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Prime Minister

I believe much of this is niggling and unjustifiably negative. But I think you should read: I have marked the key passages.

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HOUSE OF COMMONS

Second Report from the

TREASURY AND CIVIL SERVICE COMMITTEE

1979-80

THE BUDGET AND THE GOVERNMENT'S EXPENDITURE PLANS 1980-81 to 1983-84

Together with the Proceedings of the Committee, the Minutes of Evidence and Appendices.

Ordered by the House of Commons to be printed 30th April 1980

584

The Treasury and Civil Service Committee is appointed under S.O. No. 86A to examine the expenditure, administration and policy of the Treasury, the Civil Service Department, the Board of Inland Revenue, and the Board of Customs and Excise and associated public bodies, and similar matters within the responsibilities of the Secretary of State for Northern Ireland.

The Committee consists of a maximum of eleven members, of whom the quorum is three. Unless the House otherwise orders, all Members nominated to the Committee continue to be members of the Committee for the remainder of the Parliament.

The Committee has power:

(a) to send for persons, papers and records, to sit notwithstanding any adjournment of the House, to adjourn from place to place, and to report from time to time;

(b) to appoint persons with technical knowledge either to supply information which is not readily available or to elucidate matters of complexity within the Committee's order of reference.

The Committee has power to appoint one sub-committee and to report from time to time the minutes of evidence taken before it. The sub-committee has power to send for persons, papers and records, to sit notwithstanding any adjournment of the House, and to adjourn from place to place. It has a quorum of three.

MONDAY 26TH *NOVEMBER* 1979

The following were nominated as members of the Treasury and Civil Service Committee:

Mr Kenneth Baker
Mr Anthony Beaumont-Dark
Dr Jeremy Bray
Mr Edward du Cann
Mr Timothy Eggar
Mr Michael English
Mr Terence Higgins
Mr Robert Sheldon
Mr Richard Shepherd
Mr Richard Wainwright
Mr Ken Woolmer

Mr Edward du Cann was elected Chairman on 29 November 1979.

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Second Report

The Treasury and Civil Service Committee have agreed

to the following Report:

THE BUDGET AND THE GOVERNMENT'S EXPENDITURE PLANS

1980-81 to 1983-84

Scope of this Report

1. This report has had to be prepared promptly after we completed taking oral evidence from the Chancellor of the Exchequer on 28th April so that we could publish to the House in time for the debate on the Public Expenditure White Paper (Cmnd 7841) and for the Second Reading of the Finance Bill.

2. The Government's main objectives, as described in the Financial Statement and Budget Report 1980-81, are to reduce inflation and to create conditions in which sustainable economic growth can be achieved. The Committee endorses these objectives. To this end, the government has set out a declining path for the rate of growth of the money stock (measured at present in terms of sterling M3) from 7-11% in 1980-81 to 4-8% in 1983-84. The Government has stated that there is no question of departing from this money supply policy, which it considers essential to the success of any anti-inflationary strategy. Since we will shortly be embarking on a wide ranging enquiry into monetary policy we do not in this report examine this firm conviction of the Government that limiting the money supply must be the main pillar of policy and that there are certain definite relationships between the PSBR, the money supply, inflation and economic growth. We plan to report on these crucial aspects of monetary policy at a later date. Here we have concentrated on the following four main areas:-

(a) The need for more information about the assumptions on which policy is based;
(b) Output and Unemployment;
(c) Public Expenditure and Revenue estimates;
(d) The outlook for the corporate sector.

(a) The need for more information about economic policy assumptions

3. In this year's Financial Statement and Budget Report the prospects for expenditure and revenue for the next four years have been brought together. While we question below the plausibility and consistency of some of the assumptions on which the Government is basing its policies, we welcome this development, which was recommended by the former Expenditure Committee in its Report in 1979[1] on the Government's Expenditure Plans (Cmnd 7439).

4. We questioned Treasury officials before our discussion with the Chancellor. Our purpose was to establish a basis of fact from which to develop our questioning. On several occasions officials said they were unable to answer our questions on grounds of confidentiality. As a result, this process was not as successful as we would have wished. Also it was a surprise to the Committee that the Chancellor laid such heavy stress on the need for confidentiality in his opening statement to the Committee. We understand the difficulties of the Bank of England, as the Governor described them to us, and are sympathetic to his view that it will be necesary for him on occasion to respond to the Committee's enquiries with discretion, having regard to the role of the Bank of England, and to the need for reticence about potentially market sensitive information. There may also be occasions when the Chancellor or Treasury officials find it difficult to expand in public on various subjects when there are similar considerations. Furthermore, the Committee sympathised with the Chancellor when he drew our attention to the dangers that may result if his comments at any time on politically sensitive and topical matters (e.g. unemployment) are taken out of context. The Committee appreciates the inevitable uncertainty of forecasts and the tentative nature of assumptions, and the need to take such uncertainties into account in deciding policy. It is only to be expected that a Select Committee of the House which includes in its membership of 11 no fewer than 5 former Ministers, including 3 former Treasury Ministers, would readily understand these points and guard against them.

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1 Fourth Report, Expenditure Committee 1978-79, HC237

5. It remains the responsibility of the Committee to do its best to see that Parliament, and through Parliament the nation, is better informed about economic matters, about the judgements of Ministers and why they are made. The Leader of the House gave the undertaking when the new departmentally-related Select Committees were set up that Ministers would make every effort to ensure that the fullest possible information is made available to the Committee[1]. It is the responsibility of the Committee continuously to monitor the work of the Treasury in its management of the economy, and to report to the House as it thinks appropriate. To do this it is necessary for the Committee itself to be properly informed not only about policy but about the reasons why policy decisions are made and the information available to Ministers on which they are based. We are fortunate in being advised by Dr. Alan Budd, Dr. Paul Neild and Mr. Terry Ward, to whom we would wish to pay a tribute. Their guidance and help is greatly appreciated. We also had useful papers from the National Institute and the Economist Intelligence Unit which are published with the evidence. We have in fact received ample material from our own advisers and other sources to enable us to make our own judgements. But that is not the point. It must be right for the Committee to be made aware of the basic information upon which the judgements of Ministers are made and the Committee must be put in a position to discover any gaps in the official calculations. Without this it will not be possible to comment on Ministers' judgements in a way that will invariably be fair to those who make them. Nor will it be possible consistently to give to the House of Commons the advice which the House will rightly expect to receive. We endorse the comments of our Chairman, made in reply to the Chancellor's observations, that Governments tend to be obsessive about secrecy.[2] The Commitee therefore intends to discuss further with the Chancellor ways of ensuring that our work is not hampered on future occasions.

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1. Official Report, 25 June 1979, col. 45.
2. Q.344

6. We also had considerable difficulty in assessing the feasibility of the Government's expenditure plans up to 1983-84, as the White Paper does not provide a break-down by economic category, or indeed other details, of the totals of expenditure after 1980-81. "Breakdown by economic category" is a technical phrase which covers the difference between, for example in the case of housing, raising rents and not building subsidised houses. Both cut public expenditure as it is defined but one affects the price index and the other affects employment in the building industry. Other examples could, of course, be chosen: the point is that without the table it is impossible for the House to assess the economic implications of these reductions in public expenditure, for employment, for investment and so on. We were even told by Treasury witnesses that no table showing this breakdown existed.[1] Thus it is quite impossible to assess the major programmes, such as housing and the external financing requirements of the nationalised industries, on which the whole expenditure strategy largely depends. This breakdown has been supplied in previous White Papers. Para 6, page 4 of the White Paper suggests that this information, which we would regard as essential for our assessment of all expenditure plans, is not likely to be provided in the future. This would be a major retrograde step.

7. Although the method of presentation of White Papers on Expenditure has varied somewhat over the years there has been a clear trend towards providing more information. We are therefore disappointed that without previous announcement and without consultation with the House it should have been arbitrarily decided to abandon the customary practice of forecasting expenditure in broad detail for some years ahead. Forecasting expenditure - or indeed anything else - has always been hazardous. The Chancellor in his evidence to us, suggested that such forecasts would include a catalogue of meaningless figures[2]. We do not agree. We believe that the arguments advanced by Plowden in favour of giving the House of Commons and the nation more rather than less information about future spending plans are as valid now as they were at the time they were advanced. This applies in particular to capital expenditure, where projects take a number of years to complete and often a long interval between the initial decision being taken and the bulk of the expenditure being incurred. We trust that the policy of spelling out the Government's expenditure plans in some detail will be restored next year.

1. Q. 72
2. Q.392

(b) Output and Unemployment

(i) Output

8. The assumption about output growth used to construct projections of Government revenue and expenditure is that GDP will increase by an average of 1 per cent a year from 1980 onwards. This is said to be a 'deliberately cautious' assumption (Financial Statement, para.9, p.18). When combined with the government's short-term forecast of a fall in GDP of 2½% in 1980, it implies that real output will be only marginally higher in 1983 than in 1979.

9. However, the Treasury has made it clear to us that it regards the assumption of 1% per annum growth in the years following 1980 as not having the same status as a forecast. Much has been made of this distinction between an assumption and a forecast. It is still permissible to question the validity of an assumption just as it is the likely accuracy of a forecast. It is in this sense that the Committee puts forward its views whether this particular assumption is realistic.

10. Our advisers suggest that, far from being "cautious", this assumption may well turn out to be optimistic, especially since it implies a major turn round in the economy from mid-1981 onwards. Thus the short-term forecast envisages GDP falling by 2½ per cent in 1980 and continuing to fall in the first half of 1981. Although no information is given in the Financial Statement on the assumed year-to-year growth path from then onwards, the Treasury suggested in evidence that output would need to increase by 2 per cent or slightly more in 1982 and 1983.[1] We were provided with little convincing evidence as to why a turn-round of this size should take place and it sems to depend to a significant extent on world trade growing at a much higher rate over the medium-term than over the short-term[2].

11. Yet output growth of at least this rate is crucial if there is to be scope for tax reductions or increases in expenditure in future years. The figures presented in the Financial Statement suggest that there could be a fiscal adjustment of £3½bn at 1978-79 prices in 1983-84 (table 9, page 19, Financial Statement). It only takes a small reduction in the growth of GDP below the 1% assumed by the Treasury to eliminate the scope for this adjustment in the years up to 1983-84.

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1. Q.92
2. Q.97

12. The apparent implications of the assumed growth in GDP for the growth of the different sectors of the economy merit comment. Slightly less than ½% of the 1% a year growth in GDP consists of the growth in oil production.[1] According to Treasury officials, manufacturing output could be expected to fall by ½ per cent a year, on the basis of its past relationship to GDP. If there is also a decline in public expenditure as is planned, this means that there would have to be a significant growth of the private service sector[2] in order to achieve an overall growth in GDP of the rate assumed. It is open to question event whether private services will be able to absorb the additional unemployment resulting from a decline in manufacturing output and in the public sector.

13. The prospects for manufacturing industry are particularly depressing. It was stated in evidence to the Committee that manufacturing output was estimated to decline by about 4½% in 1980[3], which with an average fall of ½ per cent a year over the next three years, would imply that manufacturing production might be over 6 per cent lower in 1983 than in 1979.

(ii) Unemployment

14. Although the Treasury does not provide forecasts of unemployment some assumptions have to be made in order to estimate future expenditure on social security benefits and other variables. The assumption adopted in the White Paper is that registered unemployment increases to 1.8 million in 1981-82 and then remains at that level up to 1983-84. The Treasury declined to state the basis upon which this assumption was made. The Chancellor stated that the figures in the White Paper were internally consistent. However he also confirmed that, because of the differences in dates of preparation, there was not a common set of assumptions between the White Paper and the Financial Statement. In particular he agreed that the implications for unemployment of the growth rates assumed in the medium-term strategy might be higher than the level assumed in the White Paper.[4] Our advisers estimated that registered unemployment could lie between 2.2 and 2.5 million by 1983. Higher unemployment means higher expenditure on social security benefits and, whether this is financed through higher National Insurance contributions or through general taxation, the scope for tax reductions in future years will be significantly lower than appears in the medium-term strategy if the PSBR targets are to be met.

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1. Q.15
2. Q.204
3. Q.10
4. Q.495

(c) Public Expenditure and Revenue estimates

15. The Government is planning a radical change in direction. Expenditure on defence, law and order, health and social security is to rise over the survey period while the plans for industry, energy, trade and employment, housing, education, and the nationalised industries' borrowings are substantially reduced. Overall the White Paper states that the Government intends to reduce total public expenditure progressively in volume terms over the next 4 years to a level in 1983-84 about 4% lower than in 1979-80. Expenditure in 1982-83, which was the last year covered by the previous Government's White Paper (Cmnd. 7439) is planned to be 11½% lower than those plans indicated. This is a reduction of £9 billion at 1979 survey prices.

16. In our discussions with the Chancellor and the Treasury on the medium-term estimates for public expenditure, we were principally concerned to ask questions about:

(i) nationalised industry finances;
(ii) housing;
(iii) public sector pay;
(iv) the relative price effect;
(v) the balance between capital and current spending.

We discuss these below in order. It was plain to the Committee that much of the assumed reduction in public expenditure over the medium-term was to be derived from an improvement in the position of the nationalised industries' finances and from a reduction in housing expenditure. Nationalised industries' financing alone represents about half the projected expenditure savings.

(i) Nationalised Industries

17. The improvement in nationalised industries' finances assumed in the White Paper is approximately £2½bn between the 1979/80 and 1983/84 fiscal years. This seems an optimistic assumption. 40% of the savings over the period are expected to come from better performance, such as increased productivity and a rationalisation of operations in the loss-making industries, 25% from increased prices in real terms in gas and electricity and the rest from a variety of sources - for example the catching up with underbilling

in 1979-80 as a result of the Post Office strike[1]. We question whether improvements in efficiency and performance, particularly in the loss-making industries, can be expected to produce the turn-round assumed of them. The Committee believes that the Treasury's break-down may prove unrealistic. A greater proportion of any turn-round that occurs may have to come from increasing charges in these areas. Such increases in nationalised industry charges will make it more difficult to bring down the rate of inflation in the medium-term, not only from the direct impact of higher prices themselves, but also from the knock-on effects likely to result in the form of higher pay settlements. Rather than reducing the size of the public sector, the public expenditure "cuts" may well merely take the form of higher charges to the community of existing public sector services. In the absence of further detailed information, for which we asked,[2] we regard the targets for the nationalised industries to be questionable. We therefore propose to enquire further into this matter.

18. No detailed plans are presented for the housing programmes beyond 1980-81, but a significant part of the £2½ bn total reduction in housing expenditure over the medium-term may well take the form of reduced council house subsidies. To put this figure in perspective, it would be roughly equivalent to the virtual ending of capital expenditure on housing or the total elimination of subsidies. From the evidence gathered by the Committee the Treasury showed extreme reluctance to say how this cut in housing expenditure would be brought about[3]. Apparently, the government would prefer that the detailed decisions were either left to a later date or taken by the local authorities. However, in subsequent discussions it became clear that the Chancellor was of the opinion that a real increase in rent levels was necessary[4]. The Chancellor also recognised that any increase in the real burden of rents would pose a problem regarding its effect on pay settlements and inflation[5].

1. Q 345
2. See letter from the Chancellor to the Chairman of the Committee, 29th April 1980; Evidence, p.
3. Q.311
4. Q.397
5. Q.398

(iii) Public Sector pay

19. The Committee were concerned to hear that although the cash limit for the Civil Service pay settlement this year had been set at 14% the actual Central Government pay bill in 1980-81 was going to be 25% above 1979/80[1], and 23% for Central Government and local authorities combined. The Committee finds it difficult to draw from this the conclusion that the government is being firm on public sector pay. The Chancellor has argued that much of the discrepancy between the 14% figure and the 23% or 25% pay increase is due to the Clegg awards together with the staged settlements for civil servants and some local authority employees.[2] We also received a note from the Treasury setting out the position in more detail.[3] Since these awards were made as a result of a comparability exercise begun by the previous government, the present government is disposed to argue that the responsibility rests with the previous administration. Nevertheless, a serious question must be raised whether, given the framework of the Government's overall policies, it was prudent to allow the Clegg awards to be paid almost in full. The Chancellor has assured the Committee that the cash limits for 1981/82 will not encompass a substantial element of staged settlements, and will therefore in percentage terms more nearly reflect the actual percentage increase in next year's ordinary pay settlements. This remains to be seen. We are not convinced that cash limits are fully effective in controlling public sector pay. We are therefore pursuing the matter with the Chancellor.

20. If settlements in commerce and industry, including the nationalised industries, continue rising in 1980-81, and then exceed central and local government settlements, there may well be pressure for further catching up payments. We discuss below the elements of the cash squeeze on industry. It is often argued that increases in private sector pay are amongst the main contributors to the cash squeeze on industry. In so far as large public sector pay increases adversely affect the climate in which private sector pay negotiations occur when each sector suspects the other of stealing a march, the government cannot escape responsibility for what it has paid its employees and the example it appears to set.

1. Q.336
2. Q.373; see also letter from the Chancellor to the Chairman of the Committee, Evidence, p.
3. Evidence, p.

(iv) The Relative Price Effect

21. The movement of public sector pay relative to that in the private sector contributes to the relative price effect. Roughly speaking, this allows for the differential betwen the growth in public sector costs as opposed to costs in the other areas of the economy. Table 5.12 on page 182 of the White Paper shows that an allowance of £550 million at 1978/79 prices has been made for the relative price effect in 1980/81[1]. This represents a 0.7% relative price change over the previous year. In view of the large increase in public sector pay that has been revealed in the evidence to the Committee and further developments such as substantial increases in the pay of the Armed Forces, this allowance may be on the low side. That is to say the cost of the government's programmes in 1980/81 may be higher than that shown in the White Paper on account of the differential between the large increase in public sector pay compared with private sector pay for the 1980/81 financial year.

22. Turning now to the medium-term, no details are provided about what is expected to happen to the relative price of public expenditure after 1980/81. Nevertheless an assumption about relative costs must have been made in order to relate the expenditure plans to projections of government revenue. The medium-term financial strategy incorporates the assumption that the average price of expenditure in each of the three years 1981/82 to 1983/84 rises at the same rate as the general rate of inflation. Although this conforms with the experience since 1975/76, this particular period was affected by the Labour government's incomes policy which held down public sector pay, so that by 1979 average wages in the public sector had been reduced by 12% relative to earnings in the private sector. Since a formal incomes policy is not part of present government strategy, it would seem more appropriate to assume that the relative price of public expenditure will resume its long-term trend. Over the period 1960-1978, the relative price effect added an average of around 0.8% a year to the cost of public expenditure (excluding debt interest), which is about the same as is assumed for 1980/81 in the White Paper itself. If this assumption is incorporated in the projections set out in the medium-term financial strategy, it would add £2½bn, at 1978/79 prices, to the cost of the expenditure plans by 1983/84, and thereby reduce significantly the fiscal adjustment assumed for that year.

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1. Further details are given in the memorandum submitted by the Treasury; Evidence, p.

(v) Capital and Current spending

23. Finally, we turn to the balance in the government's spending proposals between capital and current spending, on the assumption that cuts are to be made to total expenditure on the scale set out in the White Paper. While we take the Chancellor's point that low growth may reduce the need for some forms of capital spending now, we feel that too much emphasis has again been given to cutting investment expenditure rather than current expenditure, at least in 1980/81. We have received disquieting written evidence to this effect[1]. The failure to provide a detailed breakdown of expenditure by economic category makes it virtually impossible to assess the impact on the economy of the spending plans and of the split between investment spending and current spending in later years. From the piecemeal information given, it would appear that capital expenditure undertaken by local authorities, and other bodies such as water authorities, will bear a large part of the future reductions which are planned. In the Education programme, for example, capital spending is forecast to fall by 20% in real terms between 1980/81 and 1983/84, and it looks as if there is going to be a much greater fall in housing construction.

24. The shorter-term split is somewhat clearer. Mainly because of the government's actions, a drop of some 17½% in general government expenditure on fixed investment in 1980 compared with 1979 is planned.[2] In financial years, we find that the reduction is 10% between 1979/80 and 1980/81, with the result that the volume of spending in this area will be some 40% below the level in 1974/75. The Committee recognises that the Chancellor has proposed custs in the social programmes of current expenditure which will produce savings in future years, but in 1980/81 current spending on goods and services is planned to remain more or less unchanged and transfers, excluding child benefits (where account has to be taken of the offsetting reduction in child allowances), are forecast to rise by 2%. These figures produce an overall effect on the government's total spending of a 1% reduction in 1980/81 compared to 1979/80, before allowing for the special sales of assets, (although in cost terms spending will be much the same this fiscal year as last). Although we recognise that all modern governments find it easier to reduce capital rather than current expenditure, the Committee is concerned about the implications for the economy inherent in the planned reductions in capital expenditure.

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1. See memorandum submitted by the National Federation of Building Trades Employers and the Federation of Civil Engineering Contractors; Evidence, pp 70-73.
2. Q.417

(vi) Public Sector Revenue

25. On the basis of the Treasury's medium-term assumptions regarding the growth of overall economic activity, the financial strategy set out in the Financial Statement provides figures for the path of public sector revenue. (These are shown in table 8, page 18 of the Financial Statement). Taxes on income, expenditure and capital are projected to move from £52½ billion, at 1978-79 prices in 1980-81 to £52 billion in 1981-82, £54 billion in 1982/83, and £55½ billion in 1983/84. The non-oil and oil components of these overall figures need to be examined separately. In evidence to the Committee, the Treasury revealed that the assumptions relating to North Sea taxes (from oil and gas activities) were that they would yield £2¾ bn in 1980/81, £3¼ bn in 1981/82, £4¾ bn in 1982/83, and £4¾ bn in 1983/84.[1] This implies non-oil tax revenue of £49¾ bn in 1980/81, £48¾ bn in 1981/82, £49¼ bn in 1982/83, and £50¾ bn in 1983/84, a profile which largely reflects the fluctuations in real GDP growth from one fiscal year to the next. Clearly, the movement in this non-oil revenue series is highly dependent upon, and very sensitive to, the underlying GDP assumptions - revenue falls in 1981/82 because of the assumed fall in output and increases in 1982/83 and 1983/84 as output expands. To the extent that we have doubts about the GDP growth profile, we must have doubts about these revenue figures. In particular, we question whether there will be a significant increment to non-oil revenue in the years following 1981/82, especially in view of the doubt that exists over the possible turn-round in the economy at that stage. To reiterate, the elimination of this increment to revenue would limit the scope for tax cuts in the later years.

26. The figures mentioned above for oil and gas revenues include government receipts from royalties, corporation taxes, and petroleum revenue tax. Unfortunately, it is impossible to assess properly the likely accuracy of these estimates without much more detailed information than the Chancellor was prepared to supply. The calculation of the size of these revenues depends crucially on the precise assumptions regarding the output and price of North Sea oil and the movement of the exchange rate, most importantly against the US dollar. We were able to gain some information, namely that the oil price assumption for future financial

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1. Q.253

years is that the dollar oil price increases in line with world export prices from 1980-81 onwards. Since oil prices are currently fixed in dollar terms, a rise in the exchange rate will tend to cut the revenue from North Sea oil in sterling terms, whilst a depreciation of the currency relative to the US dollar will tend to raise it. On the available evidence, we cannot judge conclusively whether these revenue estimates from North Sea oil and gas are too pessimistic. However, we are advised that the revenue profile for North Sea oil and gas receipts err on the side of caution, assuming as it does not only an unchanged real price of oil, but seemingly also very little change in the dollar/sterling exchange rate and a relatively low growth in production. We believe that the revenue arising from North Sea oil production may well have been underestimated, possibly considerably so. The tone of the Treasury's evidence confirmed this opinion.

(d) The Corporate Sector

27. The Committee feel that there are several factors which together tend to indicate that the corporate sector will face a substantial liquidity squeeze not only in the short-term, but probably in the medium-term as well. Amongst these, we may cite the projected slow growth in overall economic activity, high interest rates, the squeeze on profitability from the effects of a continuing strong pound (which adversely affects exports while boosting imports), and the difficulty in resisting high pay settlements in the private sector when public sector earnings growth and interest rates are both high. The comments made to us by the Governor of the Bank of England did not remove our concern on this score.[1]

28. The Chancellor has not felt able to supply the Committee with the Treasury's central forecasts of either the short-term industrial and commercial sector deficit or the possible position in the medium-term. The Committee recognises there may be good reasons for the Chancellor not publishing such quantitative estimates. However, he has indicated that the deficit is likely to be substantial[2]. Our own advisers have suggested that the short-term outlook for this deficit in the non-oil sector will be a minimum of £6bn this calendar year. Other forecasts indicate that the deficit in 1980 could be considerably larger.

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1. Q.437
2. Q.413

29. Apart from some relief for small businesses mentioned in the Budget, which the Committee welcomes, the economic environment as described above will provide little help to the corporate sector - rather the reverse. The advice the Committee has received suggests that the cash squeeze on industry will not be a short-term phenomenom given the medium-term financial strategy. Indeed, it may well be that the corporate sector has to bear a large proportion of the overall burden of adjustment in order to meet the targets proposed in the financial strategy. In particular, the adverse corporate sector deficit likely to be experienced this year may well persist, if not grow, over the medium-term. Although the one year effect ofa large corporate sector deficit can probably be adequately accommodated by industry, especially in view of its low gearing now compared with 1974/75, the cumulative effect of persistently high deficits may well be very damaging especially in times of high interest rates. In general, we are convinced that the government should not only take a very active interest in what is happening to the corporate sector, but should have measures ready to relieve what could become a very damaging deficit.

Consequences of the medium term strategy for the economy

30. To assess objectively the impact of the government's medium-term financial strategy on the UK economy, it is necessary to have a detailed view of the likely or possible course of various economic variables. Specifically, we should like to know what the strategy implies for the future course of bank lending to the corporate and personal sectors, external flows, and institutional cash flows. Unless we have some idea of these, it is not possible to say with any degree of confidence whether the medium-term strategy is consistent with a substantial fall in interest rates.[2] This is a very complex subject, as is the relationship between growth of the money supply and inflation.

31. As already indicated the Committee will shortly be embarking on a wide ranging enquiry into Monetary Policy as it has evolved both in this country and abroad with a view to reporting to the House at a later date. We want to explore in some depth current thories about such crucial relationships as those between the P.S.B.R., money supply, inflation and economic growth and to test such theories against the available evidence. We would hope then to be better equipped to comment on the government's current economic policies. In the meantime we have thought it right to record our reservations and anxieties.

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1. QQ.48-52 and QQ.412-413.
2. Financial Statement and Budget Report 1980-81, page 16, paras 3-4.

PROCEEDINGS OF THE COMMITTEE RELATING TO THE CONSIDERATION OF THE REPORT

WEDNESDAY 30th APRIL 1980

Members present:

Rt Hon Edward Du Cann, in the Chair

Mr Kenneth Baker
Mr Anthony Beaumont-Dark
Dr Jeremy Bray
Mr Timothy Eggar
Mr Michael English
Rt Hon Terence Higgins
Rt Hon Robert Sheldon
Mr Richard Shepherd
Mr Richard Wainwright
Mr Ken Woolmer

Draft Report, proposed by the Chairman, brought up and read.

Ordered, That the Report be read a second time, paragraph by paragraph.

Paragraph 1 agreed to.

A paragraph brought up and read the first time, as follows:

" 1A: Before discussing the Government's policy in any detail and offering our observations on the Budget and Public Spending White Paper, it is right that we should acknowledge certain basic issues which affect both Government policy and our assessment of it. First, one must recognise that we live in circumstances of exceptional uncertainty. This means several things. Conventional economic models are of limited and diminishing use in providing forecasts, and the policies of any Government must necessarily rest on the judgement of Ministers to a greater extent than in the past. Second, the thrust of much of this Government's monetary and fiscal policy is directed towards changing patterns of behaviour. It is wrong to put too much weight on judgements about the plausibility or otherwise of policy which rest implicitly or explicitly (as most economic model-building does) on the assumption that relationships remain as they were in the past. Third, there will be matters on which it is appropriate that Ministers and officials should observe a certain reticence. Interest and exchange rate policy are obvious examples. Fourth, the basic issues which this Committee, the House and the country at large are most concerned about are the policies the Government are pursuing rather than the fine detail of the documents they publish. In seeking to assess those policies what really matters is to understand the reasoning behind them, the determiniation and realism with which they are being pursued and the consistency of the objectives and instruments of policy. The Committee stresses that it has not, in the short time available to it, found it possible to consider matters of policy as much as would have been desirable."

-(Mr Anthony Beaumont-Dark.)

Motion made, and Question put, That the paragraph be read a second time.

The Committee divided.

Ayes, 1	Noes, 9
Mr Anthony Beaumont-Dark	Mr Kenneth Baker
	Dr Jeremy Bray
	Mr Timothy Eggar
	Mr Michael English
	Rt Hon Terence Higgins
	Rt Hon Robert Sheldon
	Mr Richard Shepherd
	Mr Richard Wainwright
	Mr Ken Woolmer

Paragraph agreed to.

Paragraphs 2 to 5 read and agreed to.

Paragraph 6 read.

An Amendment proposed, to leave out the words "without the table it is impossible for the House to assess the economic implications of these reductions in public expenditure, for employment for investment and so on" and insert the words "it seems remarkable to us, not merely that this breakdown by economic category was omitted from the White Paper but that the Government did not have it prepared for itself and consequently did not know all the consequences of its own actions."-(Mr Michael English.)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 1	Noes, 7
Mr Michael English	Mr Kenneth Baker
	Mr Anthony Beaumont-Dark
	Mr Timothy Eggar
	Rt Hon Terence Higgins
	Rt Hon Robert Sheldon
	Mr Richard Shepherd
	Mr Richard Wainwright

Paragraph agreed to.

Paragraphs 7 and 8 agreed to.

Paragraph 9 read.

An Amendment proposed, in line 5, after "forecast", insert the words "to some extent this is a distinction without a difference, neither are prophecies."-(Mr Michael English.)

Question, That the Amendment be made, put and negatived.

Paragraph agreed to.

Paragraphs 10 to 17 read and agreed to.

Another paragraph brought up and read the first time, as follows:

"17A. We are also concerned that no objective standards seem to be supplied to the Treasury to enable them to determine the treatment of nationalised industries. For example, in the case of monopolistic corporations, where the nationalised corporation is practically the entire industry, the only yardstick as to how far its prices should be allowed to rise must be a comparison with prices in other countries for the same commodity, allowing for all the various factors which may influence costs in the relevant industry. Such an assessment was apparently not available to the Chancellor who referred Your Committee to the several Departments concerned with nationalised industries[1]. With non-monopolistic industries, the market can be allowed to determine their pricing but then it would seem reasonable that normal commercial policy should be allowed to determine their investment policy, i.e. an investment designed to increase productivity sufficiently to finance the capital required at current interest rates should proceed and others should not. Fixing an arbitrary External Financing Limit has, of course, no relevance to this whatsoever. Its only relevance is to the quite artificial fact that some, though far from all, nationalised industry investment is classified as public expenditure under the present artificial definitions."—(Mr Michael English.)

Motion made and Question, That the proposed paragraph be read a second time, put and negatived.

Paragraph agreed to.

Paragraphs 18 to 23 read and agreed to.

Paragraph 24 read.

An Amendment proposed, after words "special sales of assets", to insert a footnote as follows:

"[2]Although such sales are regarded as a reduction in public expenditure on the current definitions, they do not really have any permanent effect on it and cannot be assumed to continue at the same rate since eventually the country, like a bankrupt company, would end up with public expenditure, no further assets to sell, and a reduced income from the assets already sold."
—(Mr Michael English.)

Question, That the Amendment be made, put and negatived.

Paragraph agreed to.

Paragraphs 25 to 31 read and agreed to.

Ordered, That this be the Second Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No.85 (Select Committees (Reports)) be applied to the Report.