of the coal strike. There is a case, therefore, in order to avoid limiting our room for manoeuvre in future, for rejecting the Committee's recommendation that a departmental breakdown be given. On the other hand, however, we could provide such estimates and the Committee's request for them looks reasonable. Given our generally unforthcoming line on the other recommendations, we have considered it right, in the draft response, to say that we will at least consider the Committee's request. OK

Nationalised industry rates of return

8. The response argues that since nationalised industry rates of return are systematically reviewed, there is no need for further reappraisal.

9. I should be grateful to know if you are content with the attached draft response.

Richard Pratt

RICHARD PRATT

The Government's Economic Policy: 1984 Autumn Statement

This memorandum gives the Government's observations on the recommendations in the Treasury and Civil Service Committee's First Report on the 1984-85 Session, which discussed the Autumn Statement.

Public Expenditure Priorities

"Against this background we recommend a reappraisal of the machinery for determining public expenditure priorities, as reflected in the Autumn Statement, with particular reference to the need to improve the allocation across departments and a more open discussion of the best machinery for achieving this." (Paragraph 14)

The Government shares the Committee's concern that there should be an adequate mechanism for determining public expenditure priorities and, after each Public Expenditure Survey, it considers how this machinery might be improved. The Government, however, believes that the Committee have underestimated the extent to which the present arrangements facilitate the discussion and assessment of priorities between and within different spending programmes.

Under the present arrangements, the Government sets the public expenditure planning totals for the Survey period against the background of the revenue projections and the PSBR path as set out in the MTFS. Since the Survey begins shortly after the Budget and the publication of the MTFS, it would be impractical and unnecessary to revise the MTFS at this stage.

As the Chancellor of the Exchequer pointed out in the debate on the Autumn Statement (Thursday 6 December 1984, Official Report, column 524) the process of establishing priorities within the overall planning total involves lengthy and detailed assessments of expenditure programmes. The spending plans of each department are extensively analysed by officials and the implications of increases or decreases in expenditure on particular programmes are displayed in detail.

These analyses then provide the basis for Ministerial discussions and decisions. While the appraisal of public spending programmes is concerned, in detail, with their outputs, cost-effectiveness and the value for money obtained, ultimately, the judgement between expenditure priorities is necessarily political. The Survey procedure is designed to give Ministers the fullest information on which to make their judgement within and across departments; but it cannot substitute for such judgements.

No procedure can be perfect, and the case for changes in procedure is kept under review. But it is significant that over the years, and since 1978-79, there have been marked changes in the pattern and composition of total public expenditure. These reflect the Government's priorities and demonstrate the capacity of the present planning system to bring such shifts about.

Distortions in the Planning Total

"Specifically, we recommend that debt interest be included in the planning total; and that when taxation and administrative changes occur, such as with National Insurance Surcharge and housing and sickness benefits, the published planning total information relating to the past be represented in a manner which maintains a statistical consistency with the plans for the future. We also recommend that asset sales should not be treated as negative expenditure." (Paragraph 32)

The presentation, in the annual White Papers, of the Government's spending plans is designed to maintain proper statistical consistency between the information relating to the past and the plans for the future. The Committee's Report correctly records the Government's view that since debt interest is susceptible to only limited control over the relatively short period covered by the Public Expenditure Survey, to include it in the planning total would tend to weaken the overall discipline of the total. As the Report notes, this and other points covered by this recommendation have been made in earlier reports from the Committee and the Committee has repeated its recommendations.

For its part, having carefully considered the points made in the Committee's report, the Government holds to the views set out in paragraph 5 of its response to the Committee's Report on 1984 Public Expenditure White Paper. (Third Special Report from the Treasury and Civil Service Committee, 30 April 1984)

Plans for 1985-86

"Accordingly, we recommend that the Treasury include a departmental split for the current year's estimated outturn as an integral part of future Autumn Statements." (Paragraph 36)

The Committee recommends that future Autumn Statements should include a departmental split for the current year's estimated outturn. The Government's current practice has been to wait until the annual Public Expenditure White Paper before providing such a detailed analysis of estimated outturn. This has been repeated in the 1985 White Paper, Cmnd 9428.

Provision of a similar degree of detail two or three months earlier in the financial year, when substantially less outturn information is available, presents significant practical difficulties. The Government will, however, give further consideration to whether it is able notwithstanding the uncertainties to meet the Committee's request.

Nationalised Industries

"In our view, the time has come for a reappraisal of the relative rates of return for all nationalised industries". (Paragraph 52)

The financial framework within which nationalised industries are expected to operate has previously been outlined to the Committee[1] and is derived from principles originally set out in the 1978 White Paper on Nationalised Industries (Cmnd. 7131). The framework is designed to promote the efficient allocation and use of resources and to reconcile the industries' medium-term commercial aspirations with the needs of macro-economic management.

An essential feature of the framework is that industries' investment programmes are expected to achieve a required rate of return (RRR). This rate of return is common to all industries and is currently set at 5 per cent per annum in real terms before tax. It is intended to represent the opportunity cost of capital and is derived primarily from estimates of what the private sector has earned in the recent past and is expected to earn in the future.

The RRR applies to industries' investment programmes and is not necessarily a guide to the rate of return that individual industries should achieve on their existing assets. Such rates of return are normally embodied in financial targets which are the primary instrument of control in the medium-term. Financial targets are based on discussion with the industries and reflect a judgement about the application of the basic principles on investment and economic pricing to the particular trading environment of the industry concerned. Because financial targets span a fixed period of time, typically 3 years, they are already systematically reviewed from time to time and the Treasury sees no need for further reappraisal.

A list of the current financial targets is attached.

[1] See Note by HM Treasury "Financial Framework for Nationalised Industries" in Eighth Report from the TCSC, Session 1980-81 (348-II).

ANNEX

CURRENT NATIONALISED INDUSTRY FINANCIAL TARGETS

Industry	Financial Target
National Coal Board	Breakeven after grants annually
Electricity Supply Industry (England and Wales)	**Electricity Supply** 1.4 per cent return on average net CCA assets in 1983-84 and 1984-85 **Showrooms and Contracting** 5 per cent return on average CCA assets 1984-85 to 1987-88
North of Scotland Hydro-Electric Board and South of Scotland Electricity Board	1.75 per cent return on average net CCA assets 1983-84 to 1985-86
British Gas Corporation	4.0 per cent return on average net CCA assets 1983-84 to 1986-87
British Steel Corporation	Breakeven before interest by 1984-85
Post Office	4.2 per cent return on turnover 1984-85
National Bus Company	Current cost operating surplus before interest of £18.5 million at 1980 outturn prices by 1985
Water (England and Wales)	1.0 per cent[1] return on average net CCA assets to be achieved 1984-85
British National Oil Corporation	Pre-tax profit of £10 million over a 4 year period 1983-86
National Girobank	19 per cent pa return on historic cost assets
British Airports Authority	3 per cent pa return on average net CCA assets plus 0.2 per cent times annual growth in terminal passengers
Civil Aviation Authority	7 per cent pa return on average net CCA assets
British Rail	Freight and Inter City to achieve a current cost operating profit of 5 per cent by 1988 and 1988-89 respectively. PSO grant target £635 million in 1983 prices by 1986.
London Regional Transport	Revenue support of £95 million in 1987-88

(1) Average of targets announced for individual water authorities.

pmp.

FROM: MRS R LOMAX

DATE: 4 February 1985

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr Bailey
Mr Anson
Mr Monck
Mr Cassell
Mr Battishill
Mr Scholar
Mr Burgner
Mr Evans
Mr Odling-Smee
Mr Gray
Mr Stibbard
Mr Williams

MR PRATT

TCSC REPORT ON THE AUTUMN STATEMENT

The Chancellor was grateful for your minute of 1 February. He is content with the attached draft response to the Committee.

RL

MRS R LOMAX

P

CABINET OFFICE

From the Chancellor of the Duchy of Lancaster
Lord Gowrie

MANAGEMENT AND PERSONNEL OFFICE
Great George Street
London SW1P 3AL
Telephone 01-233 8610

The Rt Hon The Viscount Whitelaw CH MC DL
Lord President of the Council
Privy Council Office
Whitehall
LONDON SW1

19 March 1985

Dear Lord President,

EIGHTH REPORT FROM THE TREASURY AND CIVIL SERVICE SELECT COMMITTEE

ACCEPTANCE OF OUTSIDE APPOINTMENTS BY CROWN SERVANTS

... Further to my letter of 15 February, I now enclose a 'Confidential Final Revise' copy of the response to the above Select Committee report, which is to be published as a Command Paper tomorrow (Cmnd 9465). Publication is to be announced in Parliament by the Prime Minister in answer to an arranged Parliamentary Question.

The Cabinet Office (MPO) Press Office has been briefed to handle any enquiries from the media and questions can therefore be redirected to the MPO as necessary.

A copy of this letter and enclosure goes to all Cabinet colleagues, the Paymaster General and to Sir Robert Armstrong.

Yours sincerely,

Sonia Phippard

GOWRIE (Approved by Lord Gowrie and signed in his absence)

CH/EXCHEQUER
20 MAR 1985
MST

20/3

FROM: R PRATT
DATE: 19 FEBRUARY 1985

MR BATTISHILL

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Littler
Mr Bailey
Mr Anson
Mr Cassell
Mr Lavelle
Mr Scholar
Mr Odling-Smee
Mr Monger
Mr Fitchew

FUTURE TCSC BUSINESS

The TCSC Clerk spoke to me today about the Committee's programme for the next few weeks. There are various reports to be published as follows:

(i) on the Public Expenditure White Paper - will be published in typescript version on 28 February (at 11.30am) with a printed version available on 4 March in time for the debate in the House;

(ii) on the exchange rate - to be published on 6 March;

(iii) on VAT harmonisation - to be published on 26 February.

2. The Clerk also told me that it was likely that the TCSC would begin their hearings on the Budget on 25 March, with a session for officials. The Chairman has yet to consider his plans beyond that.

3. Since this programme will use up most of the scheduled meetings in the next few weeks, the Clerk discussed the two major enquiries - into long term trends in public expenditure, and into consequences of membership of the EC. It is clear that the Committee are in some difficulty with both of these. They do not wish to spend more than a year on either of them; they would like to produce a report which was fairly weighty in both cases, and yet despite having spent over 6 months on both enquiries, they have hardly begun to cover any of the necessary ground. The Clerk thought it likely that the Committee would defer any further sessions with Permanent Secretaries from departments, and try to get some evidence from outside. He had no

idea what the Committee would decide to do with the sub-committee enquiry into membership of the EC.

Richard Pratt

RICHARD PRATT

UNCLASSIFIED

FROM: A M W BATTISHILL
DATE: 19 February 1985

pmp

MR PRATT

cc PS/Chancellor 12/2
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Littler
Mr Bailey
Mr Anson
Mr Cassell
Mr Lavelle
Mr Scholar
Mr Odling-Smee
Mr Monger
Mr Fitchew

You have the earlier papers.
Mary 20/2

FUTURE TCSC BUSINESS

There is one small point on your conversation with the Clerk to the TCSC that I asked you to take up with him.

2. It is not really on for the Committee to contemplate examining Treasury officials as early as Monday 25 March. This would coincide with the last day of the Budget debates. Apart from the fact that some of us might be tied up that afternoon with work on the Chancellor's wind-up speech, it would be pretty unsatisfactory for us to have to give evidence before the Budget debates are concluded and the Chancellor has given his closing speech. I seem to remember this point coming up last year when we persuaded the Committee with no great difficulty to wait until the following Wednesday to begin their evidence.

3. Even though Easter follows pretty closely after the Budget this year, this ought not to cause the Committee any great difficulty. They should be able to fit in three sessions - Wednesday 27 March, Monday 1 April and Wednesday 5 April (Ash Wednesday) before the Easter Recess. This is on the assumption that the House is likely to go into Recess on Maundy Thursday, following the pattern of most recent years. It would be useful if you would have a word with Mr McKay about this, before the Committee firm up their arrangements; since he is new he may not know of the conversations I had a year ago with his predecessor.

AB

A M W BATTISHILL

003/81

R/

CONFIDENTIAL

From: P R C GRAY
Date: 21 February 1985

Arrived 22/2

CHIEF SECRETARY

This didn't arrive until today & I've not been able to discover what, if any, response the CST has made. We'll check on Monday. X is nasty
Mary
22/2

cc Chancellor
Sir Peter Middleton
Mr Bailey
Mr Anson
Mr Monck
Mr Battishill
Mr Jameson
Mr Odling-Smee
Mr Scholar
Mr Pirie
Ms Seammen
Mr Perfect
Mr Pratt
Ms Spencer

TCSC HEARING 18 NOVEMBER: FOLLOW UP MEMORANDUM

There were two points that arose when you gave evidence to the TCSC last Monday where you undertook to write to the Committee providing further information. These were:

(i) following question 209, why the figures for payments to the unemployed rise by less than the assumed rate of inflation.

(ii) following question 304, whether there were any industries which have no borrowing at all to finance future investment.

2. There was also another issue, the difference between the Scottish and English and Welsh local authority capital control systems (question 281) where, although the transcript does not record an undertaking to write, you had volunteered more information on the legal minutia. There would seem no harm in providing further information on this.

3. I now attach a draft memorandum to send to the Committee. We have undertaken in discussions with the Clerk to try to send this before the end of the week, so that it is available to the Committee when they finalise their Report next Monday. The normal form is to send the memorandum to the Clerk under cover of a letter from

Battishill or Mr Pratt.

4. There is no particular awkwardness or embarrassment about the material on local authority controls or company indebtedness, although the material on the latter aspect is still subject to a final check by the economists.

X 5. However, the query about the trend in the figures for payments to unemployed people is embarrassing. The reasons are set out in the attached internal DHSS minute, which explains the line taken in the draft memorandum.

6. Are you content for us to send the memorandum to the Committee tomorrow?

PRCG.

P R C GRAY

CONFIDENTIAL

1. Mr Wallace
2. Mr Ellis

EXPENDITURE ON UNEMPLOYED PEOPLE

1. At a meeting of the Treasury and Civil Service Committee on 18 February Ralph Howell asked the Chief Secretary why it was that in table 3.12.5 of the PEWP expenditure on unemployed people increased by only 9 per cent between 1984-85 whereas the RPI increased by 13 per cent. Treasury require a contribution for a reply to the Clerk of the Committee by tomorrow.

2. This is very tricky. The main reason for the 4 per cent disparity (equivalent to about £250m in 1987-88) is policy changes agreed in PES, particularly the unannounced ones. These account for about £200m of the £250m reduction in expenditure. Two other factors have only a relatively small influence: use of the Rossi index instead of the RPI to uprate supplementary allowance (which accounts for £40m); and a reduction in the numbers getting unemployment benefit, largely offset by an increase in the numbers getting SA (which accounts for £10 m net). The PES changes consist of the board and lodging proposals (£60m) plus the PES shortfall (£144m) which was arbitarily allocated to supplementary allowance - as you know, it is not necessarily the case that the savings will actually be made in this area.

3. The obvious difficulty in replying is that we do not want to admit that the figures assume unannounced cuts. Furthermore, there is a difficulty about referring to the use of the Rossi index for making supplementary benefits forecasts because the Government has not previously said that the Rossi index is used for forecasts (though of course it is well known that it is the basis for uprating supplementary benefit) nor does it publish assumptions about the future movement of the index. Treasury are generally unwilling to publish assumptions about the future movement of compone of the RPI - the particular difficulty here being that the Rossi index implies assumptions about the component which has been excluded, to wit housing costs.

4. A brief and vague reply seems to be called for which avoids any quantification of the contributory factors. A draft is attached. This might just satisfy Mr Howell (and the rest of the Committee) assuming his question springs from innocent curiosity (as to why expenditure on unemployed people should be predicted to fall in real terms) rather than suspicion that the estimates conceal unannounced cuts. But we obviously must be prepared for potentially very awkward follow-up questions. We might, for example, be asked to quantify the effects of the different factors and/or to specify all the relevant policy changes. We would then either have to spell out the basis for the figures in full - which gets us into all the difficulties of justifying the adjustment of our estimates in this way as well as accusations that our earlier reply was misleading; or engage in yet more devious strategies of concealment. It is not a happy predicament.

A Laurance

20 February 1985

cc: Mr Whippman

7/20/2

QUESTIONS RAISED AT THE COMMITTEE'S HEARING ON 18 FEBRUARY 1985

Payments to Unemployed People

1. Mr Howell asked (questions 206-209) why expenditure on the unemployed was shown in table 3.12.5 of the White Paper as increasing by only 9 per cent between 1984-85 and 1987-88, less than the assumed increase in the RPI.

2. As is clear from that table, by far the greater part of expenditure on benefits for unemployed people is in the form of means-tested benefits. As these benefits are not uprated directly in line with the RPI, one would expect some divergence. The main reason apart from this is policy changes, such as those concerning supplementary benefit payments for board and lodging.

Differences between Capital Control Systems

3. The Committee may find it helpful to have a further explanation of the difference between the Scottish system of capital controls and that in England and Wales as regards the carry-forward of receipts from one year to be spent in later years. This point arose in the hearing following questions from Mr Mitchell (questions 279-281).

4. The difference arises from the different legislation applying. For Scotland, the capital controls system is based on section 94 of the Local Government (Scotland) Act 1973, whereby the Secretary of State for Scotland gives consent to expenditure levels, defined as he considers appropriate. Consents to individual authorities to incur capital expenditure are therefore given as, broadly, a capital allocation, enhanced by 100% of capital receipts received within the financial year.

5. For England and Wales, the Local Government Planning and Land Act 1980 is the statutory basis of the capital controls system. It defines expenditure limits for individual authorities to include all, or a prescribed proportion of, <u>all</u> capital receipts ie both those arising in-year and those carried forward from previous years.

6. The "Scottish system" of no carry-forward of receipts could probably only be applied in England and Wales with amending legislation, because the 1980 Act does not allow different prescribed proportions for in-year and accumulated receipts. (The Act does contain a power to determine by regulation that receipts before a date specified shall not permit enhancement of spending limits, but it is not certain that it would be a correct use of this power to prevent each year the carry forward of the previous year's unspent receipts.)

Borrowing and Investment

7. In discussion of the plans for the water authorities the Chairman asked (question 304) for examples of industries having no borrowing at all to finance future investment.

8. The summary sector capital accounts (see, for example pages 58-59 of Economic Trends, January 1985 published by the Central Statistical Office) show that in recent years industrial and commercial companies have, in aggregate, had a financial surplus. That is to say, in those particular years industrial and commercial comapnies' capital expenditure has been fully financed from internal resources.

9. The balance sheet structure of individual industries and companies varies greatly, but it is not uncommon for particular companies to have no net debt; the case of GEC has frequently been quoted as an example.

H M TREASURY
22 February 1985

CC CHANCELLOR
CHIEF SECRETARY
FINANCIAL SECRETARY
ECONOMIC SECRETARY
MINISTER OF STATE.
SIR PETER MIDDLETON
SIR TERENCE BURNS
MR. BAILEY.
MR. LITTLER.
MR. WILSON.
MR. CASSELL.
MR. MONCK.
MR. SCHOLAR
MR. LAVELLE
MR. ODLING-SMEE
MR. MONGER
MR. LANKESTER
MR. H.P. EVANS.
MR. M.L. WILLIAMS
MR. GRAY.
MR. HANNAH.

bf 22/3

COMMITTEE OFFICE
HOUSE OF COMMONS
LONDON SWIA OAA
01-219 3285 (Direct Line)
01-219 3000 (Switchboard)

TREASURY AND CIVIL SERVICE COMMITTEE

13th March 1985

Dear Tony,

I have to let you know of some decisions arrived at by the Committee at their recent meeting. I am afraid they range over a fairly wide field, but I hope it may be convenient for you to have them brought together in one letter.

As you know, it is expected that the Budget hearings will begin on 27th March, when Treasury officials are invited to attend. An invitation is going to the Governor of the Bank for a subsequent day. The Chairman of the Committee intends to write to the Chancellor of the Exchequer, inviting him to give oral evidence. I would be most grateful if you could let me know as soon as possible when it is expected that the Second Reading of the Finance Bill will be. On this will depend whether or not the Committee invite further witnesses or devote the meeting in the first week after the Easter adjournment to consideration of a report.

I expect that a report may be made shortly on the basis of some of the written evidence submitted by you in connection with the Spring Supplementary Estimates. At that time, the written evidence upon which the Committee propose to make no observations will also be published.

Just before or just after Easter, I anticipate there may be a report commenting on your response to the Committee's Second Report of the Session on The Structure and Form of Financial Documents.

The Committee intend to take one day's evidence on the 1985-86 Estimates. The date they presently have in mind is Monday 29th April, but I will of course confirm this in the near future. The Committee have expressed a desire to concentrate on two aspects of the Estimates. The first is the Inland Revenue Valuation Office. I wonder if you would be good enough to put in hand the preparation of a brief paper outlining the work of the Office, the complement, and the work load. I think it would be helpful

5/102

to refer to changes in the duties undertaken by the Office over, say, the past ten years, and any consequent alterations in cost. The Committee might also be interested in the objectives set for the Valuation Office, and any performance assessment made. The second issue of interest to the Committee has already been commented on in the context of the Spring Supplementary Estimates. This is Class XIV, 4 as it relates to the transfer value payment to the Royal Ordnance plc. The Committee observe that a provision of £200m is likely to be sought in the 1985-86 Estimates. They will wish to question witnesses on this matter, so that if you should think it necessary to elaborate further the paper already submitted in respect of the Supplementary Estimate, please do so. Should any further aspects of the Estimates come to the Committee's attention once the paper containing the Estimates has been laid, I will of course be in touch with you again.

In the longer term, certain plans have been made - some more tentative than others - for the pattern of the Committee's inquiries up to the summer adjournment. The Long-term Trends inquiry is to continue, in the expectation that the evidence will be completed before the summer adjournment. For the most part, witnesses will be third parties of outside bodies who will comment on official evidence already given, together with MoD and DHSS witnesses, and (finally) Treasury evidence. You will know, I think, that the Sub-Committee are to undertake a brief inquiry into the Head of the Government Accountancy Service and thereafter to look into membership of the EMS, in the context of the broader European inquiry. Subject to final decisions, the main Committee are, following their attention to the Budget and the Estimates, likely to turn to some aspect of the effect on the UK of the current strength of the dollar. I will let you know the outcome of any decisions the Committee may take to define further their interest in this matter.

I apologise for the length of this letter, and for the fact that I am writing separately raising two more detailed points arising from the Budget and Spring Supplementary inquiries.

Yours sincerely

Bill McKay

W.R. McKay
Clerk to the Committee

A.M.W. Battishill Esq.,
Central Unit
H M Treasury
Parliament Street
SW1P 3AG

gmp.

FROM: K F MURPHY
DATE: 25 MARCH 1985

MR BATTISHILL

Ch.

Some good questions, amidst the dross. See espec. those on the financial framework.

RL.
26/3

cc Principal Private Secretary
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Cassell
Mr Monck
Mr Kemp
Mr Monger
Mr Lankester
Mr Evans
Mr Lavelle
Mr Odling-Smee
Mr Scholar
Mr Sedgwick
Mr Stibbard
Mr Robson
Mr Peretz
Mr Folger
Miss Peirson
Ms Seammen
Mr King
Mr Riley
Mr S Davies
Mr Shaw
Mr Pratt

PS/Inland Revenue

OFFICIALS APPEARANCE BEFORE THE TCSC

I have now obtained the likely range of questions which will be put to the Treasury team on Wednesday of this week. They are listed below; but, as you can judge from their length, it is unlikely that the team would be asked them all. Unfortunately, since Mr Higgins is unwell today, his officials are unable to give us any idea of which aspects the Committee will wish to focus on specifically.

2. The questions are as follows.

MTFS

1. The Chancellor has said that there was nothing sacrosanct about the mix of monetary and fiscal policy. What exactly does this mean? Is now the time to copy the US example?

2. Why have you introduced this year money GDP figures into the FSBR?

US example was got by the [illegible] [illegible] [illegible] [illegible] standards

3. If the money GDP figures were to run on course, but either MO or £M3 were to be above the target range, would this be of concern to you?

4. Would low pay settlements, with a consequent reduction in money GDP growth, allow a more expansionary fiscal and/or monetary policy?

5. If real growth were to rise to 5 per cent by 1988-89, but inflation were not to be squeezed out, would the money GDP targets have to be increased?

6. Why you have dropped any reference to PSL2 and M2?

7. Why did the Bank intervene last week to stop the fall in the base rate?

PSBR

8. Is not the £2 billion increase in the Reserve a major switch in priorities from tax cuts to expenditure?

9. If North Sea oil revenues were to fall, and the PEWP expenditure plans were to hold, how would you use the increased Reserve?

10. Since the extra Reserve is at the expense of this year's fiscal adjustment, is there not a danger that future years tax cuts will be pre-empted by public expenditure which will not otherwise have been incurred?

11. Since the PSBR has been constant at about 3¾ per cent of GDP for the last few years, what reason do you have for forecasting a declining profile over the rest of the decade?

12. Is there any significance in your focussing in paragraph 2.15 of the FSBR on the ratio of public sector debt to money GDP?

13. What would happen if both the dollar exchange rate and North Sea oil prices were to fall by 20 per cent?

14. In the 1984 FSBR, it was assumed that oil prices would remain broadly flat; for 1985, the assumption is that they should fall. Why have you changed this assumption? Would it not be preferable to work from unchanged assumptions?

Exchange rate

15. Do not paragraphs 2.11 and 2.12 of this year's FSBR amount to a policy of exchange rate targetting? Why are short term interest rates no longer to be determined by the market?

16. When will it be right to join the EMS?

Employment

17. What will the employment and training measures, and the restructuring of NICs do to the unemployment count?

18. Is the Government's objective to reduce inflation irrespective of the numbers looking for work?

19. Is it not true that you are forecasting a 2½ per cent a year growth in non-North Sea output up to 1988-89? And is there not a risk that this will not be achieved given that the comparative figures for the decade from 1974 was only 0.7 per cent.?

20. Why are the GDP projections this year not higher than last year's, given that growth has been faster this year than expected and the Budget includes measures intended to improve the prospects for growth?

National Insurance Contributions

21. Is it not true that the NICs changes effectively create three new traps? What would have been the revenue effect of withdrawing the employees upper earnings limit?

22. Given the NICs changes, do you still believe that the contributory principle is of importance? Is it not true that NICs are effectively a tax? Will the promised Green Paper on tax reform consider the amalgamation of the tax and national insurance systems?

Public expenditure

23. Do you believe that with the £2 billion increase in the Reserve, there is a better chance of keeping to targets?

24. What will the miners' strike cost in 1985-86?

25. You forecast inflation increasing up to 6 per cent by the mid-year. Do the PEWP plans allow for this rise, particularly on benefits uprating?

26. How does the PSBR cost of the miners' strike at £2¾ billion square with the figure you quoted last summer of £25 million per week?

27. If the Reserve is allocated pro rata by economic category, public investment would fall by some 10 per cent. Does this concern you?

28. A similar allocation would produce a reduction in public corporations investment of some 21 per cent below the 1984 Budget plans. Since all public investment is supposed to be considered on a case by case, why is it thought that less is needed now than was thought a year ago?

<u>Manpower</u>

29. If pay rates are to increase this year by more than 3 per cent, will there be a corresponding reduction in manpower levels?

30. Do you accept that there is considerable scope for manpower reductions in the wider public sector?

<u>The forecast</u>

31. <u>On interest rates.</u> Table 3.3 in this year's FSBR seems to indicate that mortgage rates are expected to remain at their existing levels for the rest of this year. Is this correct? Do you not think that this high interest rate policy imposes a high price on the economy as a whole?

32. The published forecast is predicated on an assumption that exchange rates remain at their January/February 1985 levels. Last year's FSBR had an assumption of exchange rates remaining at their average for the previous calendar year. And the Autumn Statement used yet another different assumption. Is there not a case for having consistent assumptions?

33. Given the surge in the £ since the Budget, are not these exchange rate assumptions out of date?

34. The 1985 average exchange rate level is forecast to be some 9 per cent below the 1984 level. We calculate that the effect of this on import prices would be to produce a 3 per cent rise in the general price level. Why is this not reflected in your forecast for inflation?

35. <u>On consumption</u>. Why do you predict a 4 per cent increase in the first half of 1986 over the first half of 1985 given the continuing expected high level of interest rates and the time delay before tax cuts can take effect?

36. <u>On stocks.</u> Is destocking really likely to continue now that the miners' strike is over, and demand is buoyant?

37. <u>On cost competitiveness.</u> Charts 3.3 and 3.4 show that the UK has not gained insofar as its balance of manufacturing trade is concerned from the fall in the value of Sterling. Are you not concerned about this? What happens when the oil runs out?

K F Murphy

K F MURPHY
CU

FROM: K F MURPHY
DATE: 25 MARCH 1985

bf pmp

MR BATTISHILL

cc Principal Private Secretary
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Cassell
Mr Monck
Mr Kemp
Mr Monger
Mr Lankester
Mr Evans
Mr Lavelle
Mr Odling-Smee
Mr Scholar
Mr Sedgwick
Mr Stibbard
Mr Robson
Mr Peretz
Mr Folger
Miss Peirson
Ms Seammen
Mr King
Mr Riley
Mr S Davies
Mr Shaw
Mr Pratt

PS/Inland Revenue

OFFICIALS APPEARANCE BEFORE THE TCSC

I have now obtained the likely range of questions which will be put to the Treasury team on Wednesday of this week. They are listed below; but, as you can judge from their length, it is unlikely that the team would be asked them all. Unfortunately, since Mr Higgins is unwell today, his officials are unable to give us any idea of which aspects the Committee will wish to focus on specifically.

2. The questions are as follows.

<u>MTFS</u>

1. The Chancellor has said that there was nothing sacrosanct about the mix of monetary and fiscal policy. What exactly does this mean? Is now the time to copy the US example?

2. Why have you introduced this year money GDP figures into the FSBR?

3. If the money GDP figures were to run on course, but either MO or £M3 were to be above the target range, would this be of concern to you?

4. Would low pay settlements, with a consequent reduction in money GDP growth, allow a more expansionary fiscal and/or monetary policy?

5. If real growth were to rise to 5 per cent by 1988-89, but inflation were not to be squeezed out, would the money GDP targets have to be increased?

6. Why you have dropped any reference to PSL2 and M2?

7. Why did the Bank intervene last week to stop the fall in the base rate?

<u>PSBR</u>

8. Is not the £2 billion increase in the Reserve a major switch in priorities from tax cuts to expenditure?

9. If North Sea oil revenues were to fall, and the PEWP expenditure plans were to hold, how would you use the increased Reserve?

10. Since the extra Reserve is at the expense of this year's fiscal adjustment, is there not a danger that future years tax cuts will be pre-empted by public expenditure which will not otherwise have been incurred?

11. Since the PSBR has been constant at about 3¼ per cent of GDP for the last few years, what reason do you have for forecasting a declining profile over the rest of the decade?

12. Is there any significance in your focussing in paragraph 2.15 of the FSBR on the ratio of public sector debt to money GDP?

13. What would happen if both the dollar exchange rate and North Sea oil prices were to fall by 20 per cent?

14. In the 1984 FSBR, it was assumed that oil prices would remain broadly flat; for 1985, the assumption is that they should fall. Why have you changed this assumption? Would it not be preferable to work from unchanged assumptions?

Exchange rate

15. Do not paragraphs 2.11 and 2.12 of this year's FSBR amount to a policy of exchange rate targetting? Why are short term interest rates no longer to be determined by the market?

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K F Murphy

K F MURPHY
CU

COMMITTEE OFFICE
HOUSE OF COMMONS
LONDON SWIA OAA
01-219 5766 (Direct Line)
01-219 3000 (Switchboard)

TREASURY AND CIVIL SERVICE COMMITTEE

PRESS NOTICE

The 1985 Budget

As in previous years, the Treasury and Civil Service Committee is to report on the Chancellor's Financial Statement and Budget Report. The programme of oral evidence sessions is as follows:

Wednesday 27 March (Room 6) - H M Treasury Officials

Monday 1 April (Room 15) - Governor of the Bank of England

Wednesday 3 April (Room 15) - Chancellor of the Exchequer.

All three meetings begin at 4.30 p.m., and will be open to the press and public.

25th March 1985 S. Priestley

(pwo)

P2.11

FROM: P WYNN OWEN

DATE: 1 April 1985

CHANCELLOR

GOVERNOR'S TCSC APPEARANCE

We should receive a full report by 11.30am tomorrow from Mr Murphy of CU on the Governor's TCSC appearance. This minute merely records a few salient points which I have gleaned from another official.

2. The Governor went through his draft opening statement virtually word for word, though we will have to wait to find out whether he took on your comments.

3. Initial questions concerned the exchange rate. The Governor pointed to the irrational strength of the dollar and said that the Bank was alert to the possible consequences of precipitate movements in the markets. He made it clear that the authorities were prepared to signal that interest rates should not fall, when this was necessary to achieve monetary objectives. When asked why there had not been a larger fall in base rates two weeks' ago, he said that it was very important to be careful. In general, his line on interest rates was fairly vague, though I gather he got into something of a mess on the correlation between rising interest rates and inflation, only to be rescued by Nick Budgen MP.

4. On the EMS, he was asked about his Mary Goldring interview. He stuck by what he had said, but explained that his comment that it would have meant "less volatility" applied to the foreign exchange market but not necessarily the money markets.

5. I gather that a lengthy portion of the Governor's time was wasted with questions about the poverty trap and de-indexing benefits. The Governor acknowledged that de-indexing benefits might have some economic attractions, but stuck to his guns in saying that this was not really his business and that the decisions were political ones.

6. When asked if it was his policy to keep the aggregates at the middle of their target ranges, the Governor said that there was a rough trade-off between keeping the target aggregates at the middle or top of their target ranges and the level of the exchange rate, with an implication that he attempted to balance the two. We shall have to wait to find out exactly how he expressed this.

7. The Governor said that overfunding was needed to control monetary growth and explained that short term corporate bonds may make overfunding less necessary.

8. When asked why the Government did not target money GDP, the Governor replied that the information often arrived too late and that there were no useful counterparts.

9. On a possible rise in money velocity in 1985/86, I gather that Charles Goodhart answered questions well.

10. In general, the Governor's performance sounds unexceptional. In most areas he was fairly vague and, when asked by the Chairman whether it was possible to control both the price of money and its volume, he asked Mr Fleming to answer on his behalf.

PWO.

PHILIP WYNN OWEN

FROM: M W Norgrove

DATE: 1 April 1985

MR K F MURPHY

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Littler
Mr Cassell
Mr Monck
Mr Anson
Mr Battishill
Mr Kemp
Mr Monger
Mr Lankester
Mr Sedgwick
Mr Lavelle
Mr Evans
Mr Odling-Smee
Mr Scholar
Mr Folger
Ms Seammen
Mr Robson
Mr Pratt

OFFICIALS' APPEARANCE BEFORE THE TCSC

The Minister of State has seen your note of 28 March covering last Wednesday's session before the TCSC.

On paragraph 9, the Minister of State has commented that "no access to the Reserve" is tougher than our normal line; and that last year's pay increase was surely not entirely accommodated in the way you describe?

MWN

M W NORGROVE
Private Secretary

M22

FROM: MISS O'MARA
DATE: 1 April 1985

MR MURPHY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Mr T Burns
Mr Bailey
Mr Littler
Mr Cassell
Mr Monck
Mr Anson
Mr Kemp
Mr Battisihill
Mr Monger
Mr Lankester
Mr Sedgwick
Mr Lavelle
Mr Evans
Mr Odling-Smee
Mr Scholar
Ms Seammen
Mr Robson
Mr Pratt

OFFICIALS' APPEARANCE BEFORE THE TCSC

The Chancellor was grateful for your minute of 28 March. In the light of this, he would like to see figures showing UK manufacturing exports as a percentage of total world trade in manufactures in 1984 and in the nine previous years.

MOM

MISS M O'MARA

The Governor

Bank of England

London EC2R 8AH

1 April

C. If you have comments we need to get them in quickly.

Rxo 1/4

Dear Rachel.

TCSC

Herewith, as requested, a copy of the Governor's opening statement and his background briefing for this afternoon's 'appearance'.

Yours ever

John Bartlett

1/4/85

CHANCELLOR OF THE EXCHEQUER

c/

You'll want to see Philip's note on the Governor's appearance (below). We don't yet have the figures on UK manufacturing exports for which you asked — we'll chase tomorrow.

MOM

1/4

P.S. Peter Middleton's office have pointed out that Qn 129 asks for a note on the NI contributory principle, preferably before the Committee see you. Nothing has reached us yet but we'll chase early tomorrow.

PPS Peter Lilley has just sent the list of questions below. We'll circulate to those coming to your briefing mtg in the morning — but you might like to consider if you want any additions

M32

(hw) [illegible]

FROM: MISS O'MARA
DATE: 2 April 1985

MR BATTISHILL

cc Sir P Middleton
Sir T Burns
Mr Cassell
Mr H P Evans
Mr Lankester
Mr Lavelle
Mr Odling-Smee
Mr Scholar
Mr Culpin
Mr Folger
Ms Seammen
Mr Shields
Mr Cropper
Mr H Davies

BRIEFING FOR THE CHANCELLOR'S TCSC APPEARANCE

At his meeting this morning, the Chancellor commissioned some material for his appearance before the TCSC tomorrow:

(i) a note reconciling the Chancellor's speech to the American Chamber of Commerce with the Governor's appearance before the TCSC yesterday (**Action**: Central Unit to co-ordinate);

(ii) a note on the National Insurance contributory principle to be cleared by Treasury Ministers this evening and passed to the Committee tomorrow (**Action**: Ms Seammen); Not for [illegible]

(iii) a draft speaking note, drawing on the Chancellor's wind-up speech, casting doubt on the value of indicating the likely size of the next year's fiscal adjustment at the time of the Autumn Statement (**Action**: Central Unit);

(iv) a brief note indicating when forecasts of the PSBR were first revealed in the Autumn and in what detail (**Action**: Mr Evans);

(v) where the US currently stands as regards figures and ranges for M1, M2 and M3 (**Action**: Mr Shields);

(vi) a brief note giving useful facts and figures on National Insurance contributions, including the public expenditure cost of abandoning the contributory principle (**Action**: Ms Seammen);

(vii) a note on relative unemployment and vacancy figures (**Action**: Sir T Burns on the basis of material already provided). [illegible] Kg

2. If the remaining clearers do not move tomorrow, the Chancellor said he would be grateful if HF could speak to the Bank before his appearance in front of the Committee to discover their latest thinking on the likely movement of interest rates (**Action**: Mr Lankester).

3. Finally, the Chancellor said he would welcome any further thoughts which Sir Peter Middleton and Sir Terence Burns might have on popular misapprehensions which he should attempt to set straight when speaking to the Committee.

NO

Nothing tonight

MOM

MISS M O'MARA

Spare

FROM: R GLEED

DATE: 2 April 1985

PS/CHANCELLOR OF THE EXCHEQUER

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Littler
Mr Cassell
Mr Monck
Mr Anson
Mr Kemp
Mr Battishill
Mr Monger
Mr Lankester
Mr Sedgwick
Mr Lavelle
Mr Evans
Mr Odling-Smee
Mr Scholar
Ms Seammen
Mr Robson
Mr Pratt
Mr Murphy

OFFICIAL'S APPEARANCE BEFORE TCSC

I attach the figures you requested in your minute of 1st April. These are consistent with FSBR Chart 3.3 (attached).

R. Gleed

R GLEED

UK SHARE OF WORLD TRADE IN MANUFACTURES

	Value	Volume
1975	9.0	10.9
1976	8.4	10.6
1977	8.8	10.7
1978	8.8	10.6
1979	9.1	10.1
1980	9.7	9.7
1981	8.6	8.8
1982	8.5	9.2
1983	8.0	8.9
1984 (estimated)	7.8	8.8

3.15 The lower exchange rate means that over the last year most measures of price and cost competitiveness of UK manufactures have shown gains estimated at about 10 per cent. The gain in labour cost competitiveness has been less than the fall in the exchange rate, as earnings in the UK, particularly in manufacturing, continue to grow faster than those of our major competitors. This trend is expected to continue over the forecast period implying, on the assumption of no major changes in the exchange rate, that some of the recent gains in cost competitiveness will be reversed.

3.16 The lower exchange rate has not been fully reflected in import prices because of a reduction in importers' profit margins; nevertheless, import prices of goods and services rose 12 per cent between the fourth quarters of 1983 and 1984. The non-oil terms of trade deteriorated by 2 per cent mainly because of the fall in the exchange rate: little further change is expected over the next year.

Balance of payments in 1984

3.17 The UK current account was in balance (on provisional data) for 1984 as a whole. Deficits on manufactured goods, food and basic materials, and transfers were roughly offset by surpluses on services, oil, and interest, profits and dividends.

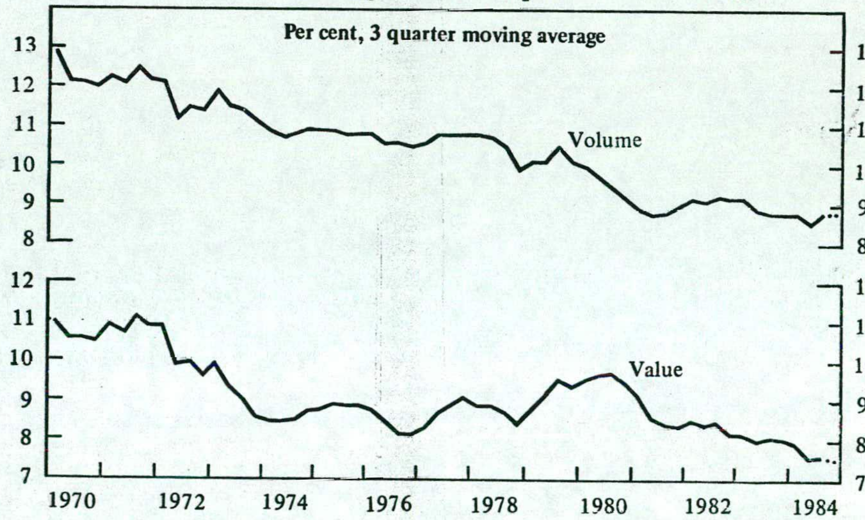
3.18 The direct effect of the coal strike on the current account in 1984 is estimated to have been about £2¾ billion. Following the ending of the strike, the effect on the 1985 balance will be lower, at about £1¼ billion in the first quarter of the year.

Export volumes

3.19 Export volumes (excluding oil and erratics) rose by 9 per cent in 1984, the largest increase in a single year since 1976. Exports of manufactures (excluding erratics) rose by some 10½ per cent, largely due to the very rapid growth, probably of 10 per cent or so, in world trade in manufactures. Since 1981, the gradual improvement in cost competitiveness has helped the UK broadly to maintain its volume share of world trade in manufactures. The fall in the exchange rate, which has led to a lowering of UK export prices relative to those of our competitors, has contributed to a fall in the value share. Both volume and value shares are shown in chart 3.3.

CHART 3.3

Share of UK exports in main manufacturing countries' exports of manufactures



3.20 In 1985, UK exports of manufactures are expected to grow somewhat faster than world trade, as recent gains in cost competitiveness help export volumes. Exports of non-manufactures should also continue to grow. Exports of goods (excluding oil) are forecast to grow by 7½ per cent in total.

Import volumes

3.21 Import volumes (excluding oil and erratics) also grew rapidly in 1984 as the domestic recovery continued, rising by 10½ per cent. Imports of manufactures grew by a similar amount. This compares with an increase of 5 per cent in

Mr. Lawson: I have said many times that the policies that we are pursuing are the best prospects to reduce unemployment. It is a problem throughout the western world.

My hon. Friend the Member for Horsham (Mr. Hordern) referred to my autumn statement. In it, I followed the convention that was established by my predecessor of announcing what leeway I then foresaw, on some purely conventional assumptions, for altering the burden of taxation in the Budget. That convention arose following pressure fromthe Treasury and Civil Service Select Committee which wished to examine the building blocks available to the Chancellor of the Exchequer in framing the following year's Budget. My predecessor adopted that practice because it was the wish of the House. My hon. Friend was right to say, in his excellent speech, that the convention has some drawbacks and inconveniences. The announcement of the fiscal adjustment either depresses or arouses expectations out of all proportion to what it merits, and the leeway that a Chancellor may believe he has in the autumn is a poor indicator of what he will have in the spring. It certainly does not commit him to a course of action, since that must be a matter for judgment at the appropriate time.

In November's autumn statement I said that, as matters then appeared, I should be in a position to lower the burden of taxation in the Budget. It is still too early for me to judge whether I shall be able to do so. But to put the matter beyond doubt, I should say this: our fiscal policy will determine whether tax cuts are possible; our wish to cut taxation will not be allowed to determine our fiscal policy. If to reduce taxation would in any way—I do not say that it would—put our economic strategy at risk, it would have to be ruled out. If to lower taxation might lead to defeat in the fight against inflation, tax cuts would have to be forgone for the time being. In the Budget I shall set the public sector borrowing requirement at a responsible level that will ensure the continuation of our policies. Then and only then, I shall decide whether I have the scope to reduce taxation, and, if so, by how much.

Whether or not I can cut taxation in this Budget, many Conservative Members believe that an economy that enjoys lower taxation will be more able to foster enterprise and, therefore, to grow and to provide jobs and prosperity. The clear lesson from many countries is that where taxation is lowest, economies tend to be the most dynamic and successful. The lesson from British history is that high Government spending and taxation produce, at best, sluggish growth and steadily increasing unemployment.

The right hon. Member for Sparkbrook mentioned the coal strike. During the past 10 months and more, the Government have given their full backing to the National Coal Board in resisting the wholly unacceptable demands of Mr. Scargill. The issues have been whether the management of the Coal Board should be allowed to manage the industry, and Mr. Scargill's demand that the taxpayer should pour ever larger subsidies into preserving uneconomic pits at the cost of thousands of jobs in other industries. We shall not do that. It is a striking tribute to the strength of our economy that we have been able to endure the strike for as long as nearly 11 months—we shall endure it indefinitely if need be—with so little damage to the economy. We all know why the debate has been called. It has been called because the right hon. Gentleman had a date with Mr. Alfonsin, the president of Argentina, today. He was so embarrassed that he had to find some excuse to cancel that. That would have been too much.

This debate has nothing to do with the economy; it has nothing to do with jobs; it has nothing to do with the prosperity of the country. The motion should be rejected by the whole House.

Question put, That the amendment be made:—

The House divided: Ayes 395, Noes 222.

Division No. 85] **[10.00 pm**

AYES

Adley, Robert
Aitken, Jonathan
Alexander, Richard
Alison, Rt Hon Michael
Amery, Rt Hon Julian
Amess, David
Ancram, Michael
Arnold, Tom
Ashby, David
Aspinwall, Jack
Atkins, Rt Hon Sir H.
Atkins, Robert *(South Ribble)*
Atkinson, David *(B'm'th E)*
Baker, Rt Hon K. *(Mole Vall'y)*
Baker, Nicholas *(N Dorset)*
Baldry, Tony
Banks, Robert *(Harrogate)*
Batiste, Spencer
Beaumont-Dark, Anthony
Beggs, Roy
Bellingham, Henry
Bendall, Vivian
Benyon, William
Best, Keith
Bevan, David Gilroy
Biffen, Rt Hon John
Biggs-Davison, Sir John
Blackburn, John
Blaker, Rt Hon Sir Peter
Body, Richard
Bonsor, Sir Nicholas
Bottomley, Peter
Bottomley, Mrs Virginia
Bowden, A. *(Brighton K'to'n)*
Bowden, Gerald *(Dulwich)*
Boyson, Dr Rhodes
Braine, Rt Hon Sir Bernard
Brandon-Bravo, Martin
Bright, Graham
Brinton, Tim
Brittan, Rt Hon Leon
Brooke, Hon Peter
Brown, M. *(Brigg & Cl'thpes)*
Browne, John
Bruinvels, Peter
Bryan, Sir Paul
Buck, Sir Antony
Budgen, Nick
Bulmer, Esmond
Burt, Alistair
Butcher, John
Butler, Hon Adam
Butterfill, John
Carlisle, John *(N Luton)*
Carlisle, Kenneth *(Lincoln)*
Carlisle, Rt Hon M. *(W'ton S)*
Carttiss, Michael
Cash, William
Chalker, Mrs Lynda
Channon, Rt Hon Paul
Chapman, Sydney
Chope, Christopher
Churchill, W. S.
Clark, Hon A. *(Plym'th S'n)*
Clark, Dr Michael *(Rochford)*
Clark, Sir W. *(Croydon S)*
Clarke, Rt Hon K. *(Rushcliffe)*
Clegg, Sir Walter
Cockeram, Eric
Colvin, Michael
Conway, Derek
Coombs, Simon
Cope, John
Cormack, Patrick
Corrie, John
Couchman, James
Cranborne, Viscount
Critchley, Julian
Crouch, David
Currie, Mrs Edwina
Dickens, Geoffrey
Dicks, Terry
Dorrell, Stephen
Douglas-Hamilton, Lord J.
Dover, Den
du Cann, Rt Hon Sir Edward
Dunn, Robert
Durant, Tony
Dykes, Hugh
Edwards, Rt Hon N. *(P'broke)*
Eggar, Tim
Emery, Sir Peter
Evennett, David
Eyre, Sir Reginald
Fairbairn, Nicholas
Fallon, Michael
Farr, Sir John
Favell, Anthony
Fenner, Mrs Peggy
Finsberg, Sir Geoffrey
Fletcher, Alexander
Fookes, Miss Janet
Forman, Nigel
Forsyth, Michael *(Stirling)*
Forsythe, Clifford *(S Antrim)*
Forth, Eric
Fowler, Rt Hon Norman
Fox, Marcus
Franks, Cecil
Fraser, Peter *(Angus East)*
Freeman, Roger
Fry, Peter
Gale, Roger
Galley, Roy
Gardiner, George *(Reigate)*
Gardner, Sir Edward *(Fylde)*
Garel-Jones, Tristan
Gilmour, Rt Hon Sir Ian
Glyn, Dr Alan
Goodhart, Sir Philip
Goodlad, Alastair
Gorst, John
Gow, Ian
Gower, Sir Raymond
Grant, Sir Anthony
Greenway, Harry
Gregory, Conal
Griffiths, E. *(B'y St Edm'ds)*
Griffiths, Peter *(Portsm'th N)*
Grist, Ian
Ground, Patrick
Grylls, Michael

FROM: A M W BATTISHILL
DATE: 2 April 1985

CHANCELLOR OF THE EXCHEQUER

cc Sir Peter Middleton
Sir Terence Burns
Mr Cassell
Mr H P Evans
Mr Lankester
Mr Lavelle
Mr Odling-Smee
Mr Scholar
Mr Culpin
Mr Folger
Ms Seammen
Mr Shields
Mr Cropper
Mr H Davies

BRIEFING FOR THE CHANCELLOR'S TCSC APPEARANCE

Attached below are the various briefing notes which were commissioned at your meeting this morning.

2. Copies of the transcript of evidence given yesterday by the Governor have been circulated separately to those concerned.

AMB

A M W BATTISHILL

FROM: P WYNN OWEN
DATE: 2 April 1985

NOTE FOR THE RECORD

cc Mr Cassell
Mr Lavelle
Mr Peretz
Mr Battishill

OPENING STATEMENT FOR THE GOVERNOR'S TCSC APPEARANCE - 1 APRIL

The Chancellor saw the Governor's opening statement and defensive briefing and had the following comments, which I relayed to the Governor's private office an hour or two before the Governor's appearance:

(i) Page 1, last paragraph - the Chancellor felt that this made it sound slightly as if the Government had a bank lending policy;

(ii) Page 2, first full paragraph - the second sentence correctly refers to sterling M3 within its target period for the third year in a row. The Chancellor felt that the text should also refer to M0 being within its range since it had been targeted;

(iii) Page 3, final paragraph - the Chancellor noted that a link was drawn between unit labour costs and inflation. He wanted to remind the Governor that the more important link was between unit labour costs and employment;

(iv) Page 3, final paragraph - the Chancellor wished to see the phrase "downward pressure on real activity" rephrased. While he acknowledged that it may have had some theoretical validity, he felt that it was unfortunate if the Governor wanted to say such a thing so soon after the CBI's recent figures;

(v) Q&As Page 5 - on the treatment of asset sales as negative expenditure, the Chancellor wondered whether the Governor could be a little more robust - for instance, drawing attention to the fact that we were merely following international convention.

2. Of these points, the only one the Chancellor felt strongly about was (iv).

Pwo.

P WYNN OWEN

M32

FROM: MISS O'MARA
DATE: 2 April 1985

MR BATTISHILL

cc Sir P Middleton
Sir T Burns
Mr Cassell
Mr H P Evans
Mr Lankester
Mr Lavelle
Mr Odling-Smee
Mr Scholar
Mr Culpin
Mr Folger
Ms Seammen
Mr Shields
Mr Cropper
Mr H Davies

BRIEFING FOR THE CHANCELLOR'S TCSC APPEARANCE

At his meeting this morning, the Chancellor commissioned some material for his appearance before the TCSC tomorrow:

(i) a note reconciling the Chancellor's speech to the American Chamber of Commerce with the Governor's appearance before the TCSC yesterday (**Action**: Central Unit to co-ordinate);

(ii) a note on the National Insurance contributory principle to be cleared by Treasury Ministers this evening and passed to the Committee tomorrow (**Action**: Ms Seammen);

(iii) a draft speaking note, drawing on the Chancellor's wind-up speech, casting doubt on the value of indicating the likely size of the next year's fiscal adjustment at the time of the Autumn Statement (**Action**: Central Unit);

(iv) a brief note indicating when forecasts of the PSBR were first revealed in the Autumn and in what detail (**Action**: Mr Evans);

(v) where the US currently stands as regards figures and ranges for M1, M2 and M3 (**Action**: Mr Shields);

(vi) a brief note giving useful facts and figures on National Insurance contributions, including the public expenditure cost of abandoning the contributory principle (**Action**: Ms Seammen);

(vii) a note on relative unemployment and vacancy figures (**Action**: Sir T Burns on the basis of material already provided).

2. If the remaining clearers do not move tomorrow, the Chancellor said he would be grateful if HF could speak to the Bank before his appearance in front of the Committee to discover their latest thinking on the likely movement of interest rates (**Action**: Mr Lankester).

3. Finally, the Chancellor said he would welcome any further thoughts which Sir Peter Middleton and Sir Terence Burns might have on popular misapprehensions which he should attempt to set straight when speaking to the Committee.

MOM

MISS M O'MARA

36/64

PS/CHANCELLOR

FROM: MS D SEAMMEN
DATE: 2 April 1985

cc. Sir P Middleton
Sir T Burns
Mr Evans
Mr Odling-Smee
Mr Battishill
Mr Scholar
Mr Culpin
Mr Folger
Mr Cropper
Mr H Davies

c/ You have this on your TCSC folder. Are you content for the note to be sent tomorrow?

Mary 2/4

Note OK. As for covering note, I am puzzled. It seems that the £1 bn is the correct figure & the £3 bn figure primarily fanciful — I can't see any reason to take that 'second step'? NL.

TCSC

I attach

a) a note on the contributory principle which, if the Chancellor agrees it, can go to TCSC tomorrow

b) useful facts and figures on national insurance contributions. on TCSC folder

On the Chancellor's question of the cost of abandoning the contributory principle, it does depend on what assumptions you make. We have never given any estimate in public. If however you assume that everyone gets the full rate of the appropriate contributory benefit - eg. all unemployed people get the full UB rate, all long term sick and disabled get the full invalidity benefit rate, then additional expenditure would be easily of the order of £1 billion. If you also assume that all pensioners, men and women, married and single, get the single rate, retirement pension, then we would add another £2 billion or so; giving a grand total of at least £3 billion. We might of course not want to take the second step; but since a married woman gets a pension on her husband's contributions (it is strictly her pension and not an addition to the husband's pension) it is not an unreasonable assumption to make for the purpose of the question.

If therefore, the Chancellor wants to use the £3 billion figure, he might reasonably say

> 'the cost of abandoning the contributory principle depends on the assumptions made; but it could easily be of the order of £3 billion'.

MS D SEAMMEN

NOTE BY TREASURY AND DHSS OFFICIALS

The contributory principle

The contributory principle means that people's entitlement to benefits is determined by their record of contributions. In practice, this has two requirements:

- that people who pay contributions establish a right to particular benefits when they are no longer earning; and

- that only by paying or being credited with contributions can people qualify.

The Government remains committed to that principle but does not believe that it also requires a particular structure of contributions. That is why the Chancellor said in his Budget statement that while he proposed to retain the essential features of the contributory principle, there were desirable changes that could be made to NI contributions to improve the flexibility of the labour market and the prospect for jobs, and yet preserve benefit rights.

Contributions by working people have never been sufficient to pay for the full cost of benefits. An adequate NI Fund depends additionally on contributions by employers and also - though decreasingly - from the Consolidated Fund in the form of the Treasury Supplement. The balance of these different inputs to the NI Fund changes from time to time. Although it has been administratively convenient in running the NI Scheme to maintain a particular relation between the employer's and employee's contributions, that is not a requirement of the contributory principle. The employer's contribution confers no benefit rights: as a result, no constraint attaches to the abolition of the upper earnings limit and full weight can be given to employment objectives. Employers generally will gain more than they will lose from that abolition.

FROM: R I G ALLEN
DATE: 3 APRIL 1985

MR FOLGER

Noted

cc PS/Chancellor
PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Monger
Mr Matthews
Mr Culpin
PS/IR

C/ To note.
3/4

TCSC: CHANCELLOR'S APPEARANCE, 3 APRIL

There are press reports picking up two main aspects of yesterday's IFS Conference: first, the remarks by Alan Budd about exchange rate policy, second, John Kay's claim that the tax system is more now progressive than it was in 1978-79. The Chancellor might be questioned about both of these points, and you asked for my comments on the second.

2. John Kay's talk was an interesting one but, unfortunately, there were no hand-outs. We had to rely on slides flashed up (fairly briefly) on a screen. So the basis for his calculations is not entirely clear. But what Kay appeared to be comparing was a set of "linearisations" of the tax system at various points of time drawing on FES data. This is a familiar IFS procedure. The calculations include direct and indirect taxes and NICs. But they exclude higher rate taxpayers and hence are of only limited value in comparing how the 1979 structure compares with today's. We are hoping to have discussions with the IFS next week to go into their calculations in a bit more detail (and they will eventually be published, along with the rest of the Conference papers, in the May issue of Fiscal Studies).

3. In the meantime, I think it would be unwise for the Chancellor to venture a comment on the figures, which are not entirely helpful to the Government. He can say, quite genuinely, that neither he nor Treasury/Revenue officials have yet had the opportunity to study the calculations used by the IFS.

RIA

R I G ALLEN

psp

COMMITTEE OFFICE
HOUSE OF COMMONS
LONDON SWIA OAA
01-219 (Direct Line)
01-219 3000 (Switchboard)

CH'E CHEQUER
REC. 10 APR 1985 10/4.
~~ACTION~~ INFO: Mr Battishill
COPIES TO CST, FST, MST, EST
Sir P. Middleton
Sir T. Burns
Mr Pratt,
Mr Cropper, Mr Lord,
Mr Davies, Mr P. Lilley M.P.

TREASURY AND CIVIL SERVICE COMMITTEE

April 1985

My dear Chancellor,

On behalf of the Treasury and Civil Service Committee, I am writing to thank you for agreeing to appear, together with Sir Peter Middleton and Sir Terence Burns at our meeting recently.

As you know, we are to take further evidence from the TUC and the CBI, and then we hope to make a report to the House in time for the Second Reading of the Finance Bill.

With all good wishes
As ever
Terence

Terence L. Higgins

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
H M Treasury
Parliament Street
SW1P 3AG

cc PPS 12/2
PS/Chief Secretary
PS/FST
PS/EST
PS/MST
PS/Sir P. Middleton
PS/Sir T. Burns
Mr Barling
Mr Cassell
Mr Monck
Mr Bottomley
Mr Scholar
Mr Folger

1 - R
2 - [illegible]

COMMITTEE OFFICE
HOUSE OF COMMONS
LONDON SW1A 0AA
01-219 5766 (Direct Line)
01-219 3000 (Switchboard)

TREASURY AND CIVIL SERVICE COMMITTEE

PRESS NOTICE

The 1985 Budget

The Treasury Committee's public hearings on the 1985 Budget will be concluded on Monday 15 April. The Committee hope to take evidence from witnesses representing the Trades Union Congress and the Confederation of British Industry. The meeting will begin at 4.30 p.m., in Room 15 at the House of Commons.

4th April 1985

S. Priestley

1-23

Ch
Final chance to
make any last
minute changes –
+ see suggestions
of others.
RE
12/4

PS/P

FROM: R PRATT
DATE: 12 APRIL 1985

Seems OK.
N

CHANCELLOR OF THE EXCHEQUER cc Mr Battishill

TCSC BUDGET ENQUIRY

You may wish to see the attached, corrected, version of the transcript of your evidence to the TCSC on Wednesday 3 April.

2. I will be sending the corrected version of the transcript to the TCSC on Monday, 15 April.

Richard Pratt

RICHARD PRATT

1-9

FROM: R PRATT
DATE: 19 APRIL 1985

1. MR BATTISHILL

2. CHANCELLOR OF THE EXCHEQUER

These replies have been extensively discussed with PM and ST.

Ch.

Content with draft reply (for Battishill's signature)?

RL 19/4

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Cassell
Mr Monck
Mr Byatt
Mr Odling-Smee
Mr Watson
Mr Monger
Ms Seammen
Mr Folger
Miss Noble

TCSC BUDGET ENQUIRY

The TCSC have asked two further questions, following your oral evidence on 3 April. A copy of the Clerk's letter is attached.

2. The first of the questions follows up your exchange with Mr Fisher about the use of the Treasury model to assess the employment effects of alternative Budget measures. The Clerk asks if the model was used to compare the employment effects and if so what was the result.

3. The draft reply builds on your own response to Mr Fisher in downplaying the significance of the Treasury model. (It is also consistent with what Mr Battishill told the Committee when asked whether the model was used to analyse Budget representations made by outside bodies. Copies of the relevant extracts from the transcript are attached.) By itself, however, such a response might still prompt the Committee to say that while they understand all that, they would still like to see the results of a model simulation.

4. The model was, of course, used to simulate different policy measures and the results - particularly the PSBR effects - were used to build up the scorecard. We cannot say, therefore, that we did not use model simulations but, as you know, (for the reasons given in the draft reply) the precise employment numbers were subject to a very wide margin of uncertainty.

5. The second question asks whether or not firms which employ over 10,000 people are better or worse off as a result of the combined effect of the abolition of NIS and the NIC restructuring. The Clerk goes on to ask whether any kind of companies have been adversely affected by the NIS and NIC changes.

6. By combining the effect of the NIS abolition and NIC restructuring, the Clerk makes it easier for us to give a very positive response. Although it is possible that some individual firms, consisting of very highly paid people, might be worse off as a result of the two changes, it is difficult to conceive of any overall category of company which would be worse off.

7. Because of other pressures, and your own absence abroad, we have not been able to meet the Committee's deadline of 15 April. However, the Committee have said that they intend to publish our reply and in order to meet their own printing deadlines have asked if we could send them our response no later than Monday 22 April.

Richard Pratt

RICHARD PRATT

DRAFT LETTER FROM MR BATTISHILL TO:

Clerk to the Treasury
& Civil Service Committee
Committee Office
House of Commons
LONDON SW1A OAA

Thank you for your letter of 4 April, in which you asked for some further information on matters arising from the Chancellor's oral evidence to the TCSC.

2. The Committee asked, in relation to Q323, whether the assessment of employment effects of income tax cuts as against other possible Budgetary measures was reinforced by the use of the Treasury model.

3. The Treasury model is used throughout the year to simulate policy changes and the results of that work are available to the Chancellor of the Exchequer when he comes to consider his Budget decisions. But computer runs do not provide all the answers. The Treasury model, like the majority of macro economic models, does not fully capture all the consequences of alternative measures: for example, it does not take account of the beneficial effects on enterprise and incentives, and hence employment, of cuts in income tax or of the likely full effects of introducing a graduated scale of employers National Insurance contributions. Other factors had to be considered, therefore, in reaching judgements about particular measures, and in forming a view of those most likely to promote enterprise and employment.

4. The Committee also asked about the combined effects of the abolition of the National Insurance Surcharge and the restructuring of National Insurance Contributions.

5. Abolition of the National Insurance Surcharge reduced employers contributions by about £3 billion a year. The restructuring of national insurance contributions announced in the Budget will reduce employers contributions, in respect of the lower paid, by a further

£880m in a full year. Since the abolition of the upper earnings limit will cost employers about £800m, employers overall have made a substantial gain from the combined effect of NIS abolition and NIC restructuring.

6. The balance of gains and losses for any particular firm will depend on the earnings distribution of its employees, not on its size. But since the increase in the employers' contributions only outweighs the effect of the abolition of NIS in the case of an employee who earns more than about £17,500 a year (x times average earnings), it is clear that the ~~vast~~ Overwhelming majority of employers will gain overall from the NIC changes and the abolition of NIS. Indeed, it is not possible to identify ~~a particular~~ any class of employer (whether categorized by employee size, or industrial sector) which will not gain overall from the changes.

COMMITTEE OFFICE
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TREASURY AND CIVIL SERVICE COMMITTEE

4th April 1985

Dear Tony,

I enclose a copy of the transcript of yesterday's oral evidence by the Chancellor of the Exchequer and Treasury officials.

The Committee would be obliged if you would provide certain information on matters arising from the evidence.

At Q.323, the Chancellor was asked about the benefit of changes in tax thresholds in relation to those derived from other options foregone. Members would be interested in knowing whether this aspect of the Budget judgement was reinforced by use of the Treasury model; and if so, what the result of the computer runs was.

Second, are firms which employ over 10,000 people in a better or worse position since the Budget changes in National Insurance contributions than they were before (or at any stage in the course of) the abolition of the surcharge. or if a broad judgement is not possible, what kind of companies, if any, will find themselves now adversely affected by comparison with their position before the progressive changes in the surcharge.

Could you please let me have your response by Monday 15 April?

Yours sincerely
Bill.

W.R. McKay
Clerk to the Committee

A.M.W. Battishill Esq.,
Central Unit
H M Treasury
Parliament Street
SW1P 3AG

EXTRACT FROM CHANCELLORS APPEARANCE ON 3rd APRIL 1985.

bands at a very, very low level of earnings, that is obviously desirable.

323. Presumably, Chancellor, when deciding on how to allocate this money, you looked at other job options. When feeding through the likely effect - presumably through the Treasury model - of changes in tax thresholds and using the money in that way, did you also feed through the increased effect that the same amount of money would have, and a more substantial effect, on the national insurance contributions or, indeed, the same amount of money spent on the infrastructure, which almost everybody, from the CBI to we in the Labour Party, were encouraging you to spend? Do we take it, because you chose tax thresholds on which to use that money, rather than on the one hand infrastructure or on the other NIC, that the Treasury model indicated that that was the most efficient and most job-productive way of using that money?

(Mr Lawson) I do not think that you want to rest too much weight on the Treasury model or any other model - any computer model - of the economy.

324. How did you decide which one of these two to use?

(Mr Lawson) It is a matter of judgement. We do spend a substantial amount of money on what you have called the infrastructure, and in particular the areas that I would call the infrastructure: on both roads and on the sewers and the water industry generally. There we are planning to increase spending quite substantially in real terms over the coming year.

325. You have not answered my question, with all respect, Chancellor. Can you confirm for me that your estimate was that it is a more efficient way to create 25,000 jobs, by using that money through tax thresholds, than by using the same amount of money to

increase whatever sums you are already spending on infrastructure? Do you not think that that would have created more than 25,000 jobs?

(Mr Lawson) Probably not.

326. You are the only person who thinks that!

(Mr Lawson) Anyway, the point is, taking a medium-term view - which is what it is right to take - a lower burden of taxation will lead to an economy that is more dynamic. That is what will lead to more jobs.

327. Another measure you introduced was the wages councils which you also referred us to. How will abolishing the wages councils actually create jobs? Or I think you referred to it as "restructuring the creation of jobs".

(Mr Lawson) No, I never said anything like "restructuring the creation of jobs".

328. You used the word "restructuring" those industries or the employment prospects of those industries.

(Mr Lawson) No, I do not think so.

329. You believe that it will create jobs, by abolishing the wages councils, do you?

(Mr Lawson) I think we all know of cases where there are employers who would be prepared to take on employees at wages for which those employees are prepared to work, and who are unable to do so because of the ----

330. ---- massive demands?

(Mr Lawson) ---- minima laid down by the wages councils.

331. Are you referring to minima?

(Mr Lawson) I even saw someone - ~~I even~~ from, I think ~~it was~~ the Low Pay ~~Group~~ Unit - who ~~said~~ agreed that the wages councils cost jobs, but they argued that it was only a small number of jobs.

EXTRACT FROM APPEARANCE OF OFFICIALS ON 27th MARCH 1985.

Chancellor, despite the constraints under which he was operating, could have attempted this or that measure to try and increase the level of employment. Is it the case that the Treasury has made any specific analysis, for example, of the effect of raising the tax threshold as against spending more on council housing? Is there any sort of ranking list which was drawn up in advance of the Budget?

(Mr Battishill) A whole number of proposals were put to the Chancellor. One had only to read one's newspaper to find yet another selection of proposals for improving employment, and those are naturally looked at very carefully within the limits of the technology for estimating the effects on employment and unemployment. I do not think I can say any more than that, Chairman.

155. There was a cookbook produced some years ago showing the revenue effect of various tax changes, was there a corresponding cookbook on unemployment?

(Mr Battishill) Even the revenue changes, if I remember them correctly, were limited to the immediate ~~term~~ effects and not the sort of thing which I think one would wish to rely on in judging the unemployment and employment effects of different measures. These things are extremely difficult to predict and there has to be a high element of judgment.

Mr Fisher

156. You have referred to the fact that proposals are very current in the few months before the Budget and you referred to them being very closely looked at. Are you telling the Committee that detailed proposals, for instance by the IFS or the Child Poverty Action Group or the Low Pay Unit, are specifically looked at? That there is some purpose from the Treasury point of view in those statements being made, ie put through the Treasury model, or are they, from the Treasury point of view, totally ignored?

(Mr Battishill) I am saying that in a sense this Budget was no different from any other Budget with which I have been concerned in the sense that an enormous number of proposals for changes are looked at and studied in varying degrees of detail. Certainly if you are asking whether budgetary submissions from outside organisations and representatives bodies are welcome, I can categorically assure you they are, and studied.

157. And put through the Treasury model?

(Mr Battishill) Sometimes, if that kind of analysis is helpful.

158. Did that happen this year?

(Mr Battishill) I would prefer not to say how we studied what proposals because ~~(a)~~ I will surely get my recollections wrong. ~~and (b)~~ I do not know that it would actually help to say how we studied what proposals, some of which may have been put through the model, some of which need not have been.

Chairman: I think that is reasonable, in the circumstances. Mr Battishill, we are most grateful to you and your colleagues for your helpful and patient answers. We shall look forward to our further sessions with the Governor of the Bank and the Chancellor next week. Thank you all very much indeed for coming.

Thanks: The points you have identified in paras 26 & 28 are strange errors! I think this has already been corrected. N

Ch.

You'll want to see.

Not too bad, - with the exception of paras 15-22 (on the Autumn Statement fiscal adjustment), which is not unexpected, despite their acquiescence on this at your appearance (see T Battishill's comments attached)

They want to come back to the fiscal monetary mix later.

They want you to reconsider the treatment of the contracted out, in respect of the abolition of the UEL (~~This was~~ You expected this one to cause trouble eventually).

Ke

19/4

1-10

yarp

FROM: R PRATT
DATE: 19 APRIL 1985

MR ODLING-SMEE
MR SCHOLAR
MR LANKESTER
MR EVANS
MR LAVELLE
MR MONGER
MS SEAMMEN
MR SHAW
MR FOLGER
MISS PEIRSON

cc Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Littler
Mr Monck
Mr Cassell
Mr Kemp
Mr Battishill
Mr Culpin

TCSC: BUDGET REPORT

I attach a draft of the TCSC report on the Budget. It has been sent to us for our comments.

2. Our normal practice is to confine any comments to purely factual matters, so I should be grateful if you would look through the draft report and let me know if there are any errors that I ought to draw to the Committee's attention

3. The Committee will be finalising their report on Monday 22 April, so I should be grateful for any comments by close of play today Friday 19 April.

Richard Pratt

RICHARD PRATT

likely to be published on Thursday 25/4
(probably before questions)

273/6

FROM: A M W BATTISHILL
DATE: 19 April 1985

MR PRATT

cc Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Odling-Smee
Mr Scholar
Mr Evans
Mr Monger
Ms Seammen
Mr Shaw
Mr Folger
Miss Peirson

All good & persuasive points. N.

TCSC: BUDGET REPORT

You circulated a draft of the Committee's report on the Budget with a request for factual errors.

2. The dividing line between a factual error and something which is simply misleading is never easy to draw on these occasions. And in doubtful cases it may be better to hold our fire for briefing, or for the Government's response. There is a difficult example in the Committee's discussion of the fiscal adjustment. Their tendentious paragraph 16 tries to suggest that if expectations of tax cuts were disappointed by the Budget this was due to the way Ministers oversold the prospective fiscal adjustment in the Autumn Statement and afterwards. We could make a number of points:

(a) The draft is wrong to say that the text of the Autumn Statement contained no qualification about the size of the fiscal adjustment. Paragraph 1.57 said

> "Any estimate of the extent of the fiscal adjustment for 1985-86 is extremely uncertain: it depends on revenue and expenditure estimates all of which are subject to major uncertainties, in both directions."

Similarly in the Oral Statement, after pointing to the usual conventional assumptions and the effect of last year's Budget the Chancellor stated:

> "Beyond that, the margin of uncertainty at this stage is very considerable, and the House will understand that the prospect for 1985-86 will need to be reviewed again, in the light of more up-to-date information, before I come to make my Budget judgement next year. ...the best figure that I can put on it [the scope for tax reductions] at the present time is about £1½ billion."

(b) The quotation from the Financial Secretary's speech to the Sun Life Investment Seminar stops just at the point when he too mentioned the uncertainties. In the very next sentence to that quoted before mentioning the £1½ billion figure he said "The margin of error in forecasts at this stage is great...".

(c) Finally, the paragraph mentions the Chancellor's Sunday Times article. This contained the following sentence:

> "(I may add that I wish I were as confident as the Press appear to be that I will have even half the scope for tax cuts that they write about)"

The first point in (a) cannot go unchallenged; and I think it is worth drawing the Clerk's attention to the other two. Frankly, the whole paragraph does not stand up.

3. Paragraph 34 says that the higher tax thresholds will take "around 270,000 more working people out of tax than would have occurred if the allowances had only been indexed". We have used a figure of about 260,000 tax units (counting husband and wife as one); and 375,000 taxpayers overall (including

the elderly). Perhaps Mr Monger could attest to the accuracy or otherwise of the Committee's figure.

4. Paragraph 38 refers several times to the lower earnings limit for NIC of £35 per week: strictly, of course, this should be £35.50.

5. Finally, a tiny point on paragraph 51. Footnote 71 reads as though the Treasury press notice is the source of all the numbers about employment effects in the first sentence. Our press notice gave figures only for the YTS and the Community Programme, and not in terms of extra jobs but in terms of the estimated effect on unemployment (I gave the same information in answer to a question from Mr Howell). The NICs figures have come from their advisers (see paragraph 43). The Clerk needs to put this right.

A M W BATTISHILL

14/1680

FROM: MRS R M DUNN
DATE: 22 April 1985

1. MR ~~GRAY~~ RCG 22/4
2. CHIEF SECRETARY

C. You may like to see the draft reply (at Annex B) to the TCSC, though CST will reply.
Rus 22/4

cc Chancellor
Sir Peter Middleton
Mr Bailey
Mr Anson
Mr Monck
Heads of Expenditure Groups
Mr Battishill
Miss Brown
Mr Odling-Smee
Mr Scholar
Mr C C Allan
Mr Stibbard
Mr Williams
Mr Perfect
Mr Pratt

GOVERNMENT'S RESPONSE TO THE TCSC REPORT ON CMND 9428

The TCSC published their Report on the 1985 White Paper (Cmnd 9428) on 25 February 1985. A copy of the Report is attached at Annex A. Following publication of the White Paper on 22 January, the Committee subsequently heard evidence from officials on 11 February. Departing from their usual practice of examining officials only on the White Paper, the Committee subsequently invited you to give evidence, which you gave on 18 February.

2. The convention is that the Government need only respond to suggestions in Select Committee Reports that are formally labelled as recommendations. In this case, there are five recommendations by the Committee dealing with; the use of cash, cost and real terms, measurement of output, manpower and presention of the expenditure planning totals. A draft response to the Committee is attached at Annex B.

3. Cash, Cost and Real Terms

The Committee recommends that we should revert to using the term "cost terms" rather than "real terms" to denote deflation by the GDP deflator. The expression "real terms" was first used in place of "cost terms", at the Chancellor's request, in the Green Paper "The Next Ten Years", primarily because "real terms" is a good deal more widely understood than "cost terms". The draft reply makes this point. The Committee also says that more emphasis should be placed on providing information in cost terms. The reply suggests that this would detract from the primary purpose of the White Paper which is to present the Government's expenditure plans - which are determined in cash. Now that GDP deflators are published for all three forward years, cost terms information can readily be derived from the cash plans.

4. Measurement of output

The Committee recommends that special consideration be given to enhancing the scope and consistency of unit costs and performance measures, and that an analysis of a number of special topics in this area might be presented in successive White Papers. It is hard to know precisely what the second part of this recommendation means; the draft reply suggests that the Government will "consider what might be done to meet this suggestion". We may find, before the 1986 White Paper, that there is a suitable candidate for inclusion which can then be presented to the committee as an attempt to meet this request.

5. Manpower

The Committee recommends the inclusion in the White Paper of a single table for public service manpower as a whole, together with a reference to the costs. You will recall that this point was raised by Mr Howell at the hearing on 18 February and you said (and are quoted in the Report) that "we will certainly do our best to oblige with the table". The draft reply repeats this more formally.

6. Expenditure Planning Totals

The Committee recommends replacing Chart 1.1 (which showed changes in the 1985-86 planning total in successive White Papers) with a comparison of plans and outturns for the Survey period. The draft reply merely notes this preference.

7. Although the Committee made no other specific recommendations, the Report expresses concern about the viability of the White Paper plans. Without undermining the normal convention of only responding to recommendations, it is possible selectively to comment on other points made by the Committee where it seems appropriate to do so. In this case, it seems appropriate to respond to this concern, given the additions to the Reserves announced in the Budget Speech, and your remarks at the hearing on 18 February. An additional paragraph

on these changes has therefore been included.

8. We should be grateful for your comments on the draft response at Annex B. This should be sent to the Committee by 25 April in accordance with the normal convention of responding to reports within two months.

Ros Dunn

MRS R M DUNN

H M Treasury

Parliament Street London SW1P 3AG

Switchboard 01-233 3000

Direct Dialling 01-233 ....

~~Rachel~~ PS/P

Some small factual changes sidelined below. Overleaf, note that £17,500 is only 1½ x average earnings – not really very impressive. I will nevertheless assume this is now all right to send in its present form. If you have any doubts, could you call me this p.m. by 4.00pm if possible.

Richard Pratt

A M W Battishill
Under Secretary

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

22 April 1985

Thank you for your letter of 4 April, in which you asked for some further information on matters arising from the Chancellor's oral evidence to the TCSC.

2. The Committee asked, in relation to Q323, whether the assessment of employment effects of income tax cuts as against other possible Budgetary measures was reinforced by the use of the Treasury model.

3. The Treasury model is used throughout the year to simulate policy changes and the results of that work are available to the Chancellor of the Exchequer when he comes to consider his Budget decisions. But computer runs do not provide all the answers. The Treasury model, like the majority of macro economic models, does not fully capture all the consequences of alternative measures: for example, it does not take account of the beneficial effects on enterprise and incentives, and hence employment, of cuts in income tax or of the likely full effects of introducing a graduated scale of employers National Insurance contributions. Other factors had to be considered, therefore, in reaching judgements about particular measures, and in forming a view of those most likely to promote enterprise and employment.

4. The Committee also asked about the combined effects of the abolition of the National Insurance Surcharge and the restructuring of National Insurance Contributions.

5. Abolition of the National Insurance Surcharge reduced private sector employers' contributions by about £3 billion a year. In addition, the restructuring of national insurance contributions announced in the Budget will reduce employers' contributions (in both the public and private sector), in respect of the lower paid, by £880m in a full year. Since the abolition of the upper earnings limit will cost employers about £800m, employers overall have made a substantial gain from the combined effect of NIS abolition and NIC restructuring.

6. The balance of gains and losses for any particular firm will depend on the earnings distribution of its employees, not on its size. Since the increase in the employers' contributions only outweighs the effect of the abolition of NIS in the case of an employee who earns more than about £17,500 a year, (more than 1½ times average male earnings) it is clear that the vast majority of employers will gain overall from the NIC changes and the abolition of NIS. It is not possible to identify any particular class of employer (whether categorized by employee size or industrial sector) which will not gain overall from the changes.

Yours sincerely

(A M W BATTISHILL)

21/254

FROM: MS V F LIFE
DATE: 22 April 1985

MR BATTISHILL

cc PS/Chancellor
PS/CST
PS/EST
PS/MST
Sir P Middleton
Sir T Burns
Mr Odling Smee
Mr Scholar
Mr Evans
Mr Monger
Mr R I G Allen
Mr Folger
Mr Pratt
Mr Halligan

TCSC: BUDGET REPORT

The Financial Secretary was very grateful to you for pointing out the quotation from his speech used by the TCSC had been misleadingly edited.

2. He suspects that Terence Higgins may make something of this during the Finance Bill Second Reading Debate. He would therefore be grateful if his briefing for his winding up speech could inlcude a copy of the TCSC Report with the appropriate section marked and a copy of the text of his speech, again with the appropriate section marked.

Vivien Life

VIVIEN LIFE

gwp.

FROM: R PRATT
DATE: 22 APRIL 1985

MR EVANS
MR RILEY
MR GRAY
MR PERETZ
MS SEAMMEN
MR SHAW
MISS PEIRSON
MR FOLGER

cc Mr Battishill
Mr Monger
Mr Culpin
Mr Hannah — 109/3
Mr Gilhooly
PS/Inland Revenue

TCSC: BUDGET REPORT

With my minute of 19 April, I circulated a draft of the TCSC report on the Budget. Further copies are attached for those who did not receive my earlier minute.

2. It is not yet clear precisely when the report will be published. However, there is a possibility that it will be published on Thursday 25 April and we will therefore need to prepare briefing for First Order Questions on Thursday afternoon. I must therefore ask for the briefing which I am commissioning below to be with me by lunchtime on Wednesday 24 April. I will circulate any further information I receive on the report's publication date.

3. For each of the subject headings below, the briefing should give the TCSC line, followed by positive and defensive points.

4. The briefing will need to cover the following, in each case, the name in brackets suggests who might take the lead for each subject:

(i) the monetary and fiscal policy stance - the assertion that this has been tightened; that there is an increased commitment to achieving public expenditure plans; that £M3 is to be in the middle of the range; and that there is some prospect of changes at a future date. (Mr Riley)

(ii) Public expenditure - the assertion that the 1984-85 expenditure outturn exceeded previous projections by £7¾ billion and would have required a £4¾ billion Reserve even without the coal strike; the comments on the adequacy of the Reserve; the questions on the timing of the decisions to increase the Reserve; and the share of capital spending in public expenditure. (Mr Gray)

(iii) Fiscal adjustment - the problems of forecasting it; the relative uncertainties of PSBR forecasts 6 months before a year starts and MTFS figures several years in advance. (Mr Evans)

(iv) Exchange rates and interest rates - the assertion that there has been a change in the Government's attitude to both exchange rates and interest rates; the comments on the effects of revisions in monetary targets. (Mr Peretz)

(v) NIC changes - the CBI reaction; the problem of having three thresholds and high marginal rates; the contributory principle; contracted out employees. (Ms Seammen)

(vi) YTS/CP - the voluntary principle. (Mr Shaw)

(vii) Costs per job - the relative cost per job of tax cuts, NIC cuts, investment etc. (Mr Folger)

I am assuming that nothing is necessary on Wages Councils or the tax changes.

Richard Pratt

RICHARD PRATT

R3.46

JMP.

FROM: MRS R LOMAX
DATE: 22 April 1985

MR PRATT

cc Sir P Middleton
Sir T Burns
Mr Bailey
Mr Littler
Mr Monck
Mr Cassell
Mr Battishill
Mr Odling-Smee
Mr Lankester
Mr Evans
Mr Folger

TCSC: BUDGET REPORT

The Chancellor has seen your note of 19 April attaching a copy of the draft TCSC report on the Budget, and Mr Battishill's note of the same date. He thinks that all Mr Battishill's points are good and important. In addition he has noted two further errors.

> Para 26, first sentence: the new monetary control arrangements were intended to give market forces a larger role in determining the structure of short term interest rates. (It is therefore not true that "one of the main features of the new arrangements was that interest rates would be determined by the market".)

> Para 28, line 22: this sentence implies that PSL2 and M2 were targets during 1984-5. This is not so.

RL.

MRS R LOMAX

R3.48

pasp

FROM: MRS R LOMAX
DATE: 22 April 1985

MR PRATT

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr Bailey
Mr Cassell
Mr Monck
Mr Byatt
Mr Battishill
Mr Odling-Smee
Mr Watson
Mr Monger
Mr Folger
Miss Noble

TCSC BUDGET ENQUIRY

The Chancellor has seen your draft reply to the TCSC in response to their two further questions. He is content subject to the following amendments. Redraft the last two sentences of paragraph 6 as follows:-

> "Since the increase in the employer's contributions only outweighs the effect of the abolition of NIS in the case of an employee who earns more than about £17,500 a year (x times average earnings) it is clear that the overwhelming majority of employers will gain overall from the NIC changes and the abolition of NIS. Indeed it is not possible to identify any class of employer (whether categorised by employee size or industrial sector) which will not gain overall from the changes."

RL.

MRS R LOMAX

CHANCELLOR OF THE EXCHEQUER

psl

Rachel

Chancellor has copy of this until a submission by Central Unit

M

CC CHANCELLOR OF THE EXCHEQUER
CST
FST
EST
MST
SIR. P. MIDDLETON.
SIR. T. BURNS.
MR. BAILEY.
MR. A. WILSON.
MR. KEMP.
MR. CASSELL.
MR. ANSON.
MR. MONCK.
MR. BYATT.
MR. BATTISHILL.
MR. ODLING-SMEE.
MR. SCHOLAR.
MR. WATSON.
MR. MONGER.
MR. MOORE.
MR. NORGROVE.
MR. GRIMSTONE.
MS. SEAMMEN.
MR. FOLGER.
MR. M.L. WILLIAMS.
MR. D.M. WILLIAMS
MISS. NOBLE.
MR. SHORT.
MR. PAIN.
MR. SPRATT.
MR. TAYLOR
MR. WILLIS.
MR. BRADLEY
MISS. WALKER

PSA

COMMITTEE OFFICE
HOUSE OF COMMONS
LONDON SWIA OAA
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TREASURY AND CIVIL SERVICE COMMITTEE

PRESS NOTICE

The 1985 Budget

The Committee's Eighth Report, "The 1985 Budget", will be published at 12 noon on Friday 26 April as House of Commons Paper no. 306. A press conference will be held at 12 noon on Monday 29 April (the same day as the second reading of the Finance Bill) in Committee Room 15 at the House of Commons. No advance copies of this Report will be available, but published copies will be placed in the Press Gallery of the House, or may be obtained in the usual way from room 309, St Stephen's House, Embankment, SW1.

Head of the Government Accountancy Services

On 20 March Mr Anthony Wilson, FCA, gave oral evidence on his role as Head of the Government Accountancy Service and Accountancy Adviser to the Treasury. That evidence is published today (Wednesday) as House of Commons Paper No. 286-i (available from HMSO).

Supply Estimates, 1985-86

The Committee will hear oral evidence in public on Wednesday 1 May from Treasury and Inland Revenue officials on estimates relating to Royal Ordnance plc, Inland Revenue computerisation and the Inland Revenue Valuation Office. The meeting will begin at 4.30 p.m. in Committee Room 15 at the House of Commons.

788 5141

24 April 1985 S. Priestley

FROM: R PRATT
DATE: 25 APRIL 1985

1. MR BATTISHILL

2. CHANCELLOR OF THE EXCHEQUER

This brief is mainly for use after the weekend, and for the Finance Bill debates. But IDT tomorrow can call on it selectively, so long as they take care not to suggest that we have had time to study the Report at length and reach a view on all the issues. If, as we are led to believe, there will be at least one recommendation the Government will have to respond formally in due course.

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Cassell
Mr Monck
Mr Watson
Mr Evans
Mr Odling-Smee
Mr Lankester
Mr Peretz
Ms Seammen
Mr Riley
Mr Folger
M. Culpin

TCSC: BUDGET REPORT

The TCSC Report on the Budget is due to be published tomorrow, at 12 noon, with a Press Conference at noon on Monday 29 April.

2. We have prepared briefing on the points likely to be raised in the Report, to be used by IDT - after publication tomorrow, or as a result of the Press Conference. The briefing will also serve as a base for a brief for the Finance Bill Second Reading on Monday 29 April.

3. The attached material is based on the draft Report - a copy of which you have already seen. We have made a number of comments on the draft Report to the Committee, but we do not yet know to what extent the published report will differ from the draft we have. The briefing will therefore need to be looked at again when we see the published report tomorrow.

4. Nevertheless, I should be grateful to know if you are content with the line taken in the attached briefing.

Richard Pratt

RICHARD PRATT

THE POLICY STANCE

The TCSC Line

1. The Committee argues that although the 1985 Budget marks a return to the arithmetic laid out in the previous budget, the policy stance has in effect been tightened because there is now an increased commitment to achieving these objectives. In support of this line they refer to the increase in the Reserve, the reluctance to allow interest rates to fall and the apparent intention to achieve the middle of the £M3 target range.

2. The Committee notes that these changes were the result of the rapid depreciation of sterling and the feeling in the markets that the government was no longer giving sufficient priority to maintaining downward pressure on inflation.

3. The Report reproduces the passage of the Chancellor's Budget Speech about the fiscal-monetary mix and the possibility of changes at some future date. Although they have not addressed this issue in the present enquiry the Committee say they hope to pursue this matter in the course of further investigations.

Positive

1. Recent policy measures do not reflect a change in the stance of policy as the Committee suggest, rather they demonstrate the government's resolve to carry out its present policies. The fall in sterling in January posed a clear threat to the ultimate objective of falling inflation. The government has had to react to this in order to maintain sound monetary conditions, and has taken firm measures to demonstrate that its public sector borrowing and monetary objectives would be met.

2. Interest rates will remain at levels judged necessary to achieve appropriate monetary conditions. This does not represent a break with previous policies. As explained in the Budget Speech, the precise combination of monetary growth and exchange rate necessary to keep financial ~~pay~~ policy on track is a matter of judgement.

3. The increase in the Reserve was certainly an attempt to make the Government's expenditure plans more credible. 1984-85 was the first year of operation of the new-style reserve and a reassessment was quite appropriate. These new arrangements will continue to develop, along with improved forecasting of demand-led expenditure.

Defensive

1. Is the Chancellor ready to change mix of monetary and fiscal policy in future years?
As the Budget Speech notes, there is nothing sacrosanct about the precise mix of monetary and fiscal policies required to meet the MTFS. Any scope for adjustment in the direction of a higher PSBR would be for consideration in future Budgets. We would need to be absolutely confident that inflation would be kept on a firm downward track. World Interest Rates, state of the dollar, oil prices all affect the policy mix which is appropriate.

2. Does this mean that the Chancellor is ready to increase the PSBR for 1986-87 to finance extra tax cuts?
The 1985 FSBR projects a 1986-87 fiscal adjustment of £3½ billion, on the basis of a PSBR of £7½ billion. Scope for tax cuts will be reassessed in the 1986 budget and will mainly depend upon restraint of public spending.

NATIONAL INSURANCE CONTRIBUTIONS

TCSC line

(a) The restructuring of NICs will result in 3 'national insurance traps' as there are now 3 earnings limits instead of 1. This means that more people are caught by the traps, and marginal tax rates are unacceptably high.

Positive

The people affected by the change are all better off than before, because their actual contributions have been reduced. Reductions in employers contributions will increase jobs available.

Defensive

[Steps a disincentive to increases in overtime?] This may occur, but the new steps are less severe than the present cliff at £35.50. Those affected will be better off because of lower contributions. To turn the steps into thresholds would cost (on a rough estimate, subject to a wide margin of error) about £4½ billion.

TCSC line

(b) The abolition of upper earnings limit on employers contribution demonstrates that there is no contributory principle on employers contribution.

Positive

'Contributory principle' means that people's entitlement to benefits depends on their contribution record. The employer's contribution confers no benefit rights, so there is no constraint on abolishing the employers' UEL to help promote employment objectives. Employers' contributions vital to <u>finance</u> NI benefits. Employers overall gain more than they lose from NIC restructuring.

Simon and Coates' estimates of PSBR "cost per job" implied by various fiscal options.

TCSC line

(i) The TCSC Report (para [51]) repeats figures first published in the 9 April 1985 edition of the Simon and Coates bulletin. "The Economic Analyst." Based on S&C simulations on various macroeconomic models, the figures are:

	£ per job PSBR cost in "second year"
income tax cuts	47,000
VAT cuts	58,800
employers' NIC cuts	59,200
public investment increase	26,200
public current spending increase	15,300
special employment measures	2,050

(ii) The Report notes "these estimates suggest that the special employment measures are remarkably cost effective." But, appositely, it notes that for the Chancellor "the supply-side effects of a generally lower tax structure are of great potential importance." It quotes without further comment the Chancellor's evidence that:

> "...the point is, taking a medium-term view - which is what it is right to take - a lower burden of taxation will lead to an economy that is more dynamic. That is what will lead to more jobs."

(iii) The estimates reported are averages over a wide range of calculations using varying methodology. Tax cut figures for example are based on widely differing individual simulation results. Expenditure results based on a completely different model, with ad-hoc adjustments for second-round effects.

Positive

(i) Government agrees employment measures most cost-effective way of directly affecting employment through public spending. Budget expenditure measures were of precisely this kind. Cost per job of extra public investment spending typically many times higher - as Simon and Coates figures suggest. Decisions on infrastructure must in any case depend on returns offered by particular projects.

(ii) As Chancellor explained to Committee, most important criterion, in judging job effects of particular Budget options, was their impact on supply performance of economy. Tax cuts have major part to play here by encouraging enterprise and bringing about a more dynamic economy. No coincidence that US and Japan, with low tax burdens, have been OECD countries with fastest growth of output and employment over recent years.

(iii) Very difficult to know that to make of precise figures to which Committee has drawn attention. For example VAT figure is for year 4, though Report describes it as year 2. And wide differences in methodology underlying estimates for individual measures add to uncertainties.

Defensive

(i) Precise simulation results depend on assumptions used. Would not necessarily agree with methodology underlying S&C results. Wide variety of disparate figures concealed by use of averages.

(ii) Cost per job implied by tax cuts may look big but note that:

- most macroeconomic models, do not fully capture the important supply-side effects from tax cuts. These will grow through time and bring down the "cost per job".

- even without supply-side effects, costs per job implied by tax cuts will tend to fall over the first few years as effects on output and employment build up.

- in practice, given government macroeconomic strategy, extra public spending will raise inflation and interest rates more than equivalent tax cuts. New jobs and activity initially created will be progressively crowded out and "cost per job" for expenditure measures will rise steadily.

(iii) [IF ASKED:] Treasury model used throughout the year to simulate policy changes and results available to Chancellor in framing Budget. But computer runs do not provide all the answers. Treasury model, like most macro economic models, does not capture all the consequences of alternative measures: for example, it does not take full account of the beneficial effects on enterprise and incentives, and hence employment, of cuts in income tax or of the likely full effects of introducing a graduated scale of employers National Insurance contributions. Other factors had to be considered, therefore, in reaching judgments about particular 1985 Budget measures, and deciding which most likely to promote enterprise and employment.

EB/MP1

25 April 1985

FROM: R PRATT
DATE: 26 APRIL 1985

1. MR BATTISHILL [initials] 26/4

2. 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 Monck
Mr Watson
Mr Evans
Mr Odling-Smee
Mr Lankester
Mr Peretz
Ms Seammen
Mr Riley
Mr Folger
Mr Culpin

Thanks. [illegible]

TCSC BUDGET REPORT

We have now received the published version of the TCSC Report. I attach a copy (top copy only).

2. There are one or two differences from the draft we had previously seen. These are as follows:

(i) A new recommendation has been inserted (this is the only recommendation in the Report). In paragraph 45, the Committee complain about the fact that the NIC changes were included in the Social Security Bill. They argue that instead they should have been introduced in a separate Bill and they recommend "... that any significant future changes in national insurance arrangements should provide for full debate at all stages".

(ii) The report now casts doubt on the estimates for North Sea oil revenues (in paragraph 20).

(iii) As a result of the comments we gave them, the Committee have amended the quotation from the FSBR on the combination of monetary growth and exchange rate need to keep financial conditions on track.

(iv) The estimates of the cost per job created by different policy measures have now been deleted.

There are a number of other minor drafting changes.

3. The Committee have failed to take account of the following points which we put to them when commenting on the draft report:

(i) That both written and oral Autumn Statements did include qualifications about the size of the proposed fiscal adjustment and that the Financial Secretary's speech (to which the Report refers) and your Sunday Times article also gave warnings that the figures were subject to a wide marginal uncertainty (paragraph 17)

(ii) The Report still says that one of the major features of the new monetary control arrangements introduced in 1981 was that interest rates would be determined by the market (paragraph 27).

(iii) Paragraph 29 still implies that PSL2 and M2 were targets in 1984-85.

4. The briefing already covers the three items mentioned above which the Committee have failed to amend. The attached briefing material contains amendments made necessary by the changes the Committee have made to the Report with the exception of the new recommendation on NICs, briefing for which will be supplied on Monday. The amendments are sidelined. now attached RP

5. As the Report now contains a recommendation (on the procedure for enacting NIC changes) it will be necessary to respond to that recommendation. Under the normal conventions, we have 2 months to respond, and a draft will be submitted in due course.

Richard Pratt

RICHARD PRATT

PUBLIC EXPENDITURE

TCSC line

(a) "Overall the original programme estimates were exceeded by £7¼ billion [in 1984-85]. ... Even allowing for [the £2½ billion cost of the miners' strike] a £4¾ billion Reserve would have been needed ... ".

Defensive

(i) Have made no secret of fact that there was some 1984-85 overrun apart from coal strike effects. Major contribution was from local authorities, where action has been taken to improve control - ratecapped authorities accounted for ¾ of overspending, tough action on grant and holdback for 1985-86.

(ii) Implied non-strike overrun of £2 billion (TCSC figure of £4¾ billion less actual Reserve of £2¾ billion) exaggerated because TCSC have added in £1 billion increase in debt interest - which is outside planning total and therefore the coverage of the Reserve.

(iii) Treatment of debt interest endlessly debated with TCSC; it is taken into account in MTFS. No question of "distortions" - treatment and figures are open for all to see.

TCSC line

(b) "£5 billion Reserve for 1985-86 does seem to go a considerable distance towards re-establishing the credibility of ... expenditure plans. Nevertheless ... four areas of potential spending ... not fully reflected in plans [pay factor, local authorities, continuing costs of coal strike, higher RPI effects on social security]."

Positive

(i) Welcome Committee's comments on action to rebuild Reserves.

(ii) Whole point of Reserve is to provide for uncertainties of the sort mentioned by Committee. Higher figures provide a prudent margin for them, and demonstrates Government's commitment to hold to plans.

Defensive

(i) Higher spending on pay bound to mean less for other services. Presumption against Reserve being used to meet extra costs of pay settlements.

(ii) Action taken to control local authority spending better - rate-capping, hold back rules

(iii) Precise post-coal strike effects still under consideration.

(iv) Reserve big enough to cope with RPI effect.

TCSC line

(c) "We are somewhat concerned that the very substantial upward revision to the planning total occurred in the brief period between the ... White Paper and the Budget. If, at Budget time, an additional £2 billion was needed ... why was this not apparent just two months earlier when the White paper was presented to the House?"

Defensive

(i) As Cmnd 9428 made clear "bulk of the figures were compiled at beginning of December 1984" and need to review figures at end of strike. Major developments between then and Budget - coal strike, market uncertainties etc.

(ii) Run up to Budget the right time to review all elements of public sector accounts.

(iii) Chief Secretary made abundantly clear position was being reviewed:

(a) In evidence to TCSC on 18 February " ... as part of that process we are reviewing the White Paper expenditure figures".

(b) In White Paper debate on 4 March " ... the review will need to ~~be~~ take~~n~~ into account a considerable range of uncertainties ... we shall need to review the White Paper figures against that background."

(iv) [If pressed on when decision taken.] Will not expect me to publish a detailed diary of the pre-Budget preparations.

TCSC line

(d) "We have repeatedly drawn the Government's attention to the declining share of capital spending as a proportion of total public spending. We are therefore disappointed that the Chancellor did not announce any measures specifically addressed to this problem".

(i) No "right" level of public capital spending. Must consider on case-by-case basis. Little evidence to support view that worthwhile projects frustrated by lack of finance.

(ii) Nationalised industries quoted in "Fabric of the Nation" as considering "present levels and patterns of investment spending are broadly consonant with proper development of their business".

(iii) Important thing is investment in economy as a whole - total fixed investment in 1984 a real terms record (£55 billion) and still rising.

Defensive

(i) In some cases reasonable to expect provision to fall as needs and priorities change. Elsewhere spending is increasing eg national roads 22% higher in real terms in 1985-86 than 1978-79; nearly £1 billion investment in water and sewerage planned for 1985-86.

FISCAL ADJUSTMENT

TCSC line

(a) By increasing the Reserve by £2bn, the Chancellor reduced scope for tax cuts. This repeats the pattern of previous years when expenditure has overrun and tax cuts have been less than the Government has hoped. This proves that revenue does not determine expenditure. In practice it is the other way round.

Positive

Increase in Reserve intended for purpose of prudent fiscal planning. No presumption that it will be fully used. Certainly no change in Government's objectives for tax reductions.

Defensive

Not at all. Government's expenditure plans settled in the light of revenue, spending and borrowing projections in the Medium Term Financial Strategy. No policy changes on public spending in the Budget, apart from the extra money for employment measures. Increase in Reserve simply for reasons of prudence, and no presumption that it will be fully used. No change in Government's objectives of lower taxation.

TCSC Line

(b) i. The Committee "strongly disagrees" with the Chancellor's view that it might be sensible to discontinue the practice of publishing a forecast of the fiscal adjustment for the next financial year at the time of the Autumn Statement.

ii. The Committee claims that the problems mentioned by the Chancellor - that such a forecast creates misapprehensions - were to a considerable extent due to the way in which the figures were presented. In particular, more should have been made of the margins of error surrounding the forecast of the fiscal adjustment.

iii. The Report goes on to hypothesise that the margins of error around the Budget projections of fiscal adjustments for several years ahead must be considerably larger. It would seem illogical, therefore, to stop publishing in the Autumn Statement a forecast of the next year's fiscal adjustment while continuing to publish in the MTFS at the time of the Budget a forecast of the fiscal adjustment for a number of years ahead.

Positive

i. The Report is quite wrong to say that the forecast of a £1½ billion fiscal adjustment in last year's Autumn Statement was not properly qualified. The text of the Autumn Statement itself stressed the uncertainty of the estimate, as did the Chancellor's oral statement. The other two instances quoted in the report - the Financial Secretary's Sun Life speech and the Chancellor's Sunday Times article - also qualified the forecast. /The relevant quotations are appended./

ii. Despite these warnings, the publication of a forecast in the autumn of the possible leeway for tax cuts either depresses or arouses expectations out of all proportion.

iii. Because the PSBR (and hence the fiscal adjustment) is the difference between two very large numbers - the gross flows on either side of the account approach £200 billion a year - a small error on either expenditure or revenue or both results in an error which is substantial in relation to the PSBR itself.

iv. The average (absolute) margin of error around a PSBR forecast for the subsequent year made in the autumn is about ± £4½ billion. This is comparable in size, if not larger, than the typical fiscal adjustment.

v. The publication of the potential fiscal adjustment in the autumn cannot commit the Chancellor to a course of action in the spring, since that must be a matter for judgement at the appropriate time.

Defensive

i. Will you continue to publish a forecast of the fiscal adjustment in the autumn? No decision has been taken, but, as the Chancellor said to the Committee, experience suggests that publication is not really a very helpful practice.

ii. Why refuse to publish a forecast for one year ahead in the autumn when the MTFS contains a forecast for several years ahead? No decision has yet been taken about whether to publish a fiscal adjustment forecast in the autumn. Not just a matter of relative uncertainties. More that the forecast is misinterpreted. It cannot commit the Chancellor to a course of action in the subsequent Budget.

/Note: The Committee are probably right in assuming that the margins of error around forecasts of fiscal adjustments more than six months ahead are considerably greater. But the calculation has not been done. There would only be 4 years' data to examine, even for the fiscal adjustment one year ahead, and the problem of adjusting for the effects of subsequent policy changes would be great./

Appendix

The Committee's Report claims that insufficient warning was given at the time of the 1984 Autumn Statement and subsequently of the uncertainties associated with the forecast of the prospective fiscal adjustment in 1985-86. But:

i. The text of the Autumn Statement (paragraph 1.7) was quite clear:

"Any estimate of the extent of the fiscal adjustment for 1985-86 is extremely uncertain: it depends on revenue and expenditure estimates, all of which are subject to major uncertainties, in both directions".

ii. In his Oral Statement, the Chancellor said:

"Beyond that, the margin of uncertainty at this stage is very considerable, and the House will understand that the prospect for 1985-86 will need to be reviewed again, before I come to make my Budget judgement next year. ... the best figure that I can put on it /the scope for tax reductions/ at the present time is about £1½ billion."

iii. In his speech to the Sun Life Investment Seminar, the Financial Secretary said, immediately after the sentence quoted by the Committee's Report:

"the margin of error in forecasts at this stage is great ..."

iv. The article by the Chancellor in the Sunday Times of 30 December 1984 (also quoted by the Committee) contained the following:

"(I may add that I wish I were as confident as the Press appears to be that I will have even half the scope for the cuts that they write about)"

OIL REVENUES IN 1985-86

TCSC line (paragraph 20)

"Some doubt about the estimate of North Sea oil revenues, which at £13½ billion for 1985-86, have been valued at a 1.10-1.15 US dollar/pound rate. If sterling remains higher than this, then the estimate of oil revenues is also likely to be too high".

Defensive

Too soon to tell. In addition to inevitable uncertainties about the dollar/sterling exchange rate. also big uncertainties about dollar oil prices and UK oil production. In past few years, estimates of North Sea oil and gas revenues have been too low, as a result of both prices and production turning out higher than expected. Quite possible that oil production will again turn out in top half of range. Much too simple to draw conclusions from only one of the several relevant factors.

By forecasting decline in oil revenues from £13½ billion in 1985-86 to £8½ billion in 1988-89 (FSBR table 2.3 page 9) government already being prudent in its assessment of future oil revenues.

EXCHANGE RATE POLICY

TCSC Line

The report claims that the exchange rate is now of increased importance in policy; and that the reference in the FSBR to "the appropriate combination of monetary growth and the exchange rate needed to keep financial conditions on track" implies a view about the desirability of some level of the rate. The TCSC call on the Government to clear up alleged confusion by admitting there has been a change of policy and explaining what it is.

Positive points

(i) The FSBR (para 2.11) is perfectly clear about the role of the exchange rate. The performance of the target aggregates will continue to be "interpreted in the light of other indicators of monetary conditions. Significant changes in the exchange rate are also important. It will be necessary to judge the appropriate combination of monetary growth and the exchange rate needed to keep financial policy on track: there is no mechanistic formula."

(ii) The FSBR does not refer to the exchange rate needed, but the combination of monetary growth and exchange rate needed.

Defensive point

(iii) Semantic discussion as to whether or not there has been some change of emphasis is sterile. The truth is that the Government has always said that the exchange rate is taken into account in assessing monetary conditions, and that is still the position.

INTEREST RATE POLICY

TCSC line

The report suggests there have been two changes in ~~the~~ interest rate policy:-

(a) It claims that the 1981 monetary control arrangements were that interest rates would be determined by the market, contrasting with recent actions by the Bank of England.

(b) It claims that "as originally articulated, the fundamental justification for the MTFS" was not just to bring inflation down, but by doing so to reduce nominal interest rates bringing benefits for investment and employment; and maintains that the Treasury is now relaxed about high nominal interest rates.

Positive points

(i) The statement in August 1981 announcing the present monetary control arrangements, did not say that rates would be determined by the market. It said that the arrangements were designed to give market forces a greater role in determining short term interest rates.

(ii) The "original" (ie. 1980) MTFS certainly recognised the benefits of lower nominal interest rates, and said that it was not the intention to achieve the planned reduction in monetary growth "by excessive reliance on interest rates". But it made it clear that the central objective was to bring down the rate of inflation through control of the money supply and that "interest rates will be adjusted as necessary in order to achieve the objective."

Defensive

(iii) Clearly lower nominal interest rates are desirable, and to achieve them requires restraint in public expenditure. But reductions in interest rates are not desirable if that means taking risks with inflation. Maintenance of continued downward pressure on inflation is the essential precondition for continued growth.

MONETARY TARGETS

TCSC Line

The report says "we do find it somewhat disconcerting that the monetary aggregate targets change each time a new MTFS is presented."

Positive point

There has been no change in the target aggregates for 1985-86, and indeed the target ranges are the same as provisionally indicated in last year's MTFS. PSL2 and M2 were not targetted in 1984-85. They were given a slightly special role as indicators to be used as checks on £M3 and MO respectively. But as explained in the FSBR (paras 2.04 and 2.05) in practice these aggregates did not prove to contain useful information to complement £M3 and MO. That is why they have been given no special role this year.

NATIONAL INSURANCE CONTRIBUTIONS

TCSC line

(a) The restructuring of NICs will result in 3 'national insurance traps' as there are now 3 earnings limits instead of 1. This means that more people are caught by the traps, and marginal tax rates are unacceptably high.

Positive

The people affected by the change are all better off than before, because their actual contributions have been reduced. Reductions in employers contributions will increase jobs available.

Defensive

[Steps a disincentive to increases in overtime?] This may occur, but the new steps are less severe than the present cliff at £35.50. Those affected will be better off because of lower contributions. To turn the steps into thresholds would cost (on a rough estimate, subject to a wide margin of error) about £4½ billion.

TCSC line

(b) The abolition of upper earnings limit on employers contribution demonstrates that there is no contributory principle on employers contribution.

Positive

'Contributory principle' means that people's entitlement to benefits depends on their contribution record. The employer's contribution confers no benefit rights, so there is no constraint on abolishing the employers' UEL to help promote employment objectives. Employers' contributions vital to <u>finance</u> NI benefits. Employers overall gain more than they lose from NIC restructuring.

TCSC Line

c) "We strongly recommend that any significant future changes in National Insurance arrangements should provide for full debate at all stages"

"The Government notes the Committee's recommendation, but observes that given the pressures on Parliamentary time, it seemed appropriate and reasonable to include in the Social Security Bill measures which required prompt legislation for implementation on schedule, and which, overall, received considerable support from both sides of the House."

H M Treasury
Parliament Street London SW1P 3AG
Switchboard 01-233 3000
Direct Dialling 01-233 3016

A M W Battishill
Under Secretary

W R McKay Esq
Treasury & Civil Service Committee
St Stephen's House
St Stephen's Parade
LONDON SW1

26 April 1985

Dear Bill,

I attach the Government's response to the Committee's Sixth Report on the Government's expenditure plans 1985-86 to 1987-88.

Yours sincerely,

Tony Battishill

A M W BATTISHILL

cc

Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Bailey
Mr Cassell
Mr Monck
Mr Byatt
Mr Odling-Smee
Mr Watson
Mr Monger
Mr Folger
Mr Pratt

THE GOVERNMENT'S EXPENDITURE PLANS 1985-86 TO 1987-88

This memorandum gives the Government's observations on the recommendations contained in the Sixth Report by the Treasury and Civil Service Committee which discussed the public expenditure White Paper (Cmnd 9428).

The Government welcomes the Committee's recognition of the improvements in presentation in the White Paper (paragraph 4) and, as noted in response to the Committee's Second Report on the Structure and Form of Financial Documents, intends to continue making improvements in future.

Cash, Cost and Real Terms.

"If the Treasury are prepared to publish these figures [GDP deflator forecasts for the whole planning period], there seems to us no reason why they could not continue the logic of the change and present as many tables as possible in cost terms or - if that is not possible - place more emphasis on percentage changes in cost-terms information. We so recommend" (paragraph 6)

"We recommend that the Treasury revert to the previous practice of using the phrase "cost-terms" [rather than "real terms"] to denote deflation by the GDP deflator" (paragraph 8).

The phrase "real terms" is used as a generic term in relation to all kinds of constant price calculations. The method of calculation principally in use now in a public expenditure context - and, in the Government's view, the most appropriate method of calculation - is deflation by the projected GDP deflator. Therefore in this context "real" and "cost" have the same meaning. The Government believes that it is generally helpful to adopt the more commonly used term; it will continue to explain the method of calculation clearly.

The Government recognises that there is a significant interest in real terms information. Several tables in Cmnd 9428 therefore present information in real terms. But the primary purpose of the public expenditure White Paper is to present the Government's expenditure plans, which are determined in cash. Because there is no presumption that cash plans would be changed if the GDP deflators were revised, the Government believes that by publishing the plans as they are determined, in cash, and by clearly stating the projected GDP deflators, the right emphasis is placed on the cash plans, whilst enabling real terms figures to be derived from these plans and deflators without extensive duplication of information.

The Government notes the Committee's view that GDP deflators should be given more prominence rather than being mentioned in a footnote and will consider whether a reference in the main text would be more appropriate in future White Papers.

The Government also notes the Committee's desire to see volume-terms information about inputs (paragraph 9). But, as indicated above, the Government is firmly committed to planning public expenditure with inputs in cash terms, and with spending regulated by the available cash resources. On the other hand, the Government believes that the outputs of public expenditure should be measured by the appropriate indicators of output, performance and activity. The Government continues to seek to improve the ways in which these are measured.

Measurement of Output

"We recommend that the need to enhance the scope and consistency of unit costs and performance measures, as set out in the White Paper be given special consideration by the Treasury. The review might include the possibility of presenting in each successive White Paper an analysis of a number of special topics in this area." (paragraph 11).

The Government agrees with the Committee's view that more detailed statements of objectives in the public sector should give rise to improvements in the White Paper and notes the Committee's desire for more unit cost and performance and performance measures. Improvements have been made; the number of output and performance measures in Cmnd 9428 has increased by about 30 per cent to over 700 compared to the 1984 White Paper (Cmnd 9143). Every programme now includes some measures of output, and about half of these either include a comparison with last year or consist of a time series. About 15 per cent of the measures included either set quantifiable targets or give comparisons with previously set targets. But it must be recognised that, given the diversity of public expenditure programmes, complete standardisation may not be achievable.

The Government believes that it is for managers in departments to develop both the statements of objectives and the output and performance measures needed to assess how well the Government's aims and objectives are being met. A good deal of work is under way in departments, as indicated, for example, in the White Paper on the Financial Management Initiative (Cmnd 9297, published in July 1984) to improve information on output and performance. The departmental chapters in Volume II of the White Paper summarise the results of much of this work. More detailed supporting information, however, may more appropriately be published in separate departmental reports.

The Treasury will continue to promote improvements in this area.

The Committee has suggested that the Treasury might present "in each successive White Paper an analysis of a number of special topics in this area". The Government will consider what might be done to meet this suggestion, bearing in mind the need to avoid making an already substantial White Paper too unwieldy. But it may be appropriate, as suggested above, for each Department to publish its more detailed output and performance measures separately, and to include an appropriate cross-reference in the White Paper. It is already the case that the bibliographies in the White Paper cross-refer to analyses of special interest, including departmental reports.

Manpower

We recommend that such a table [showing a single account on a common basis of public service manpower as a whole, either back to 1979-80 or projected forward through the planning period] should be included, together with reference to the costs" (paragraph 12)

As the Committee recognises, there are some areas where manpower figures for the planning period have not been determined and others where manpower numbers are not in general controlled by central Government. Subject to these constraints, the Treasury will consider the practicality of including a composite table covering public service manpower; and how those figures can be related to the information on costs included in the White Paper.

Expenditure planning totals

"We recommend that Chart 1.1 be replaced by a clear and direct comparison of plan and outturn for all years from the beginning of the conventional period, to be set against forecast planning totals" (paragraph 18)

The Government notes the Committee's preference for the way the information is presented in Table 2.1 as opposed to the presentation in Chart 1.1 and will consider further how best to present the plans in the 1986 White Paper.

The Government also notes the Committee's concern about the adequacy of the Reserve of £3 billion for 1985-86 and, more generally, about the viability of the White Paper plans. As the Chief Secretary indicated in his evidence to the Committee (Q322), the expenditure figures in the White Paper were reviewed in the lead up to the Budget and preparation of the 1985 Medium Term Financial Strategy. As a result of that review the Government decided to make adjustments to the planning totals for 1985-86 to 1987-88, by adding £2 billion to the Reserve and to the total in each year. These adjustments reflect a realistic assessment - in the light of a number of significant changes in the economic scene since the 1984 Public Expenditure Survey was completed - of the implications of present policies in major demand-led areas, and the prospects for spending by authorities outside the direct control of central Government.

R3.56

FROM: MRS R LOMAX
DATE: 26 April 1985

gmsp.

MR BATTISHILL

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr Bailey
Mr Cassell
Mr Monck
Mr Culpin
Mr Cropper
Mr H Davies
Mr Lord

TCSC: BUDGET REPORT

The Chancellor has only briefly glanced at Mr Pratt's minute of 25 April on which you had commented in manuscript.

> "This brief is mainly for use after the weekend for the Finance Bill debates. IDT tomorrow can call on it selectively, so long as they take care not to suggest that we have had time to study the report at length and reach a view on all the issues. If, as we are led to believe, there will be at least one recommendation, the Government will have to respond formally in due course."

2. The Chancellor will study the briefing over the weekend. In the meantime he has commented that it is clearly right to avoid giving the impression that we have reached a view on the report at this stage.

RL.

RACHEL LOMAX

From: D R H BOARD

Date: 29 April 1985

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Mr Bailey
Sir T Burns
Mr Cassell
Mr Monck
Mr Watson
Mr Battishill
Mr H Evans
Mr Odling-Smee
Mr Lankester
Mr Peretz
Ms Seammen
Mr Riley
Mr Folger
Mr Culpin
Mr Pratt

On balance, I wd prefer to wait until the formal response, & then ~~Thm~~ Ch. tie in when the debate? Then

Any views?
(a more low-key approach would be to make this point in the Treasury's formal response to the TCSC Report).
KC 29/4

TCSC BUDGET REPORT

Sir Peter Middleton has read Mr Pratt's submission of 26 April. On paragraph 3(i) (the failure of the Committee to take account of the qualifications given at the time about the size of the fiscal adjustment), Sir Peter thinks it might be worth considering a letter from the Chancellor to the Committee. This would help to keep this particular pot boiling.

Douglas Board

D R H BOARD
Private Secretary

3.68

Mrs Lomax

Mr. Board.

We have two months from date of publication ie until 26th June to reply. But, on our usual practice we would reply only to the Committee's recommendations (ie this case, one only, on using the Social Security Bill for the NICs changes). However, the Chancellor's meeting on 17th May is to discuss Autumn Statement issues and we can then raise this question again.

8/5.

for meeting next ~~Friday~~

FROM: MRS R LOMAX

DATE: 8 May 1985

~~bf 16/5~~

PSP

MR BOARD

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Mr Bailey
Sir T Burns
Mr Cassell
Mr Monck
Mr Battishill
Mr Evans
Mr Watson
Mr Odling-Smee
Mr Lankester
Mr Culpin
Mr Pratt

TCSC BUDGET REPORT

The Chancellor has seen your minute to me of 29 April. On balance he would prefer to wait until the formal response and then reply in trenchant terms. He has asked when this is likely to be.

RL

RACHEL LOMAX

1-38

cc PS/CHANCELLOR
SIR P. MIDDLETON
MR LITTLER
MR CASSELL
MR UNWIN
MR LANKESTER
MR LAVELLE
MR BATTISHILL
MR S. MATTHEWS
MR GRAY
MRS DIGGLE

Treasury Chambers
Parliament Street London SW1P 3AG

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

Your reference

Our reference

Date

13 May 1985

Dear Bill,

Thank you for your letter of 7 May in which you referred to a Financial Times article on 4 May, about monetary reform discussions said to have taken place at the Bonn Summit.

The report being prepared by the Group of Ten is in fact not yet complete and was not therefore available for discussion at the Bonn Summit. The intention is that the studies being undertaken by officials should be completed in time for a meeting of Ministers in Tokyo on 21 June. It is probable that a report will be published some time thereafter. When that happens, we shall be glad to draw it to the attention of your Committee.

Yours sincerely

Richard

R PRATT

M2.2

FROM: MISS O'MARA
DATE: 14 May 1985

MR PRATT

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Bailey
Mr Cassell
Mr Monck
Mr Battishill
Mr Watson
Mr Evans
Mr Odling-Smee
Mr Lankester
Mr Peretz
Ms Seammen
Mr Riley
Mr Folger
Mr Culpin

TCSC BUDGET REPORT

The Chancellor was grateful for your minute of 26 April which he had just had the opportunity to read. He has noted that we shall want to be especially robust about the size of the proposed fiscal adjustment.

MOM

MISS M O'MARA

Cropper → PS/Cx
10/6/85

PS/Chancellor.

TCSC

I am advised that:

i) The Committee is meeting at 10·30 today
The Sub Committee " " 4·30 today
The Committee " again on Wednesday.

It is likely that the Committee will both consider, and publish a short statement on, the Treasury's fiscal adjustment paper this week. Possibly after todays meeting, which is mainly about international monetary arrangements. This would, of course, mean publication of the Treasury paper.

The Committee's view may be that if the Treasury declines to publish an estimate for the adjustment, they might get their own advisers to construct one, and they could publish that.

PJ

MONDAY 10 am

pwsp.

FROM: R PRATT
DATE: 12 JUNE 1985

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Littler
Mr Bailey
Mr Anson
Mr Cassell
Mr Watson
Mr Evans
Mr Odling-Smee
Mr Scholar
Mr Lankester
Mr Monger
Mr Lavelle
Mr Folger
Ms Seammen
Mr Riley
Mr Peretz

TCSC REPORT ON THE BUDGET

I attach a draft response to the TCSC report on the Budget, which has been prepared in consultation with MP, EA and ST. Sir Peter Middleton has seen and agreed the draft.

2. Our normal convention, when responding to Select Committe reports, is to comment only on those recommendations specifically addressed to the Government. In their report on the Budget, the TCSC have included only one recommendation - on the handling of legislation to implement National Insurance changes. However, the report also comments in fairly strong terms ("We strongly disagree") on what you said, when giving evidence to the Committee, about the dangers of publishing a forecast fiscal adjustment in the Autumn Statement. The attached draft response, therefore, also comments on this aspect of the Report.

3. One of the advantages of our normal convention is that the absence of any comment on particular points made in Select Committee reports cannot be taken to mean agreement or acquiescence. We do not want our departure from convention on this occasion to jeopardise that advantage and so it might be sensible to make it clear, in a covering letter to the TCSC Clerk, that we are departing from our normal convention solely because of the unusually strong terms in which the remarks about the Autumn Statement fiscal adjustment are made. I attach a possible draft letter to the Clerk, which would be sent from Central Unit.

4. It is slightly peculiar that our response to the report on the Budget covers only two points - handling of National Insurance changes, and whether there should be a fiscal adjustment forecast as part of the Autumn Statement. However, the Committee understand the conventions governing the nature of our response as well as we do. We must assume that they framed their report in the full knowledge that where they make comments but not specific recommendations, they cannot necessarily expect to get a response from the Government.

5. I should be grateful if you would let me know if you are content with the attached draft response, and, in particular, whether you wish to retain the last, square bracketed, sentence, repeating that the Government is considering discontinuing the publication of the forecast fiscal adjustment in the autumn.

Richard Pratt

RICHARD PRATT

DRAFT LETTER FROM CENTRAL UNIT:

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

TCSC REPORT ON THE BUDGET

I attach the Government's observations on the Select Committee's Eighth Report - on the 1985 Budget.

2. The report contained only one recommendation and, of course, the Government's observations include a response to that.

3. However, in paragraphs 16 and 17 of the Report the Committee quotes from the Chancellor's evidence concerning the forecast fiscal adjustment that has in past years been included in the Autumn Statement. The Report says that the Committee "strongly disagree" A with the Chancellor's views that "it might well be sensible to discontinue ~~it~~ [continued publication of the Autumn Statement fiscal adjustment forecast]". Given the terms in which these comments are made, the Government has thought it right to include a reference to this point in their observations on the Select Committe's Report on the Budget.

[RCP]

From: SIR PETER MIDDLETON
Date: 17 June 1985

Chy
As requested.
(You don't get this as your bilateral.) You [illegible] leave the pps, I think.
RE
17/6.

PSP

CHANCELLOR cc Mr Pratt

TCSC REPORT ON THE BUDGET

I doubt whether there is a lot we can do to beef up the draft attached to Mr Pratt's 12 June submission. We could refer to the Committee's own failure to understand the point as shown ... by paragraph 20 of their report (attached). But the quote is not a really good one to use against them; and it would antagonise them greatly. The Press situation was so confused as regards tax cuts that we have failed to turn up any really good quotes.

2. I think I should be inclined to leave the piece as it is; it makes the point pretty clearly and will certainly evoke a lot of Press comment. We could accompany it with a briefing effort to ensure that our point gets over. Meanwhile there is one small change I would suggest to the first paragraph on the second page of the draft reply - namely amending the final sentence to read:

> "This was certainly a factor in the unsettled conditions both in the domestic markets and in the foreign exchange markets earlier this year."

PEM

P E MIDDLETON

Secretary said that it "confirmed that there should be room for further tax cuts in the next Budget".[1] This was followed at the end of the year by an article from the Chancellor in the Sunday Times, which strongly suggested that the forthcoming budget would include tax cuts.[2]

18. At the time, this Committee commented:

> ". . . a smaller fiscal adjustment would be more realistic, since we believe that 1985–86 expenditure is likely to be higher than the Treasury have forecast . . . whereas last year there was little hint of tax cuts in the forthcoming budget, this year when there are greater potential risks for the PSBR projections—because of the situation in the coal fields and the strength of the dollar—this is not the case."[3]

19. We think that it would be quite wrong to make a change of the kind the Chancellor suggests on the basis of this year's experience, since there should be no future difficulty in avoiding the problems which arose this year.

20. The Chancellor made much of the margin of uncertainty of a PSBR forecast made five to six months in advance. Nevertheless, as we noted above, the shortfall on the 1985–86 fiscal adjustment relates to a more cautious approach to the expenditure plans, rather than to any real surprises about underlying levels of revenue and expenditure. On the other hand there is some doubt about the estimate of North Sea oil revenues, which at £13½ billion for 1985–86, have been valued at a 1.10–1.15 US dollar/pound rate. If sterling remains higher than this, then the estimate of oil revenues is also likely to be too high.

21. The Chancellor did not refer to the fiscal adjustment projections included as part of the annual revisions to the MTFS made at the time of the Budget. But we assume that the Chancellor does not intend to remove the fiscal adjustment from the FSBR calculations, since it is difficult to conceive how the MTFS projections could be presented in the absence of the fiscal adjustment figures. If this is in fact the case, it would be irrational to withdraw information already provided on the grounds that the margin of uncertainty over a six-month period is too great, yet at the same time retain the Budget projections for the fiscal adjustment—which extend forward for a number of years.

22. As officials acknowledged, pre-budget submissions from outside groups such as IFS and CAPG etc. are "studied in varying degrees of detail".[4] We believe that submissions of this type cannot be prepared properly unless these organisations have at least some idea—albeit approximate—of the potential scope for new policy initiatives. Indeed a major feature of the TUC's evidence was their concern about the lack of full and open discussion about budget proposals. The General Secretary of the TUC said to us:

> "I think we would like to talk more openly. If I have it right, there is one time you can talk to the Chancellor, and it is probably the worst time in the long term, because you are arguing about what he or she has done . . . before

[1] Speech to Sun Life Assurance Investment Seminar, 19 November 1984.
[2] A Budget for Jobs, The Sunday Times, 30 December 1984.
[3] HC(1984–85)44, First Report from the Treasury and Civil Service Committee, 1984–85, paras 38–40.
[4] Q 156.

R7.78

PSP

FROM: MRS R LOMAX
DATE: 25 June 1985

MR R PRATT

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Bailey
Mr Anson
Mr Cassell
Mr Watson
Mr Evans
Mr Odling-Smee
Mr Scholar
Mr Lankester
Mr Monger
Mr Fitchew
Mr Folger
Ms Seammen
Mr Riley
Mr Peretz

TCSC REPORT ON THE BUDGET

The Chancellor has seen your minute of 12 June. He has made a number of changes which are reflected in the attached redraft of the Treasury's response to the TCSC Budget Report.

...

Rh.

RACHEL LOMAX

DRAFT RESPONSE TO TCSC BUDGET REPORT

This Memorandum gives the Government's response to the Eighth Report of the Treasury and Civil Service Select Committee on the 1985 Budget. It comments on two matters: the Comittee's recommendation as to the appropriate legislative arrangements for handling any future changes in national insurance contributions; and the Committee's response to the Chancellor of the Exchequer's suggestion that the fiscal adjustment might be omitted in future from the Autumn Statement.

"We strongly recommend that any significant future changes in national insurance arrangements should provide for full debate at all stages."

The Government notes the Committee's recommendations. In view of the pressures on Parliamentary time, however, the Government does not accept that it was inappropriate or unreasonable to include in the Social Security Bill then before the House measures announced in the Budget which required early legislation if they were to be implemented by the beginning of October, and which received considerable support from both sides of the House.

"In his evidence before the Committee, the Chancellor suggested omitting the fiscal adjustment in future from the Autumn Statement ...We strongly disagree ... We think that it would be quite wrong to make a change of the kind the Chancellor suggests on the basis of this year's experience, since there should be no future difficulty in avoiding the problems which arose this year."

The prospective fiscal adjustment is a piece of arithmetic which follows from the economic forecast published in the Autumn Statement, assuming the same PSBR as in the Financial Statement and Budget Report published earlier in the year at Budget time. The only information it reveals is essentially a forecast of the putative PSBR, on the basis of the public expenditure plans contained in the Autumn Statement and conventional assumptions about tax rates and allowances, for the following fiscal year. As such, it is of little or no practical value, since the margin of uncertainty is massive and no operational decisions are based upon it.

It is certainly not a guide to the likely scale of tax changes in the Budget. Budget decisions are taken several months later; they are based on later information, including a completely new economic forecast, and reflect decisions about the

appropriate size of the PSBR taken in the context of the review of medium term strategy undertaken at Budget time.

Experience since the fiscal adjustment was introduced in 1982 shows that the published figure is assigned a significance out of all proportion to its very limited value. This year was no exception. It provoked endless and often wild speculation about the likely extent of tax cuts in the Budget. This undoubtedly contributed to the concern in the financial markets about the Government's resolve to maintain sound control of fiscal and monetary conditions, which was a factor in the unsettled conditions in the foreign exchange markets earlier this year.

The Government wholly reject the Committee's view that the problem was exacerbated by insufficient warnings about the extent to which any forecast fiscal adjustment was liable to change. The Committee appear to have overlooked the clear, unambiguous warnings about the extreme uncertainty of the forecast fiscal adjustment which were included both in the Chancellor of the Exchequer's Oral Statement to the House on 12 November and in the printed Autumn Statement, thus:

> "Any estimate of the extent of the fiscal adjustment for 1985-86 is extremely uncertain: it depends on revenue and expenditure estimates all of which are subject to major uncertainties, in both directions. For the public sector as a whole, the flows on either side of the account approach £200 billion." (A.S. para 1.57)

The speech to the Sun Life Assurance Investment Seminar made by the Financial Secretary to the Treasury [reference] and the Chancellor's Sunday Times article [reference] - to which the Committee drew attention - also contained similar clear warnings about the uncertainties underlying the fiscal projections.

The Government has no wish to withhold from Parliament or the public information about the public finances which genuinely assists public understanding and debate. The broad direction of fiscal policy is already indicated in the projections for some years ahead that are included each year in the MTFS. However, given the misunderstandings which have arisen both at home and overseas, it has serious doubts as to whether continued publication of an updated fiscal adjustment in the autumn, based on purely conventional assumptions, genuinely contributes to that process. The Government is therefore seriously considering whether it might be better to discontinue it.

1-1.4

1 ~~Marginal~~
2 ~~Photocopy~~
3 pmp

Treasury Chambers
Parliament Street London SW1P 3AG

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Switchboard 01-233 3000

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

Your reference

Our reference

Date 25 June 1985

Dear Bill

TCSC REPORT ON THE BUDGET

I attach the Government's observations on the Select Committee's Eighth Report - on the 1985 Budget.

2. The report contained only one recommendation and, of course, the Government's observations include a response to that.

3. However, in paragraphs 16 and 17 of the Report the Committee quotes from the Chancellor's evidence concerning the forecast fiscal adjustment that has in past years been included in the Autumn Statement. The Report says that the Committee "strongly disagree" with the Chancellor's views that "it might well be sensible to discontinue it [continued publication of the Autumn Statement fiscal adjustment forecast]". Given the terms in which these comments are made, the Government has thought it right to include a reference to this point in their observations on the Select Committe's Report on the Budget.

Yours,

Richard

RICHARD PRATT

cc Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Sir Geoffrey Littler
Mr Bailey
Mr Anson
Mr Cassell
Mr Watson
Mr Evans
Mr Odling-Smee
Mr Scholar
Mr Lankester
Mr Monger
Mr Fitchew
Mr Folger
Ms Seammen
Mr Riley
Mr Peretz

THE 1985 BUDGET

This Memorandum gives the Government's response to the Eighth Report of the Treasury and Civil Service Select Committee - on the 1985 Budget. It comments on two matters: the Comittee's recommendation as to the appropriate legislative arrangements for handling any future changes in national insurance contributions; and the Committee's response to the Chancellor of the Exchequer's suggestion that the fiscal adjustment might be omitted in future from the Autumn Statement.

"We strongly recommend that any significant future changes in national insurance arrangements should provide for full debate at all stages." (paragraph 45)

The Government notes the Committee's recommendations. In view of the pressures on Parliamentary time, however, the Government does not accept that it was inappropriate or unreasonable to include in the Social Security Bill then before the House measures announced in the Budget which required early legislation if they were to be implemented by the beginning of October, and which received considerable support from both sides of the House.

"In his evidence before the Committee, the Chancellor suggested omitting the fiscal adjustment in future from the Autumn Statement ...We strongly disagree ... We think that it would be quite wrong to make a change of the kind the Chancellor suggests on the basis of this year's experience, since there should be no future difficulty in avoiding the problems which arose this year." (paragraphs 16-19)

The prospective fiscal adjustment is a piece of arithmetic which follows from the economic forecast published in the Autumn Statement, assuming the same PSBR as in the Financial Statement and Budget Report published earlier in the year at Budget time. The only information it reveals is essentially a forecast of the putative PSBR, on the basis of the public expenditure plans contained in the Autumn Statement and conventional assumptions about tax rates and allowances, for the following fiscal year. As such, it is of little or no practical value, since the margin of uncertainty is massive and no operational decisions are based upon it.

It is certainly not a guide to the likely scale of tax changes in the Budget. Budget decisions are taken several months later; they are based on later information, including a completely new economic forecast, and reflect decisions about the

appropriate size of the PSBR taken in the context of the review of medium term strategy undertaken at Budget time.

Experience since the fiscal adjustment was introduced in 1982 shows that the published figure is assigned a significance out of all proportion to its very limited value. This year was no exception. It provoked endless and often wild speculation about the likely extent of tax cuts in the Budget. This undoubtedly contributed to the concern in the financial markets about the Government's resolve to maintain sound control of fiscal and monetary conditions, which was a factor in the unsettled conditions in the foreign exchange markets earlier this year.

The Government wholly reject the Committee's view that the problem was exacerbated by insufficient warnings about the extent to which any forecast fiscal adjustment was liable to change. The Committee appear to have overlooked the clear, unambiguous warnings about the extreme uncertainty of the forecast fiscal adjustment which were included both in the Chancellor of the Exchequer's Oral Statement to the House on 12 November and in the printed Autumn Statement, thus:

> "Any estimate of the extent of the fiscal adjustment for 1985-86 is extremely uncertain: it depends on revenue and expenditure estimates all of which are subject to major uncertainties, in both directions. For the public sector as a whole, the flows on either side of the account approach £200 billion." (A.S. para 1.57)

The speech to the Sun Life Assurance Investment Seminar made by the Financial Secretary to the Treasury on 19 November 1984 and the Chancellor's Sunday Times article[1] - to which the Committee drew attention - also contained similar clear warnings about the uncertainties underlying the fiscal projections.

The Government has no wish to withhold from Parliament or the public information about the public finances which genuinely assists public understanding and debate. The broad direction of fiscal policy is already indicated in the projections for some years ahead that are included each year in the MTFS. However, given the misunderstandings which have arisen both at home and overseas, it has serious doubts as to whether continued publication of an updated fiscal adjustment in the autumn, based on purely conventional assumptions, genuinely contributes to that process. The Government is therefore seriously considering whether it might be better to discontinue it.

[1] 'A Budget for Jobs', The Sunday Times, 30 December 1984

HM Treasury
25 June 1985

Spoken

FROM: ROBERT CULPIN
DATE: 3 JULY 1985
Arrived 4/7

CHANCELLOR

cc Sir P Middleton
Mr Bailey
Sir T Burns
Sir G Littler
Mr Cassell
Mr Wicks
Mr Monaghan
Mr Pratt

PAPERS FOR THE TCSC

When we send papers to the TCSC, they become the property of the Committee. The TCSC publishes them after a delay, sometimes with comments. We control neither the timing nor the context of publication. We cannot even refer journalists to our own papers until the TCSC sees fit to release them.

2. This is ridiculous. Last week's note on whether to publish a fiscal adjustment in the Autumn Statement was designed to put the cat among the pigeons. I wanted to publicise it on our own terms. Yet I discover that we have - by default - left handling to the TCSC.

3. When it suits us, I should like to make papers available to the press at the same time as we send them to the TCSC. We needn't do it every time - some papers are too boring to bother. But it would be sensible to consider the option case by case.

4. I have discussed with Central Unit how best to do it. We are advised that we could not just make things available to the press: that could be a breach of parliamentary privilege. We should have to publish them formally. But that could be done simply through an arranged PQ. The answer need only say that we have sent x to the TCSC and put a copy in the Commons Library.

5. Do you agree that we should consider this, as a matter of course, for future TCSC papers?

I do
RL.
4/7

RC

ROBERT CULPIN

R7.106

pst

FROM: MRS R LOMAX
DATE: 8 July 1985

MR CULPIN

cc Sir P Middleton
Mr Bailey
Sir T Burns
Sir G Littler
Mr Cassell
Mr Wicks
Mr Monaghan
Mr Pratt
Mr Cropper

PAPERS FOR THE TCSC

On Friday the Chancellor discussed your minute of 3 July with Sir Peter Middleton. They agreed that there clearly was a problem with material given to the Select Committee but that the approach suggested in your minute would cause great difficulty with the Committee. They agreed that further thought was needed; in the meantime the only possibilities seemed to be:-

(i) to put pressure on the Committee to publish Treasury evidence by getting backbenchers to table arranged Questions

(ii) to use material given to the Select Committee more freely in Ministerial speeches.

2. On the response to the Budget Report, the Chancellor intends to raise the question of the fiscal adjustment when he addresses the 1922 Committee on 11 July.

RL.

RACHEL LOMAX

Spoken to Mr Higgins.

He is v. much opposed to the fiscal adjustment proposed (surprise! surprise!), will pillory it as retrograde etc etc; But has promised to leave it off of the agenda for the TSC mtg on Mon & to publish it next wk, Xeroxed (rather than printed) to save time.

m

Ch

The clerk to the TCSC rang Nigel back to say he thinks we have a good case for pressing for publication – given the delay – & would advise Higgins accordingly. The Committee's response is already in draft.

So Nigel's option (i) looks a better bet.

Would you like to have a word with Higgins?

RH.
17/7

pse give T Higgins a phone for me.

FROM: N L Wicks
DATE: 17 July 1985

CHANCELLOR OF THE EXCHEQUER

cc CST
FST
EST
MST
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Cassell
Mr Scholar
Mr H P Evans
Mr Odling-Smee
Miss Peirson
Mr Culpin
Mr Cropper
Mr Lord
Mr Davies

PUBLICATION OF TREASURY RESPONSE TO THE TCSC ON THE 1985 BUDGET

The TCSC Clerk has told me that his Committee are most unlikely to publish our Memorandum on The 1985 Budget (including our views on the publication of the fiscal adjustment) before the Recess. Indeed, the Committee may not formally consider the issue before then. The delay is due to their wish to have their advisers' comments. If they do consider the Memorandum before the Recess, it may be published together with any response they wish to make - and the Clerk led me to believe that they will make a response - some time in August.

2. I explored, very tentatively, with the Clerk the possibility of some procedure permitting publication before the Recess. He doubted whether his Chairman would agree to that until the Committee had agreed their own response so that the two documents could be published together. If the Committee did come to an early view on their response, they might agree to place a photocopied version, including our Memorandum, in the Vote Office so as to allow early publication. This was an unusual procedure which would have to be justified through some urgency for publication. The Clerk wondered whether such a case could be made in this instance.

3. There look to be three courses:

(i) you could try to persuade the TCSC Chairman to publish our Memorandum before the Recess. My conversation with the Clerk suggests that the Chairman might resist this, particularly if this involved publication of the Treasury Memorandum without simultaneous publication of the Committee's own views.

X Overtaken see my note

(ii)(a) Though the Committee have control over publication of the text of the Memorandum, they have no copyright, as it were, on the substance of the policy enshrined in the text. You could, therefore, publicise the policy in a speech on some suitable occasion (without mentioning the TCSC interest). Unfortunately, you have no suitable speech occasion before the Recess, and it would be difficult to contrive one for this particular topic at such short notice.

(b) An alternative possibility would be to inspire a PQ, coupled with a Press Release, which would, in effect, ask you about your intentions for publishing an estimate of the fiscal adjustment in the 1985 Autumn Statement. Presumably it should be for Written Answer? But for answer when? Next Thursday when Treasury is first order? Or before or after on Friday? Your answer could deploy the substance of our response to the TCSC. This approach could well annoy the TCSC since they are bound to suspect an inspired Question. But you would ha the perfectly good reply that they should not have delayed publication.

(iii) We could let matters take their course through August. If the Memorandum had still not been published by the end of August and was not expected soon, we could revert to a version of either (i) or (ii)(a) above - ie try to persuade the Chairman to publish early in Sept of find an occasion in September to mention our plan for publication of the fiscal adjustment in a speech, if not in the Edinburgh speech on 20 September, for which I understand you are thinking of a European theme, at a speaking occasion which we could no doubt contrive. This course would enable us to publish our views well before the appearance of the Autumn Statement, which seems essential.

4. We would be grateful for your views.

N.L.W.

N L WICKS

CHANCELLOR OF THE EXCHEQUER

Ch.

You wanted to ask the Whips to orchestrate some backbench support, when the TCSC response is published next week.

KL.

18/7.

VR20

CONFIDENTIAL

FROM: MRS LOMAX
DATE: 18 July 1985

MR WICKS

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Cassell
Mr Scholar
Mr H P Evans
Mr Odling-Smee
Miss Peirson
Mr Culpin
Mr Cropper
Mr Lord
Mr H Davies

PUBLICATION OF TREASURY RESPONSE TO THE TCSC ON THE 1985 BUDGET

Acting on the advice in your minute of 17 July, the Chancellor has spoken to Mr Higgins. Not surprisingly, Mr Higgins is very much opposed to the fiscal adjustment proposal and fully intends to pillory it as retrograde. However, he has promised to have it top of the agenda for the TCSC meeting on Monday and to publish it next week, probably in Xerox form rather than print.

RL.

RACHEL LOMAX

WED PRAYERS

for Prayers folder

FROM: N L Wicks
DATE: 19 July 1985

CHANCELLOR

Ch/
Not ideal, from the
standpoint of
orchestrating backbench
support
RL
19/7

cc PS/CST
PS/FST
PS/EST
PS/MST
PS/Sir P Middleton
Mr Bailey
Sir T Burns
Mr Cassell
Mr Scholar
Mr H P Evans
Mr Odling-Smee
Miss Peirson
Mr Culpin
Mr Cropper
Mr Lord
Mr Davies

PUBLICATION OF TREASURY RESPONSE TO THE TCSC ON THE 1985 BUDGET

The TCSC Clerk telephoned me this morning to say that publication of the Treasury Response will probably be on Friday 26 July.

N.L.W.

N L WICKS

23:3

FROM: C R PICKERING
DATE: 23 July 1985

1. MR WICKS N.L.W. 23-7

2. CHANCELLOR OF THE EXCHEQUER

cc CST
EST
MST
Sir P Middleton
Mr Hannah
Mr Cropper
Mr Lord
Mr H J Davies
CB/01

FIRST ORDER QUESTIONS: TCSC AND THE FISCAL ADJUSTMENT

We checked with the Clerk whether the TCSC report on EMS was being published before First Order Questions on Thursday.

2. It is not. However, the Committee are publishing at 2.30pm on Thursday the Government's observations on their report on the Budget, and the Committee's response on the desirability of publishing a forecast fiscal adjustment in the Autumn Statement.

3. A copy of the Government's observations is attached. On the fiscal adjustment, there are five main points made:

(i) the prospective fiscal adjustment is an arithmetical calculation, revealing principally the putative forecast PSBR in the following financial year. That forecast is subject to a large margin of error.

(ii) The fiscal adjustment is no guide to the scale of likely Budget tax changes.

(iii) The fiscal adjustment attracts a lot of, often very wild, comments, which can unsettle the financial markets, as they did in 1985.

(iv) Ministers gave clear unambiguous warnings about the extreme uncertainty of the forecast fiscal adjustment which were included both in the Chancellor of the Exchequer's Oral Statement to the House on 12 November and in the printed Autumn Statement.

(v) The Government is considering whether to discontinue the publication of the fiscal adjustment.

4. If Treasury Ministers are asked at First Order Questions about the TCSC's response to these points, it is clearly reasonable to respond that, since it has only just been published, you have no substantive comment to make.

pp KVenn

C R PICKERING

THE 1985 BUDGET

This Memorandum gives the Government's response to the Eighth Report of the Treasury and Civil Service Select Committee - on the 1985 Budget. It comments on two matters: the Comitee's recommendation as to the appropriate legislative arrangements for handling any future changes in national insurance contributions; and the Committee's response to the Chancellor of the Exchequer's suggestion that the fiscal adjustment might be omitted in future from the Autumn Statement.

"We strongly recommend that any significant future changes in national insurance arrangements should provide for full debate at all stages." (paragraph 45)

The Government notes the Committee's recommendations. In view of the pressures on Parliamentary time, however, the Government does not accept that it was inappropriate or unreasonable to include in the Social Security Bill then before the House measures announced in the Budget which required early legislation if they were to be implemented by the beginning of October, and which received considerable support from both sides of the House.

"In his evidence before the Committee, the Chancellor suggested omitting the fiscal adjustment in future from the Autumn Statement ...We strongly disagree ... We think that it would be quite wrong to make a change of the kind the Chancellor suggests on the basis of this year's experience, since there should be no future difficulty in avoiding the problems which arose this year." (paragraphs 16-19)

The prospective fiscal adjustment is a piece of arithmetic which follows from the economic forecast published in the Autumn Statement, assuming the same PSBR as in the Financial Statement and Budget Report published earlier in the year at Budget time. The only information it reveals is essentially a forecast of the putative PSBR, on the basis of the public expenditure plans contained in the Autumn Statement and conventional assumptions about tax rates and allowances, for the following fiscal year. As such, it is of little or no practical value, since the margin of uncertainty is massive and no operational decisions are based upon it.

It is certainly not a guide to the likely scale of tax changes in the Budget. Budget decisions are taken several months later; they are based on later information, including a completely new economic forecast, and reflect decisions about the

appropriate size of the PSBR taken in the context of the review of medium term strategy undertaken at Budget time.

Experience since the fiscal adjustment was introduced in 1982 shows that the published figure is assigned a significance out of all proportion to its very limited value. This year was no exception. It provoked endless and often wild speculation about the likely extent of tax cuts in the Budget. This undoubtedly contributed to the concern in the financial markets about the Government's resolve to maintain sound control of fiscal and monetary conditions, which was a factor in the unsettled conditions in the foreign exchange markets earlier this year.

The Government wholly reject the Committee's view that the problem was exacerbated by insufficient warnings about the extent to which any forecast fiscal adjustment was liable to change. The Committee appear to have overlooked the clear, unambiguous warnings about the extreme uncertainty of the forecast fiscal adjustment which were included both in the Chancellor of the Exchequer's Oral Statement to the House on 12 November and in the printed Autumn Statement, thus:

> "Any estimate of the extent of the fiscal adjustment for 1985-86 is extremely uncertain: it depends on revenue and expenditure estimates all of which are subject to major uncertainties, in both directions. For the public sector as a whole, the flows on either side of the account approach £200 billion." (A.S. para 1.57)

The speech to the Sun Life Assurance Investment Seminar made by the Financial Secretary to the Treasury on 19 November 1984 and the Chancellor's Sunday Times article[1] - to which the Committee drew attention - also contained similar clear warnings about the uncertainties underlying the fiscal projections.

The Government has no wish to withhold from Parliament or the public information about the public finances which genuinely assists public understanding and debate. The broad direction of fiscal policy is already indicated in the projections for some years ahead that are included each year in the MTFS. However, given the misunderstandings which have arisen both at home and overseas, it has serious doubts as to whether continued publication of an updated fiscal adjustment in the autumn, based on purely conventional assumptions, genuinely contributes to that process. The Government is therefore seriously considering whether it might be better to discontinue it.

[1] 'A Budget for Jobs', The Sunday Times, 30 December 1984

HM Treasury
25 June 1985

FROM: N L Wicks
DATE: 23 July 1985

CHANCELLOR OF THE EXCHEQUER

cc CST
FST
MST
EST
Sir P Middleton
Mr Bailey
Mr Anson
Sir T Burns
Sir G Littler
Mr Lavelle
Mr Cassell
Mr Monger
Mr Peretz
Mr Sedgwick
Mr Fitchew
Mr Edwards
Mr H P Evans
Mr Odling-Smee
Mr Scholar
Miss Peirson
Mr Kelly
Mr Culpin
Mr Cropper
Mr Lord
Mr Davies

Ch/ You asked the whips to orchestrate some backbench support on the fiscal adjustment

RL
23/7

Thanks. Discuss @ prayers.

TIMETABLE FOR PUBLICATION OF THE TCSC REPORTS

The Clerk told me this morning that the Committee have now definitely decided to publish at 2.30 pm on Thursday 25 July:

their observations on

- departmental basis of the Public Expenditure White Paper
- treatment of receipts in the Supply Estimates
- the 1985 Budget (ie publication of the fiscal adjustment).

The first two reports are technical and will raise virtually no interest. The third, in which we set out our views on publication of the fiscal adjustment, will attract interest. The 2.30 pm publication will enable you to avoid questions at

if you want – (you may not)

PQs on the grounds that you have not yet seen the report, though you can, of course, refer to our own observations. We will provide briefing. (The Clerk is not sending out advance copies of the Committee's Reports).

2. The Committee's Report on international monetary arrangements has been agreed and will be published on Wednesday 11 September, with CFRs on 9 September. Their Report on the EMS has not been agreed, partly because transcripts of evidence are not available. The Clerk thinks that the draft text shown to us may have to be completely rewritten.

N. L. W.

N L WICKS

CHANCELLOR OF THE EXCHEQUER

R/

Nigel Wicks thought No. 10 ought to have some briefing on publ'n of the fiscal Adjustm't.

Was Ch/Ex content with the briefing below? If so, we cd either send this to Andrew Turnbull as it stands — or, if you prefer, Craig Pickering can adapt it a bit.

T.

FROM: N L Wicks
DATE: 24 July 1985

MRS LOMAX

cc CST
FST
MST
EST
Sir P Middleton
Sir T Burns
Mr H P Evans
Mr Odling-Smee
Mr Scholar
Miss Peirson
Mr Culpin
Mr Salveson
Mr Cropper
Mr Lord
Mr Davies

Ch/ I gather the whips have lined up Sir P Hordern. Nigel suggests we might also pass this to Michael Portillo (see his Warrington speech, which makes some good additional points) If you are content, I will forward to Peter Lilley (or Major?) RL 24/7.

OK as slightly amended: pse ask John Major to activate Michael Portillo. L

BRIEFING ON THE CASE AGAINST PUBLICATION OF THE FISCAL ADJUSTMENT IN THE AUTUMN

Following our talk this morning, I now attach some briefing for use by those friendly to the Treasury's case.

2. Mr Pickering will submit tomorrow afternoon any further briefing necessary in the light of the TCSC's reply.

N.L.W.

N L WICKS

THE CASE AGAINST PUBLICATION OF THE SIZE OF THE ASSUMED FISCAL ADJUSTMENT IN THE AUTUMN STATEMENT

FACTUAL

1. The Chancellor told the TCSC on 3 April that in the light of experience, publication of the assumed fiscal adjustment in the Autumn Statement was not a helpful practice and it might well be sensible to discontinue it. This followed unhelpful and unfounded speculation around the turn of the year by commentators and the markets about the size of tax reductions.

2. The TCSC, in their report on the 1985 Budget, argued that it would be quite wrong to omit estimates of the fiscal adjustment and that "... there should be no future difficulty in avoiding the problems which arose this year."

3. The Treasury, in a reply sent to the TCSC on 25 June, set out at greater length why it was seriously considering whether it might be better to discontinue the practice of continued publication of an updated fiscal adjustment in the Autumn.

POSITIVE

1. The prospective fiscal adjustment is a piece of arithmetic which follows from the economic forecast published in the Autumn Statement, assuming unchanged tax rates, indexation of allowances and thresholds, and the same PSBR as in the Financial Statement and Budget Report published earlier in the year at Budget time. It has little or no practical value since the margin of uncertainty is massive and no operational decisions are based upon it.

2. It certainly is not a guide to the likely scale of tax changes in the Budget. Budget decisions are taken several months later, based on later information, a completely new economic forecast and reflecting decisions about the appropriate size of the PSBR taken in the context of the review of the medium-term strategy undertaken at Budget time.

3. Experience since the fiscal adjustment was ~~introduced~~ first published in the 1982 Autumn Statement shows that ~~the published figure~~ it is assigned a signficance out of all proportion to its very limited value. Experience

(been publishing FA's in the MTFS since 1980) this year was no exception. Despite copious health warnings (see next paragraph), it provoked endless and often wild speculation about the likely extent of tax cuts in the Budget. This undoubtedly contributed to the concern in the financial markets about the Government's resolve to maintain sound control of fiscal and monetary conditions, which was a factor in the unsettled conditions in the foreign exchange markets earlier this year.

4. The Government made absolutely clear the enormous margins of uncertainty involved in calculation of the fiscal adjustment. For example, in the printed Autumn Statement.

> "Any estimate of the extent of the fiscal adjustment for 1985-86 is extremely uncertain: it depends on revenue and expenditure estimates all of which are subject to major uncertainties, in both directions. For the public sector as a whole, the flows on either side of the account approach £200 billion."

~~And in the Financial Secretary's speech to the Sun Life Assurance Investment Seminar on 19 November 1984:~~

> ~~"The margin of error in forecasts at this stage is great, [but at the moment we believe we could reduce the burden of tax by about £1½ billion for the 1985-86 year.]"~~

[illegible] helpful

And in the Chancellor's Sunday Times article on 30 December 1984 when he said:

> "(I may add that I wish I were as confident as the press appear to be that I will have even half the scope for tax cuts that they write about)".

5. But as the Chancellor told the TCSC on 3 April:

> "...nobody took the slightest interest in the health warning: all they did was to latch onto the figure

and then it was thought that this was to be the objective, come what may, and all sorts of false conclusions were drawn..."

6. Thus, there is a strong case to discontinue publication of the updated fiscal adjustment in the autumn.

DEFENSIVE

1. The Government has no wish to withhold from Parliament or the public information about the public finances which, unlike the updated fiscal adjustment, does genuinely assist public understanding and debate. Indeed, there has been considerable improvement of information published by this Government about the public finances eg in the Public Expenditure White Papers, and in the Autumn Statement itself. The Government hopes to continue with these improvements.

1. ~~Rachel~~
2. PWP

From: K F MURPHY

Date: 24 July 1985

MR CULPIN

cc PPS
Mr Bailey
Sir T Burns
Sir G Littler o/r
Mr Cassell
Mr Wicks
Mr Cropper

TIMETABLE FOR PUBLICATION OF TCSC REPORTS

Sir Peter Middleton has seen Mr Wicks' submission of 23 July to the Chancellor. He has commented that, so far as publication of the TCSC's 1985 Budget Report is concerned, he assumes that you will be able to use the opportunity this provides to obtain some press comment on our position over the inclusion of the fiscal adjustment in the Autumn Statement.

K F Murphy

K F MURPHY
Private Secretary

[Mr. Michael Portillo]

given to witchcraft. Recently, my right hon. Friend the Chancellor of the Exchequer referred to the belief that public expenditure could cure all our ills as

"an ancient form of witchcraft."

I assure my right hon. Friend that nowadays the good people of Winchmore Hill are no more attracted to that practice than their near neighbours in Palmers Green or Cockfosters.

Frequently, when discussion in the House turns to public expenditure, a number of hon. Members wonder whether they can improve on the traditional procedures by which they consider the revenue that the Government raise at one time of the year, in the Budget, and how that money is spent at another time of the year, in the autumn round of discussions. The Armstrong committee considered that matter in 1980 and came forward with a series of proposals for bringing the consideration of taxation and spending together. The proposal was considered by the Treasury and Civil Service Select Committee and the Select Committee on Procedure (Finance). The Government went some way towards meeting the point by devising the "Autumn Statement" in the form in which we now know it.

In its present form, the "Autumn Statement" has given rise to a number of unforeseen difficulties. Public and press attention naturally focus on that part of the "Autumn Statement" in which the Government say how they view the prospective fiscal adjustment in the following Budget —whether they consider that taxation is likely to be increased or decreased. During the past two years we have seen that, whatever the Government say, the results can be unfortunate. In November 1983 the Government announced that the prospect was for a moderate increase in taxation in the following Budget. The Government were denounced for being too gloomy. People asked whether the Government were still committed to their policy of cutting taxation. In the event, all that gloom was unnecessary, because the Government were able to decrease taxes in the Budget.

Last November, the Government said that the prospect was for a decrease in taxation in the Budget, but that statement brought denunciation on the Government. At first people said, "The Government have underestimated how much money there is to give away in the Budget." People thought that the Government were being too cautious. Subsequently, the Government were denounced for having thrown caution to the wind. It appeared that the Government were more determined to cut taxation than to continue their fight against inflation.

No one can reliably estimate in the autumn the leeway that the Government will have in the spring. Whatever figure is announced, it either increases or depresses expectations. More importantly, it creates confusion about the Government's policy. Sometimes that can have serious consequences.

Our present arrangements are an uneasy halfway house between our traditional procedures and the radical proposals in the Armstrong report. This middle position does not satisfy those hon. Members who want a thoroughgoing reform. On the other hand, it sets a number of hares running about in a way that is not helpful to the Government or to the House. I cannot help thinking that the present position is likely to prove unstable and that we shall want to move either forward towards the Armstrong proposals or backward to the position in the old days when the Chancellor said very little in advance of his Budget statement.

May I use the opportunity of my maiden speech, Mr. Speaker, to make a point that concerns the relationship between public expenditure and unemployment? I am reminded of what happened to me last year at the Conservative party conference in Brighton. At about 2 am on what proved to be that terrible morning of 12 October, I was standing in the bar of the Grand hotel. Because the hour was late I got into a heated discussion with a journalist. He said, "The Government's policies are designed to create unemployment." Of course, I disagreed with that. The discussion became heated. To emphasise his point, the journalist beat the pillar beside us with his fist and said, "This is a pillar; that is a fact. Your policies are to create unemployment; that is a fact, too." The discussion became even more acrmonious and the journalist rather abusive, so I left the Grand hotel and went safely to bed in my hotel down the road.

In the morning I reflected on two things. First, I was grateful to that journalist for having been abusive towards me; otherwise I might have stayed in the Grand hotel and been there at the time the bomb went off. Secondly, I reflected on the fact that the pillar which he had thumped with his hand and which represented for him absolute certainty was probably a pile of rubble. I thought that, in the light of day, the journalist, too, was a little less certain about the motives of Government policy.

Although I understand that the Opposition believe with absolute conviction that the way to reduce unemployment is to increase public spending, I ask them to understand the absolute sincerity with which Conservative Members say that to increase public spending is to increase taxation which would lead to fewer jobs and higher unemployment.

6.8 pm

Mr. Richard Wainwright (Colne Valley): It is a great pleasure to congratulate warmly the hon. Member for Enfield, Southgate (Mr Portillo) on an admirable maiden speech. I am sure that hon. Members on both sides of the House who had the pleasure of listening to him agree that he was eloquent, confident and witty. As one who took a humble part in the election which brought the hon. Gentleman to the House, I thought that he was as agile in marshalling his presentation this afternoon as he was during the campaign in dealing with the garden gates and garden paths of Southgate. I do not want the hon. Gentleman to be alarmed. I have no intention of carrying that congratulation to the lengths that were applied earlier to his colleague and hon. Friend the Member for Enfield, North (Mr. Eggar), was who was described as winsome. That is a compliment that I shall spare the hon. Member for Southgate.

I understand that one consequence of the hon. Gentleman's election to the House is that the Conservative party has lost his expert assistance in its back rooms. But it has gained an expert Back Bencher, who may not remain a Back Bencher for long if his party returns to power during his tenure of the Enfield, Southgate seat. I am sure that we all look forward to hearing a great deal more from him and also to discovering in his later speeches whether he is in favour of advance to a green Budget, or whether he wants to go back to the bad old days which were so warmly greeted by the Conservative party antiquarians when he mentioned them in his speech.

health warnings (see next paragraph), it provoked endless and often wild speculation about the likely extent of tax cuts in the Budget. This undoubtedly contributed to the concern in the financial markets about the Government's resolve to maintain sound control of fiscal and monetary conditions, which was a factor in the unsettled conditions in the foreign exchange markets earlier this year.

4. The Government made absolutely clear the enormous margins of uncertainty involved in calculation of the fiscal adjustment. For example, in the printed Autumn Statement:

> "Any estimate of the fiscal adjustment for 1985-86 is extremely uncertain: it depends on revenue and expenditure estimates all of which are subject to major uncertainties, in both directions. For the public sector as a whole, the flows on either side of the account approach £200 billion."

delete FST: inference

And in the Chancellor's Sunday Times article on 30 December 1094 when he said:

> "(I may add that I wish I were as confident as the press appear to be that I will have even half the scope for tax cuts that they write about)".

5. But as the Chancellor told the TCSC on 3 April:

> "...nobody took the slightest interest in the health warning; all they did was to latch on to the figure and then it was thought that this was to be the objective, come what may, and all sorts of false conclusions were drawn..."

6. Thus, there is a strong case to discontinue publication of the updated fiscal adjustment in the autumn.

DEFENSIVE

The Government has no wish to withhold from Parliament or the public information about the public finances which, unlike the updated fiscal adjustment, does genuinely assist public understanding and debate. Indeed, there has been considerable improvement of information published by this Government about the public finances, eg in the Public Expenditure White Papers, and in the Autumn Statement itself. The Government hopes to continue with these improvements.

VR31

Copies: Mr Culpin / Mr Ridley (changes only)

THE CASE AGAINST PUBLICATION OF THE SIZE OF THE ASSUMED FISCAL ADJUSTMENT IN THE AUTUMN STATEMENT

FACTUAL

The Chancellor told the TCSC on 3 April that in the light of experience, publication of the assumed fiscal adjustment in the Autumn Statement was not a helpful practice and it might well be sensible to discontinue it. This followed unhelpful and unfounded specualtion around the turn of the year by commentators and the markets about the size of tax reductions.

2. The TCSC, in their report on the 1985 Budget, argued that it would be quite wrong to omit estimates of the fiscal adjustment and that "...there should be no future difficulty in avoiding the problems which arose this year."

3. The Treasury, in a reply sent to the TCSC on 25 June, set out at greater length why it was seriously considering whether it might be better to discontinue the practice of continued publication of an updated fiscal adjustment in the Autumn.

POSITIVE

The prospective fiscal adjustment is a piece of arithmetic which follows from the economic forecast published in the Autumn Statement, assuming unchanged tax rates, indexation of allowances and tax bands, and the same PSBR as in the Financial Statement and Budget Report published earlier in the year at Budget time. It has little or no practical value since the margin of uncertainty is massive and no operational decisions are based upon it.

2. It certainly is not a guide to the likely scale of tax changes in the Budget. Budget decisions are taken several months later, based on later information, a completely new economic forecast and reflecting decisions about the appropriate size of the PSBR taken in the context of the review of the medium-term strategy undertaken at Budget time.

X 3. Experience since the fiscal adjustment was first published in the 1982 Autumn Statement shows that it is assigned a significance out of all proportion to its very limited value. Experience this year was no exception. Despite copious