Economic Policy: The Next Steps. Memorandum by the Chancellor of the Exchequer

Public Expenditure: Action to assist the Construction Industry. Memorandum by the Secretary of State for the Environment

The Legislative Programme 1977-78 and The Queen's Speech on the Opening of the New Session. Note by the Lord President of the Council

Wider Implications of the Industrial Strategy. Memorandum by the Chancellor of the Exchequer and the Secretary of State for Industry

The Queen's Speech on the Prorogation of Parliament. Note by the Secretary of the Cabinet

Pay Policy. Memorandum by the Chancellor of the Exchequer

Ninth Report of the Select Committee on Expenditure 1976-77: Draft Government Response. Note by the Chief Secretary, Treasury

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Crown Agents: Fay Report. Note by the Secretary of the Cabinet


Draft White Paper on "The Conduct of Company Directors". Memorandum by the Secretary of State for Trade


National Insurance Contribution Review 1977. Memorandum by the Chief Secretary, Treasury

Pay Policy and Low Pay. Memorandum by the Chancellor of the Exchequer

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CP(77) 109 - Milk Prices. Memorandum by the Secretary of State for Foreign and Commonwealth Affairs

110 - The New Pensions Scheme. Memorandum by the Secretary of State for Social Services and the Minister for Social Security

111 - Top Salaries - National Health Service Consultants and Others. Memorandum by the Attorney General

112 - Pay of Nationalised Industry Board Members. Memorandum by the Lord Privy Seal

113 - Inquiry into the Crown Agents. Memorandum by the Lord Chancellor

114 - Public Expenditure White Paper. Memorandum by the Chief Secretary, Treasury

115 - Benefits of North Sea Oil. Memorandum by the Chancellor of the Exchequer and the Secretary of State for Energy

116 - The Pay Scene. Memorandum by the Chancellor of the Exchequer

117 - A National Development Programme. Memorandum by the Secretary of State for Energy
CABINET

ECONOMIC POLICY: THE NEXT STEPS

Memorandum by the Chancellor of the Exchequer

1. We have now gone a long way to consolidate the improvement in our financial position begun last winter. This has been widely recognised both at home and overseas - for example, at the International Monetary Fund (IMF) meeting in Washington. As a result, we are in a position to consider further measures to strengthen domestic demand, and to improve the outlook for employment.

2. Our prospects hinge, however, on the continuing success of the fight against inflation. The uncertainties surrounding the present round of pay settlements have important implications both for the size and the shape of the measures to which we should commit ourselves at this stage.

I. THE ECONOMIC PROSPECT

3. Economic activity has remained subdued this year and unemployment has continued to rise. The main increase in demand has been through exports and, to a lesser extent, industrial investment. Public sector spending on goods and services has probably fallen as planned and personal consumption has dropped sharply. The balance of payments has improved strongly: and the current account is probably now in balance or modest surplus.

4. Retail prices have slowed down. The year on year rise may well be down to some 13 per cent in the final quarter of this year and should be down into single figures during the first half of 1978. As 1978 progresses, however, the outcome will depend increasingly on the level of pay settlements during the coming round. The economic prospect which I outline below assumes that the increase in average national earnings is held to 10 per cent. But the whole prospect could worsen if earnings rise significantly faster. For example, if earnings rise by 15 per cent, retail prices would probably be accelerating back into double figures before the end of 1978.
5. From now on growth may pick up gradually as a recovery in real personal incomes and consumption increases consumer expenditure and production. With exports and private sector investment continuing to rise, total output (GDP) could increase moderately fast (perhaps of the order of 3½ per cent) during 1978. Thus, in the absence of any new policy measures, the economy may be growing at a rate just above what would be needed to stop the upward trend in unemployment.

6. The balance of payments on current account is likely to go on improving, mainly owing to North Sea oil, with a surplus which could be over £2 billion for 1978.

7. The Public Sector Borrowing Requirement (PSBR) for 1977-78 is now forecast at about £7 billion - that is, £1.7 billion below the figure to which we committed ourselves last December. It is very tentatively put at about £7 billion also in 1978-79.

8. In the first four months of 1977-78, the growth of domestic credit has been very slow, while the growth of sterling M3 has been at the bottom of the target range of 9-13 per cent. The outlook for the remainder of the current year is for the growth in £M3 to accelerate and to be towards the top end of the 9-13 per cent range for the year as a whole; a similar rate of growth could be envisaged in 1978-79. Confidence in domestic markets is however closely related to the level of pay settlements and if these are in excess of the 10 per cent assumption, interest rates will be carried up, gilts will be more difficult to sell, and consequently £M3 might be at or above the 13 per cent upper limit to the target range.

II. ASSESSMENT

Demand for Resources

9. There is now a clear case for early action to stimulate demand. We must aim at creating the conditions in which unemployment turns firmly downwards.

10. At the same time, we must avoid the mistakes of our predecessors in 1972-73. Beyond a certain point, the injection of money into the economy at this stage would be more likely to recreate industrial bottlenecks, suck in imports and stimulate inflation, than to increase our own domestic output and bring down unemployment. Inflation in Britain is still higher than the Organisation for Economic Co-operation and Development (OECD) average; there is uncertainty about the outcome of the current pay round; and both investment and consumers' expenditure may already be on the upturn. So excessive stimulus could create real risks, particularly when we look forward to 1978-79.
Monetary Prospects

11. It must be our objective not to break the present virtuous circle in which, by keeping the money supply within the target range, we have helped to sustain the exchange rate, to bring down domestic interest rates, and to reduce expectations of inflation; this in turn has strengthened confidence; and confidence in turn has made it easier for us to keep to our monetary objectives.

12. Because on present policies we may finish the year towards the top end of our target range for sterling M3, fiscal action on a large scale could imply some increase in the level of interest rates. This will depend crucially not only on the size of the fiscal package, but also on its nature - the extent to which it concentrates on measures which are consistent with the overall economic strategy to which the Government has pledged itself, and which therefore are likely to meet a favourable market response. The market's response will depend to an important extent on whether the Government is seen to be maintaining the firm control of public expenditure which it established last year.

III. SHAPE OF AN AUTUMN PACKAGE

13. All these considerations suggest that any package of measures should meet the following tests:

a. Both because we want the largest and quickest effect on unemployment and because we can count on significant headroom in 1977-78, it should give a further significant stimulus in the current year; but, because the outlook for 1978-79 is more uncertain, it should not pre-judge the size and shape of the 1978 Budget more than is essential.

b. It should be seen to be consistent with the Government's published targets for the monetary aggregates and with our IMF commitments for the current year.

c. It should be seen as a natural development of the economic strategy which I announced in the Budget and which has been endorsed at international meetings.

d. It should be consistent with maintaining a sufficient surplus on the current account and enabling us to make a start on repaying our debt.

14. The measures will also, of course, have to take account of the present position in Parliament and the pact with the Liberals.
15. On balance, I believe that measures costing up to £1 billion in the current year (1977-78) can now be justified; we need to leave some of our options open for 1978-79, but we can, I think, now commit a further £1 billion in that year - or a total of £2 billion over the next 18 months.

IV. ACTION AFFECTING 1977-78

16. The options for significant action in the current year are, for practical reasons, very largely confined to cash transactions - either tax changes or transfer payments - and even here the administrative constraints are formidable. There is little scope for varying the Government's purchases of real resources between now and next March.

Indirect Taxes

17. A cut in indirect taxes would contradict our stated objective to shift the tax burden from direct to indirect taxation. But it would in the long run have a similar demand effect to a cut in direct taxation and would reduce inflation in the short run. The standard rate of Value Added Tax (VAT) could be reduced from 8 per cent to (say) 6 per cent, and the higher rates of VAT from 12 ½ per cent to (say) 10 per cent. This would take effect from a current date in November and the demand effect would therefore be relatively small in the current financial year, since it is impossible to backdate changes in indirect taxation. Similarly, and also because of the lags in VAT collection, the cost in 1977-78 would be rather small - £115 million; but the cost in 1978-79 would be some £900 million. It would reduce the year on year inflation rate by 1 per cent straightaway.

18. It would also be possible to reduce the specific duties, but this would appear particularly perverse at a time when their real value has already fallen significantly in recent years and the arguments of energy conservation, transport and health policy point in the other direction. Indeed, now that we are committed to the indexation of personal income tax allowances, there is a strong case in principle for raising these duties annually in line with inflation.

Income Tax

19. It is not possible for the Inland Revenue to make administrative room for a cut in income tax in mid-year unless we exempt from tax in the current financial year the November increase in National Insurance pensions - at a cost of £40 million, giving a significant addition to the real income of about 2 ½ million pensioners. On this condition, the Revenue would be able to implement this autumn an increase in the personal allowances for all taxpayers for the current financial year. The obvious course is to introduce this autumn some or all of the increases in personal allowances (indexation in line with price inflation), which under the 1977 Finance Act we are required to implement next April unless we can get the
House of Commons positively to vote against them. This would be an advance or "on account" relief. On present estimates, full indexation requires increases of around 12 per cent - that is £100 in the single allowance, £160 in the married allowance and corresponding increases in the other personal allowances. This would take nearly 1 million people out of liability to tax. If introduced in 1977-78 the cost would be £985 million. There would be relatively little additional cost for 1978-79, over and above the indexation to which we are already committed under the 1977 Finance Act.

20. The increases in allowances would be backdated to April so that they applied to the whole of the current tax year. Thus they would entail lump sum tax rebates payable in November or December of up to £40 for a married man, and £25 for a single person, plus additional tax relief of a little over £1 a week for a married man thereafter.

21. Full indexation this autumn would represent a much more substantial stimulus to demand in the immediate future than the reduction in VAT or the specific duties. It could be worth nearly half of 1 per cent of GDP by the first quarter of 1978, and it would thus have a quicker impact on the unemployment figures. At the same time, it would represent a minimum additional commitment for the 1978 Budget. Thus, it would leave us with the maximum flexibility to introduce further fiscal reliefs in the Budget if economic circumstances permit. By the same token, it would give a reasonable assurance that we shall not have over committed ourselves, if events develop less favourably. It would also give maximum help to the lower paid and enlarge the gap between income from work and income from benefits.

22. If we decided to give less than the 12 per cent indexation of personal allowances at this stage - perhaps for the reasons discussed in paragraph 29 below - the effects in paragraphs 19-21 above would, of course, be correspondingly smaller. It would in that case be important to make clear that we would raise the level of allowances further in the Spring Budget so as to achieve then the full indexation prescribed in the Finance Act 1977.

Public Expenditure

23. The Contingency Reserve for 1977-78 has now been run down by our previous decisions to about £190 million. Depending on the form of assistance, the Ford Erika project in South Wales is likely to require this year some £30 million from the Contingency Reserve; but this could rise to as much as £45 million. I am sure that we should not exceed the Contingency Reserve in only the second year of its operation as a control figure.

24. Within what remains there are a number of options. For example, we could cancel the artificial administrative delay of 3 months in the payment of regional development grants and agricultural capital grants.
imposed as part of the 1976 expenditure cuts. This will have to be done some time since complaints will build up if the delays are maintained. The release of funds would benefit industry in assisted areas, and agriculture. The cost is once for all. If it were done now, the cost would be around £100 million in 1977-78 and perhaps £25 million in 1978-79.

25. Another possibility might be to pay a £10 Christmas bonus to pensioners. This would also cost about £100 million, and would inject some quick spending power this year. The weight of argument in normal circumstances would be against it. While in theory it could be regarded as once-for-all, it must lead to strong pressure to repeat it in future years. It was suggested earlier this year as something which might be done if prices over the previous 12 months proved in the event to have risen by more than the amount of the November uprating, but it now appears certain that the November uprating will exceed the actual rise of prices. The 2½ million pensioners paying tax will get an unexpected bonus since they will not now be taxed on their pension increase for the rest of this financial year, while those on supplementary pension, the poorest, will again benefit from our winter fuel scheme. It would also require legislation and there must be some risk of amendments which if carried would increase the figure further. On the other hand, if we decide to increase personal tax allowances, people in work will be receiving substantial income tax rebates shortly before Christmas. There is a case for giving at the same time some cash sum to the majority of pensioners who will not benefit from the income tax relief.

26. It is doubtful whether there are any other public expenditure measures which would contribute significantly towards stimulating demand in 1977-78, without carrying through automatically into 1978-79, when the problem will be very different.

V. MEASURES AFFECTING 1978-79

27. As I have said, it is important that we leave ourselves with the maximum flexibility in deciding the size and shape of our fiscal measures - increases in expenditure or reductions in taxation - for 1978-79.

Taxation

28. The shape of the 1978 Budget will need to be considered in the light of developments between now and next spring. There may well be little room for major fiscal stimulus in any case, depending on the level of pay settlements and the growth of economic activity in the coming months. However, it will be very important, after the sacrifices of the last three years, that the Budget should be able to give some significant relief in the structure and burden of income tax for 1978-79. In particular, April 1978 will bring a big increase in superannuation contributions under the new scheme for "Better Pensions" and a further cut in child Tax Allowances to
accompany the increase in child benefits. Moreover, the 12 per cent increase in personal tax allowances required by indexation will still be less than this year's 14 per cent increase in National Insurance benefits. There will thus be powerful political and economic arguments for further reductions in income tax in April, in addition to the more general arguments which I summarise in paragraphs 35 to 40 below.

29. The sums at stake are very large. For example, the increase in National Insurance contributions and loss of child tax allowances could next April cut some £1.50 a week off the take home pay of a man with two children on average earnings. To offset this in full could (on present estimates) cost between £1,750 million and £2,000 million, depending on the form in which relief is given. This is one reason why we might be wise to give less than the full 12 per cent increase in personal allowances at this stage, so that something is left over to be paid in April.

30. Another possibility might then be to offset the cut in real take home pay next April by introducing a reduced rate band of income tax. But again this could be very expensive. For example, a reduced rate band of £1,000 liable to tax at 25 per cent could cost £2,100 million.

Public Expenditure

31. Providing we do not over-commit ourselves to massive further cuts in taxation next year, I consider that we can plan for some increase in public expenditure in 1978–79. But we must beware of overcommitting ourselves there too. My proposal below would imply a central forecast for the PSBR of some £7.5 billion in 1978–79, before allowing for any further action in the next Budget or for any consequential effect if we were to choose the indirect tax option for action this autumn. Every addition to public expenditure reduces the scope for tax reliefs in the Budget and increases the risk that if events develop unfavourably, a net tax increase then may prove unavoidable.

32. My judgement is that we cannot afford to increase the planned total of programmes and Contingency Reserve for 1978–79 by more than an absolute maximum of £1 billion in terms of next year's prices, or some £850 million at 1977 Survey prices - or 2 per cent above the planned level of this year (1977–78). Even this would risk dangerously limiting the scope for further action on direct taxation in the next Budget. Of this increase, the measures we have already announced have committed over £500 million in 1977 Survey prices, of which the principal items were the uprating of child benefit and other social security benefits, the youth and other employment measures and construction work in the inner cities. The main element of the remainder should be further help for the construction industry, which in July we promised to consider. This expenditure on construction will benefit a wide range of programmes; and the balance, assisted by savings which Departments have identified, will enable us to meet many, though not
I regret all, other bids put forward by Departments. Detailed proposals for the various programmes are set out in the Chief Secretary's paper CP(77) 89.

Small Firms

33. There is a good deal of pressure to do something for small firms especially on the tax side. They are important to the economy as suppliers to large firms, as innovators and as employers providing more than a fifth of total employment. They may play a valuable role in dealing with the problems of the inner city areas. At present there is a widespread lack of confidence among them and, rightly or wrongly, much of the blame for this is put on the weight of taxation. Although I do not think we should be bemused by this pressure into thinking that there is a great deal wrong with the present tax regime, it is an area where we can usefully provide a psychological stimulus to activity. In conjunction with the Chancellor of the Duchy of Lancaster, who is carrying out a special study of their problems generally, we are therefore considering a number of tax and other measures whose benefit will be concentrated on small firms. We could include these with the wider economic package but they would probably cost only £10 million in the current year and would not be expected to cost more than £70 million next year.

VI. 1979-80 AND SUBSEQUENT YEARS

34. Looking forward to the medium term, the prospect remains very much as I described it in my paper of 1 July (CP(77) 70). In the optimistic case, where earnings increase by no more than 10 per cent in 1977-78, it should be possible to sustain a growth rate of about 4 per cent a year on average from 1978 to 1982. This would be a significantly faster rate of growth than we have been able to sustain in the past. However, we are unlikely to achieve this unless we improve our international competitiveness and raise the level of industrial investment. These two conditions to a considerable extent go together. Both would be at risk if inflation is not contained. Both would be helped by the successful implementation of our industrial strategy.

35. Our assessment last summer assumed that public expenditure would be held to the Cmd 6721 level in 1978-79 and to an annual growth of 2 per cent thereafter - with any fiscal action to raise demand coming through cuts in taxation. The prospect for 1978-79 justifies us in raising the planned total of expenditure by £1 billion (at output prices) in that year and I would be content to see additions to the figures for 1979-80 and 1980-81 on the scale proposed in the Chief Secretary's paper. Over the medium term as a whole, however, there are still compelling reasons why we should give priority to reductions in taxation as a means of stimulating demand.
36. First, tax reductions can help us to continue the fight against inflation. Reductions in income taxes increase real take home pay without adding to industrial costs, and help to reduce the pressure for increased money incomes. Reductions in taxation on industry reduce production costs. Reductions in indirect taxes cut prices.

37. Second, the increase of public expenditure up to 1975-76 increased the tax burden to a degree which is widely felt to have become too heavy at all levels of income.

38. Third, tax cuts can help to expand the manufacturing and private service sectors of the economy, to which we must mainly look for future growth in employment.

39. Fourth, tax cuts are likely to give us more room to act against unemployment, because they command much more confidence in financial markets than increases in public expenditure.

40. Fifth, the amount by which we will be able to stimulate demand in these later years is extremely uncertain. There may be much less room for manoeuvre than we expect at present. Taxes can be more readily adjusted than expenditure programmes.

VII. CONCLUSIONS

41. I ask my colleagues:

   a. to agree that a stimulus of up to £1 billion in 1977-78 is appropriate and to express their preference as between the options I have described in paragraphs 17-25.

   b. To agree that the public expenditure programmes for 1978-79 in Cmnd 6721 should be increased by £1 billion (at the outturn prices of that year).

   c. To agree the additions to public expenditure proposed by the Chief Secretary, Treasury, for 1979-80 and subsequent years.

D W H

Treasury Chambers
10 October 1977
BACKGROUND

1. At our meeting on 14 July (CM(77) 25th Conclusions) we discussed the question of help for the construction industry. We noted that the Chancellor of the Exchequer would be announcing additional public expenditure of £100 million for this purpose in 1977-78 and agreed that there was a strong case for further assistance in 1978-79. Accordingly in his statement to Parliament on 15 July the Chancellor of the Exchequer said that the Government were considering, in the course of the normal annual review of public expenditure, what further help could be given to the construction industry in the next financial year (Hansard cols 992-3).

2. In CP(77) 71 I set out the problem facing the industry and stressed the overwhelming case for help. Later information has confirmed how deep was the recession affecting the industry in the first half of the year. Output was 6 per cent lower than in the second half of 1976. Employment has fallen less than might be expected, with the implication that many men are being kept on in the hope of an early recovery in demand.

3. I expect such a recovery in the private sector, following the great improvement in financial markets. But this will be barely sufficient to offset the further decline in public sector work that is allowed for in present plans. If those remain as they are, the industry's total output is likely to differ little next year from this year. This carries with it the prospect of 75,000 more unemployed by the end of 1978 and the possibility of severe damage to the capacity and efficiency of the industry. Output per man has already fallen by 9 per cent since 1973. Urgent action to bring about an early recovery in demand is essential. But we need to do that in the way that will best contribute to establishing a more stable pattern of demand in the future. That requires action now in relation to programmes for this year and the two following.
PROPOSALS FOR ACTION

4. The present slump is partly due to greater-than-intended falls in expenditure this year: experience suggests that cash limits tend to depress spending to a level some way below that of agreed programmes, particularly in the construction field, where there are difficulties in making adjustments during the course of a year. I would therefore urge my colleagues - as I have been doing in relation to my own Department's programmes - to do their utmost to ensure that any shortfall on their construction programmes is minimal, even to the extent of running some extra risk that cash limits on particular blocks may be exceeded, in exceptional circumstances.

5. Departmental programmes now provide for expenditure on construction of £4,769 million in 1978-79 compared with £5,100 million in 1977-78. Merely to keep public sector construction demand in 1978-79 to this year's level would therefore require an extra £330 million; to return it to the level of last year would require £920 million. A survey of the capacity of Departments to mount additional construction programmes shows that they could usefully spend about £780 million in 1978-79 in addition to the agreed programme as set out in Cmd 6721, of which £174 million is included in the additional proposals for expenditure detailed in Annex 2 of the 1977 Public Expenditure Survey Committee (PESC) Report. The attachment to this memorandum sets out the details. There would be additional associated expenditure in 1978-79 of £15 million, and indirectly, expenditure on housing land and on loans for house purchase could amount to a further £45 million. The projects begun under any extra expenditure made available in 1978-79 would entail further expenditure in the later years of the PESC period of roughly the same order.

6. In CP(77) 71 I proposed that public sector construction programmes should be increased by £400 million in 1978-79 and that the increase should be maintained in subsequent years. I was conscious that this would do little more than keep the 1978-79 programmes at their current level. But the improvement in the economic situation now provides us with greater scope to make a positive contribution to helping the industry out of recession. My colleagues will be aware that the unions have been pressing for an extra £1,100 million. At the same time we must be realistic about what we can expect to achieve in the next 18 months. On balance I believe that a package of not less than £600 million is needed in 1978-79 to demonstrate that we are taking the industry's problems seriously. (This would include the additional proposals for construction expenditure in Annex 2 of the 1977 PESC Report.) It would add 3½ per cent to construction output and, allowing for a possible rise in private demand, would make the total demand in 1978 about the same as in 1976. It would be worth 50,000 jobs, though the direct fall in unemployment would be less than this. It would be desirable to add a sum of the same order to the programmes from 1979-80 to get back to an acceptable level and to continue with further additions in subsequent years: even to stabilise on the level I propose for next year would require the addition of a minimum of £380 million in 1979-80.
7. The effect of such a package on the public sector borrowing requirement would be reduced by the net increase in Exchequer receipts from tax and national insurance payments and the abatement of unemployment benefit. The net effect on the borrowing requirement of a package of £600 million would be £400 million in 1978-79.

8. Detailed consideration will need to be given to the way in which additional expenditure on construction should be allocated. We must try to see that help is concentrated on the sectors in greatest need, and the need to alleviate unemployment must be the first priority. Housing, which contributes about half of public sector demand, should have a large share; and a significant element should be devoted to civil engineering which has been particularly affected by cuts in public expenditure. There are also the claims of energy conservation to be considered and proposals now before the Secretary of State for Energy to allot about £50 million a year for thermal insulation and heating controls in public sector buildings will make a useful contribution. Much of the work would be done by local authorities and we shall need to consult them carefully about this in relation to their overall expenditure plans. I hope that they will accept the package as going some way to redress the balance which past cuts have produced against capital expenditure.

CONCLUSIONS

9. Despite the help that we have already provided, the crisis in the construction industry will continue next year - unless we take vigorous and positive measures now. Even my present proposals will not be enough to prevent a further rise in unemployment. We have already undertaken to consider what further help can be given and we have the capacity within Departmental programmes to make a contribution which will demonstrate our concern, and go some way to meeting criticism of our readiness to cut capital spending. But the action we take must be seen to match the scale of the problem. Moreover, because construction programmes take time to mount it would be wrong to settle for some lower figure now and wait until next year to see if it were enough.

RECOMMENDATIONS

10. I invite my colleagues:

   a. To take vigorous action to ensure that 1977-78 programmes are fulfilled.

   b. To agree that public sector construction programmes should be increased by £600 million in 1978-79 and that the level thus established should at least be maintained in the later years of the PESC period.
c. To instruct officials to consider the detailed composition of the package in the light of the considerations set out in paragraph 8 above.

P S

Department of the Environment

10 October 1977
## Summary of Departmental Capacity Identified in the Survey

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A Includes provision for Wales
B Includes provision for Scotland
C Represents 5/65 of bids which do not already include provision for Wales
D Represents 10/65 of bids which do not already include provision for Scotland

**Confidential**
CABINET

THE LEGISLATIVE PROGRAMME 1977-78 AND THE QUEEN'S SPEECH ON THE OPENING OF THE NEW SESSION

Note by the Lord President of the Council

1. I attach a revised draft of The Queen's Opening Speech, incorporating the amendments which we agreed on 11 October. These, and other amendments and additions to the text of Annex C to CP(77) 88, are sidelined.

2. There are four points for further discussion:

a. The paragraph on North Sea Oil (circulated separately under cover of a letter dated 17 October from the Prime Minister's Private Secretary to the Lord President's Private Secretary).

b. I appreciate the doubts expressed on 11 October about the inclusion in the Speech itself of a catalogue of Bills which we wished to introduce as soon as Parliamentary time could be found. Nevertheless it remains most important in my view that the Speech should reaffirm our commitment to the Merchant Shipping and Post Office Bills, and a suggested form of words is in paragraph 8 on page 4.

c. I have discussed with the Secretary of State for Energy how Parliamentary time could be found to fit the Electricity Bill into the legislative programme. The best way would be to combine this Bill not only with the Bill on Drax B but also with the Atomic Energy Bill. The Parliamentary time required for this combined Bill, together with the other two Department of Energy Bills, would be little more than that needed for the Department's four Essential Bills if they remained separate.

d. I am in consultation with the Secretary of State for Employment on whether the Employment Bill should now be regarded as Essential, and will report the outcome as soon as possible.

Privy Council Office

17 October 1977
DRAFT OPENING SPEECH

MY LORDS AND MEMBERS OF THE HOUSE OF COMMONS,

I look forward to paying a State Visit to the Federal Republic of Germany next May.

My Government re-affirm their policies in international relations and defence. They remain committed to the aims of peace and collective security; and of detente, disarmament and prevention of the spread of nuclear weapons. They will contribute fully to the work of the United Nations, the Commonwealth and the North Atlantic Alliance.

My Government, while working for policies which fully reflect the interests of the United Kingdom, will play a full and co-operative part in the activities, the development and the enlargement of the European Economic Community.

My Government will continue to contribute modern and effective forces to the North Atlantic Treaty Organisation, and to play their full part in the current Alliance studies of East/West relations and of the Alliance's defence programmes. They will continue to participate constructively in the important meeting in Belgrade which is being held as part of the follow-up to the Final Act of the Conference on Security and Co-operation in Europe, will abide by the provisions of the Final Act and will continue to seek fulfilment of all its provisions by other signatories. They remain committed to the pursuit of detente in their relations with the Soviet Union and the countries of Eastern Europe.

My Government will continue to take part in international efforts to combat recession and promote a more stable world economic order, and a fairer distribution, within an expanding world economy, of the world's wealth between rich and poor nations; they will maintain their special efforts to help the poorest countries and the poorest people.
My Government will work for a just and lasting peace in the Middle East, and the further improvement of relations between the United Kingdom and all the countries in the area. They will continue to co-operate with all concerned in the search for a lasting settlement in Cyprus, where they welcome the resumption of intercommunal talks.

My Government will continue to work for a negotiated settlement in Rhodesia, on the basis of their proposals published in September this year, which are designed to provide a secure future for people of all races. They will be ready during the current session to introduce legislation to enable Rhodesia to proceed to independence on this basis.

MEMBERS OF THE HOUSE OF COMMONS,

Estimates for the public service will be laid before you.

MY LORDS AND MEMBERS OF THE HOUSE OF COMMONS,

The strengthening of our financial position and of the balance of payments opens the prospect for a continuing improvement in the economy and the maintenance of financial stability. My Government's main objectives are the speediest possible return to full employment and a sustained growth of output. In order to achieve these objectives my Government will give the highest priority to further reductions in the rate of inflation.

My Government will continue to promote industrial training and to create and maintain jobs through manpower measures.

[Paragraph on North Sea oil]

My Ministers will continue to work in close cooperation with the Trades Union Congress and the Confederation of British Industry.

My Government will continue to urge internationally that the stronger economies should take the lead in promoting a sustained growth in the world and that adequate official finance should be made available on appropriate terms to countries with continuing deficits in the balance of payments.
My Government remain firmly committed to establishing directly elected Assemblies for Scotland and Wales. Separate Bills will be introduced for this purpose.

In Northern Ireland my Government will maintain their aims of establishing a devolved Government acceptable to both parts of the community; and eradicating terrorism by the prosecution through the courts of those responsible for violence and by continuing to develop the effectiveness of the Royal Ulster Constabulary, supported by My Armed Forces. My Government attach special importance to co-operation on matters of security with the Government of the Republic of Ireland. They will continue to seek measures to strengthen the economy of Northern Ireland and improve its social environment.

Legislation providing for the election of United Kingdom members of the European Assembly will be re-introduced.

Further consultations will be held on industrial democracy, with a view to producing proposals which should command general support, and My Ministers will continue directly to encourage the development of industrial democracy in the nationalised industries.

There will be a review of the legislation and institutions governing competition policy, to see that this makes its maximum contribution to improving industrial efficiency.

My Ministers are considering further measures to assist small firms.

My Government will hold consultations about encouraging profit-sharing through the tax system.

Legislation will be brought forward to amend company law.

A Bill will be introduced to provide public funds to finance payments to redundant shipbuilding workers in the public sector.
Legislation will be introduced to provide for payments to the Central Electricity Generating Board towards the cost of Imex B power station.

Continued encouragement will be given to the efficient production, processing and distribution of food with the aim of meeting a greater proportion of our national needs from United Kingdom agriculture. My Ministers will seek improvements in the operation of the Common Agricultural Policy.

My Government will continue to seek major reform of the Common Fisheries Policy. They will aim to secure conditions which will meet the needs of the British fishing industry, conserve fishing stocks, and ensure adequate supplies to the consumer.

A Bill will be laid before you to increase the borrowing powers of the Civil Aviation Authority and British Airways, to provide for a levy to finance aviation security and to amend the civil aviation Acts.

Legislation will be introduced for the further development of transport policy to meet economic and social needs, including those of rural areas.

Legislation will be brought before you to provide assistance for first-time home buyers.

A Bill will be introduced to renew and revive the inner urban areas.

In addition to My Government's full programme of constitutional and other reforms for the present Session, they remain committed to bringing forward at the earliest opportunity a number of further highly desirable measures of reform. These measures include improvements in safety and discipline at sea and other aspects of merchant shipping, and the right of Post Office staff to take industrial action.

Legislative proposals will be brought forward for the reform of section 2 of the Official Secrets Act 1911.
Following the Report of the Committee on the Future of Broadcasting, My Government will bring forward proposals on the constitution, structure and organisation of broadcasting in the United Kingdom.

An increase in the limit on public funds for the National Film Finance Corporation will be proposed before the present limit expires.

Measures will be brought before you to reform public sector housing subsidies in Scotland; to improve criminal procedure and reform the criminal justice system; and to extend the powers of Scottish local authorities in relation to their direct labour organisations.

My Government will make further progress with their programme of law reform.

Other measures will be laid before you.

MY LORDS AND MEMBERS OF THE HOUSE OF COMMONS,
I pray that the blessing of Almighty God may rest upon your counsels.

17 October 1977
CABINET

WIDER IMPLICATIONS OF THE INDUSTRIAL STRATEGY

Memorandum by the Chancellor of the Exchequer and the Secretary of State for Industry

1. At its meeting on 21 July (CM(77) 27th Conclusions, Minute 5), the Cabinet invited us to prepare a revised draft paper on the Wider Implications of the Industrial Strategy, for submission to the National Economic Development Council (NEDC). The Ministerial paper for NEDC and the annexed report by officials have been revised in the light of the Cabinet discussion, and of written comments from our colleagues (though we have not felt able to accept every one of the comments made). They have been further revised after discussion in a small group of Ministers (GEN 98).

2. Our earlier paper for Cabinet (CP(77) 84) explained the work of the official group which had led up to the NEDC paper in its earlier draft. It went on to:

i. list the new commitments and proposals contained in that draft;

ii. explain that certain important issues had not been discussed in the draft because it would be difficult to raise them on a tripartite basis at present;

iii. list certain other policy areas which the official group wished to draw to Ministers' attention;

iv. make proposals for further work in this field.

3. In this memorandum, we confine ourselves to summarising the main changes that have been made to the earlier draft. The main changes in the report by officials (Annex B) are as follows:

a. A section (paragraphs 1.10-1.12) has been added on Education and Training for Industry.
b. The paragraph (1. 20) on the overlap of incomes of people in, and out of, work now has a concluding sentence to show that we are trying to take steps to overcome this problem.

c. In paragraph 3. 2 there is no longer the implied suggestion that employment legislation is to stop dead. The draft now says that the Government will take full account of the volume of measures carried out in considering any fresh proposals in this field.

d. There is now (in paragraph 5. 2) a reference to the low level of company taxation in the United Kingdom, and also to the lower burden of social security contributions by industry than in other countries.

e. Paragraphs 6. 1 and 6. 2 have been added to cover the point that industry are concerned to avoid over-elaborate inflation accounting and company reporting requirements.

f. Paragraph 9. 2 includes a reference to the National Research Development Corporation.

g. The passage on competition policy (paragraph 12. 1) no longer includes a commitment to provide "guidance" on this to industry, since this is still for discussion by the Ministerial Committee on Economic and Industrial Policy (El).

h. Paragraph 13. 3 contains a clear commitment that we should aim for a greater interchange between the Civil Service and industry. The passage now says that we should be aiming for exchanges approaching 200 at any one time by the end of the decade.

In addition, the covering paper (Annex A) now gives more emphasis to the crucial need to improve our industrial performance, by all means possible, if we are to achieve our long term social and economic objectives. The drafting has also been tightened up.

4. The new commitments and proposals contained in the revised draft are the same as in the earlier draft, except in the areas of employment legislation and competition policy already mentioned. The commitments in these two areas now amount to:

i. An undertaking to take into account the volume of recent measures in considering future employment legislation.

ii. A review of the role of competition policy as part of the industrial strategy.
5. Our proposals for future work in this field remain as set out in paragraphs 8-11 of our earlier paper. Likewise, we would draw the attention of other Ministers as before to certain policy issues which the official group did not cover in their report, or did not cover fully.

CONCLUSION

6. The Cabinet is invited:

a. To approve the attached papers for submission to NEDC.

b. To endorse the proposals contained in the papers (as summarised in paragraph 4 of CP(77) 84 subject to the changes noted in paragraph 4 above).

c. To approve the proposals for further work in this field as set out in paragraphs 9-10 of CP(77) 84.

d. To take note of the points in paragraphs 5 and 6 of CP(77) 84.

D W H
E G V

Treasury Chambers
21 October 1977
ANNEX A

DRAFT NEDC PAPER

WIDER IMPLICATIONS OF THE INDUSTRIAL STRATEGY

Memorandum by the Chancellor of the Exchequer and the Secretary of State for Industry.

INTRODUCTION

1. Industry holds the key to the generation of wealth. In the post-war period we have been afflicted with a climate of opinion - effete and wrong-headed - in the UK which has been at best indifferent and at worst hostile to the role of industry in society. This tendency is deeply rooted in our history, class system and social structure. Society has not given the men and women who work in our manufacturing industry - at all levels - adequate recognition of their key role. Much of the best of our national talent has been brought up to believe that it is not nice to dirty their hands at the workbench or in the engineering shop. They have been influenced towards employment outside industry. Of course manufacturing is not the only sector which creates wealth and contributes to our trading performance. But it is in our manufacturing industry, despite its traditional dominance and its concentration of capital and skills, that we have lagged most conspicuously behind our major industrial competitors.

2. That is why the Government, in the November 1975 White Paper "An Approach to Industrial Strategy", committed itself to identifying the industrial implications of the whole range of its policies and undertook to "give greater weight, and more consistently than hitherto, to the need for increasing the national rate of growth through regenerating our industrial structure and improving efficiency. For the immediate future", it said, "this will mean giving priority to industrial development over consumption or even our social objectives. There is no other way of developing the industrial base on which the Government's whole programme of economic and social reform depends."
3. The attached paper is a first survey of the broad areas of Government policy (outside those directly covered by the work of the sector working parties) which bear in one way or another on industrial performance and efficiency. It also describes certain action already taken or now proposed to give a higher priority to the needs of industry, and makes proposals, subject to the views of the Council, on how this problem should be tackled in the longer term. It is no easy matter to change the deeply rooted attitudes and accumulation of policies which have contributed to industrial decline. The change will take many years; but the Government is determined to continue with this work. The objective must be to ensure that British industry receives at least the same degree of support, and as favourable an environment, as is given to their own industries by the countries which compete with us. That is the very minimum that we seek.

FUTURE ACTION
4. The Government proposes, subject to the views of the Council, to carry out further reviews of areas of policy which pose long-term problems for industrial efficiency. These are outlined in the attached paper as follows:

   (i) the employment of graduates by industry (paragraph 1.9);
   (ii) public sector manpower policy (paragraph 1.18);
   (iii) tax and social security in relation to work incentives (paragraph 1.25);
   (iv) the effect of standards and specifications on the export potential of products purchased by the public sector (paragraph 11.3);
   (v) mobility between the civil service and industry (paragraph 13.5);
   (vi) the burdens on industry (paragraph 13.6).

5. In addition it proposes that:
(i) Ministers from the non-industrial Departments should attend NEDC from time to time to discuss their contribution to the industrial strategy. A start was made in July when the Secretary of State for Education and Science and the Secretary of State for the Environment attended the Council.

(ii) SWPs should be invited to take note of the continuing work on the wider implications of the industrial strategy and to give their views on priority areas for changes in Government policy.

(iii) There should be regular reports to the Council on the progress made on the wider implications of the industrial strategy.

CONCLUSION

6. It is now impossible to imagine Britain's industrial scene without the tripartite Industrial Strategy. That is a measure of the success we are beginning to achieve. In the improving economic climate we must not relax our efforts. It would be disastrous if we now took it easy and cast away opportunities which may not easily return.

7. As part of the work, we must make real progress on the wider implications of the strategy. The attached paper draws attention to a wide range of problems, to many of which there are no easy or quick solutions. The Government would welcome the Council's views on effective ways in which these problems might be tackled.
WIDER IMPLICATIONS OF THE INDUSTRIAL STRATEGY

REPORT BY OFFICIALS

1. The attached report has been prepared in accordance with a remit by the Prime Minister dated 16 February for a Group of officials under Treasury chairmanship to prepare a draft paper for NEDC on the linking of industrial to other policies. The Group included representatives of the Departments of Education and Science, Employment, Energy, Environment, Health and Social Security, Industry, Prices and Consumer Protection, Trade, Transport, and the GSD, CPRS, FCO, MAFF and MOD.

2. This report (with the omission of this page) is intended to form an annex to a joint NEDC paper by the Chancellor of the Exchequer and the Secretary of State for Industry.
WIDER IMPLICATIONS OF THE INDUSTRIAL STRATEGY

Contents

LABOUR

1. The Supply of Labour to Industry: schools education; higher and further education; public sector manpower policy; incentives to work.

2. Mobility of Labour: Housing; transferability of pensions.

3. Employment Legislation

CAPITAL

4. Cost and Availability of Capital

5. Taxation

6. Company Reporting

PRODUCTION AND DISTRIBUTION

7. Infrastructure: planning and land; industrial development certificates and office development permits; building regulations; roads; public transport.

8. Production and Distribution Costs: pollution policy; energy policy; transport costs; water charges.

9. Research and Development

SALES

10. Marketing: metricalisation; standardisation.
BUSINESS ENVIRONMENT

11. Public Purchasing

12. Competition Policy

13. Relations with Government: civil service/industry mobility; burdens on industry.
LABOUR

1. The Supply of Labour to Industry

1.1 It is essential that a fair share of the nation's most able manpower - at all levels - is employed in manufacturing industry, and that their education, training and motivation are such that their ability can be fully utilised in industry. There is good reason to believe that this is not happening, and has not happened for a long time in the UK. A decisive shift of some of our most able manpower into manufacturing must be looked for if the regeneration of industry is to be achieved and sustained.

1.2 Schools Education. The influence of the education system on the economic performance of the country has been an important theme in the current public debate on school education, in which representatives from both sides of industry have played a full part. The Secretary of State for Education and Science published in July 1977 a consultative document "Education in Schools" (dealing with England and Wales) which set out conclusions and proposals for further action. Among the points in this document which are particularly relevant to the industrial strategy are the following:

i. although there is some public criticism of the schools, there is no clear evidence of a general decline in standards. In some schools the curriculum may have become overloaded to the detriment of essential skills, including literacy and numeracy. No other aims should divert attention from these essential elements of the curriculum;

ii. the balance and breadth of the school curriculum in each local education area will be reviewed by local education authorities and their teachers, and industry and commerce will be involved in this process;

iii. schools need to do more to prepare pupils for the transition to adult and working life, in particular by equipping them with a basic understanding of the functioning of the economy and activities, especially manufacturing industry, which create the nation's wealth;
iv. attention will be given to the development of methods of monitoring the performance of the school system, especially in English, mathematics and science;

v. various steps will be taken to improve the quality of the teaching force eg by requiring applicants to teacher training to have minimum qualifications in mathematics and English, and by developing in-service and induction training. (In this connection the Secretary of State recently announced a special programme to train serving teachers or unemployed qualified teachers in subjects important to the industrial strategy);

vi. encouragement will be given to the recruitment to teacher training of people who have had experience outside education;

vii. attention must be given in initial teacher training to acquainting teachers with the national importance of industry and commerce and to helping them to convey this to their pupils;

viii. local education authorities will in general need to develop more systematic approaches to the recruitment, career development, training and development of teachers, including procedures for assessment advice, and where necessary, early retirement;

ix. communications between employers, trade unions and the school need to be improved especially at the local level. Joint efforts should relate to such matters as improving understanding of the importance to our national life of productive industry and trade; the provision of work experience as part of a school course; increased opportunities for people in industry to visit schools, and teachers and pupils to visit factories; and the appointment of managers and trade unionists from industry as governors of schools;

x. local education authorities, schools and industry should consider together how careers guidance can best be developed to ensure that young people get correct and up-to-date information about jobs and training opportunities in local industry. Many schools will need to adjust their priorities to make room in the curriculum for careers education for all pupils not later than the age of 13.
1.3 Higher Education. As far as higher education is concerned, the evidence suggests that the intake by manufacturing industry of graduates falls short in both quality and quantity. The recently published consultation document, "Industry, Education and Management", reviews in detail some of the evidence for reaching such a conclusion. Many SWFs have also drawn attention to shortages in the supply of skilled manpower, particularly qualified engineers and scientists.

1.4 While there has been a substantial increase in the output of graduates entering employment over the past 25 years, the proportion entering employment in the manufacturing sector has decreased from a 1961 peak of 47% to 25.9% in 1975. The actual number of graduates recruited by industry has increased over the same period from 4611 to 6098, but in recent years has varied widely from year to year, reflecting such factors as the fluctuations in the economic cycle and the fall in employment in the manufacturing sector: the general level of recruitment in the 1970's has been lower than in the peak years of the late 1960's (8238 in 1969). These figures do not, however, reveal the final destination of the very large number of graduates who do not directly enter employment. The table below summarises an attempt to identify the sectors entered by all of those 1971 graduates known to have entered employment in the United Kingdom whether after obtaining their first qualification or later. It still relates to only about two-thirds of all 1971 university graduates:

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<td>Education</td>
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<td>Manufacturing Industry</td>
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1.5 The evidence covering the supply to industry of highly qualified manpower is, however, complex and difficult to interpret. It must be noted, for example, that the stock of graduates in industry has
risen markedly and that graduates are spreading into occupational levels not traditionally associated with them. Supply considerations are prominent among the matters covered in the recently published special report commissioned by the British Association for the Advancement of Science with Government support. The Government for its part is making a detailed factual study, making use of all available data including the experience of University Appointments Boards.

1.6 It is, however, generally agreed that the quality of the graduates recruited by industry should be improved; manufacturing industry in particular has not been attracting its proper share of the most able young people in the country. Engineering graduates, of whom the large majority take jobs in industry, have tended in the past to have on average poorer A level qualifications than those in most other subjects. While industry gets its full share of the more able amongst these graduates, a variety of factors including social attitudes and the fluctuating patterns of recruitment by industry have contributed to keeping the overall quality lower than it should be. There is, however, evidence that the trend is beginning to change. An apparent shift in attitude has led to both a marked upturn in the number of applications for courses in engineering and science in higher education, and an increased willingness on the part of graduates to seek employment in industry. There is also evidence that industrial recruitment now is steadier and more buoyant, while that of the public sector has abated. The institutions of higher education for their part have at present some spare capacity on the science and engineering side, and though this may be fairly quickly taken up, the opportunity exists for developing more courses with a clear industrial slant.

1.7 The long-term objectives for ensuring an adequate supply and use of highly-qualified manpower in industry must therefore be:

i. to increase the quantity and quality of the graduate output seeking industrial employment;

ii. for industry - particularly small and medium-sized firms - to alter its recruiting patterns to absorb more of the output of higher and further education;
taken

iii. to increase the account of industrial needs in the planning of degree courses in universities and polytechnics;

iv. to increase the knowledge and understanding of industry amongst teachers in higher education.

1.8 The following first steps towards these long-term objectives have been taken:

i. the DES has announced two financial incentives intended to attract able students into courses of particular value to industry:

a. a scheme (still to be worked out in detail) of industrial scholarships to be run in collaboration with industry. The full support of industry will be required if this scheme is to be successful, and the Government hopes that progress can be made as fast as possible;

b. a modification of the awards arrangements to enable employers to give students financial support up to £500 (in addition to present disregard of £185) without reduction of grant;

ii. in the post-graduate sphere priority is being given to the development of courses designed and run in close association with industry;

iii. a limited number of Universities, selected because they are strong in both engineering and management studies, are setting up first degree engineering courses of very high standard, with a pronounced orientation towards industry, designed for exceptionally able students who are likely to move into senior positions in industry.

iv. the UGC and the Council for National Academic Awards are also considering what kind of degree courses can best meet the needs of the growing number of students who will find their way into a broad range of jobs in industry not traditionally filled by graduates.
1.9 These are, however, only the first steps, and far-reaching changes in attitudes and practices may be required before the long-term objectives will be reached. The Government will give further consideration to these problems in the light of the statistical survey mentioned in paragraph 1.5 above, and the British Association's report. The enquiry under Sir Montague Finniston into the engineering profession which was announced on 4 July will also be relevant.

1.10 Education and Training for Industry. Industrial training is central to the industrial strategy and largely falls outside the scope of this paper. However, an increasing amount of training is carried out in colleges of further education. One of the most important areas in this respect is technician training. The Training Services Agency (TSA) have recently launched courses for technicians in electronics and computer maintenance (amongst other specialisms) and advised industrial training boards (ITBs) on developing a strategy for technician training. Moreover, the Manpower Services Commission (MSC) Review and Plan shortly to be published envisages giving high priority to extending the range of technician courses particularly where these can be linked to the industrial strategy.

1.11 The main contribution of the national network of some 700 further education (FE) colleges is in the primary education of technician, craft and operative personnel for industry providing courses leading to technician and other qualifications. The FE sector also contributes to the training and retraining of industrial personnel - by short intensive courses mounted at the request of firms or groups of firms, and by the FE element in MSC and TSA programmes. Colleges will provide courses to meet demand as they perceive it and as needs are identified and brought to their attention by, notably, employing organisations, the MSC, the ITBs and the various Regional Advisory Councils for Further Education; and these arrangements will call for the closest co-operation.

1.12 At present the further education sector is meeting the buoyant demand for vocational courses and appropriate curricula developments are being encouraged. It is also making a substantial contribution to management and trade union education. Much closer working between education and training is being promoted in relation to Training Opportunities Scheme and ITB courses, by means of the "unified vocational preparation" schemes jointly fostered by DES and the TSA, and
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in respect of the new Youth Opportunities Programme.

1.13 Public Sector Manpower Policy. Many SWPs have expressed concern that the public sector is absorbing too great a share of able manpower, particularly the well-qualified. So far, the Government has not sought to adjust the intake of qualified manpower to the public sector on the grounds of its impact on the supply available to industry.

1.14 As far as graduates are concerned, the proportion directly entering employment who entered the public services (excluding education) rose from 14.8% in 1965 to 26.2% in 1975 but fell back to 21.1% in 1976. The recent decrease in the intake of graduates by the public sector caused by public expenditure constraints has been associated with (although not necessarily the sole cause of) an increased number of graduates seeking industrial employment.

1.15 Statistics relating to other qualified people entering public services are not available, but estimates based on the 1971 Census of Population suggest that whereas 47 per cent of those with degree and equivalent qualifications are employed in the public sector (i.e. public services plus nationalised industries) 60 per cent of those with qualifications not of degree level but usually obtained after the age of 18 (a high proportion of which are in teaching and nursing but also include HNC and HND) were employed in that sector, as were 28 per cent of those with GCE A level or equivalent qualification but no higher qualifications. For comparison, slightly over a quarter of the total population were employed in the public sector in 1971. The skills exercised at the technician and craft levels are much more specific and job-related than those possessed by newly-qualified graduates. The public and private sectors are, generally speaking, in competition for those people only at a point when they leave school and before they are trained.
1.16 SWPs have in particular argued that, in many cases, manufacturing industry is unable to compete with the pay and conditions offered by the public sector. If this were widely the case, there would be a formidable combination of market and cultural forces which would lead to the public sector pre-empting qualified manpower in disproportionate quality and quantity.

1.17 This is, however, an area where facts are difficult to establish, where care must be taken to examine comparable jobs, and where generalisations are unlikely to be valid. It is also necessary to take account of the relativities between manufacturing industry and other parts of the private sector.

1.18 The Government believes that there is reason to be concerned at the possibility of pre-emption by the public sector of resources of able manpower at the expense of industry. It considers that much more account must now be taken in public sector manpower policies of their implications for the supply of labour to industry, and of relativities between the public sector and industry where they are competing for the same type of manpower. It proposes to conduct a more searching examination of the facts about public sector recruitment of qualified manpower (including pay relativities and other factors).

1.19 Incentives to Work. It is important from an industrial viewpoint that the taxation system does not distort the labour market to the extent that the normal wage structure fails to provide an adequate incentive to work and to gain skills and promotion. Yet there is widespread feeling - at all levels - that the present taxation system has weakened the incentive to work throughout the economy.

1.20 As far as the lower end of the labour market is concerned, a problem which has received much attention recently is that of the relationship between social security and welfare benefits for those out of work and earnings in work. This problem is limited in size, and its effects have been exaggerated. But situations do exist in which the net income of those unemployed or absent through sickness can, at least for a period, exceed their net earnings while in work, and in which, for others, the net additional reward from working is very small. This problem is caused not only by the level of benefits, but also by features of the tax system (low thresholds, and refunds...
f tax for those out of work). As well as the disincentive effect on those not in work, the perception of this problem can be demoralising for those in work. The Government is taking steps to reduce any such disincentive to work by tax reductions and by improvements in child benefits and similar measures when this is possible.

1.21 A closely related, but separate, problem is that of the "poverty trap" which affects those in work, and which flows from the combination of current taxation levels and means-tested benefits. This does not in practice mean, as is widely supposed, that those affected derive no net benefit from normal pay increases, because the income limits for means-tested benefits are regularly uprated and thus move up as pay moves up. But it does mean that there is a wide band of low earnings over which net income increases little if at all. For example, for a married man with 2 young children claiming all the available benefits, total net income does not increase at all between gross earnings of £30 and £45 a week, and increases by less than £5 between £45 and £60. There is therefore little incentive in this income range for a worker to increase his earnings - for example through working overtime, or through gaining skills or promotion, or through a change of job.

1.22 There has been a long-term tendency for differentials in post-tax pay between skilled and less skilled work to be compressed. As far as managerial pay is concerned, several surveys have shown that managerial pay, in the UK, is in general substantially lower than in other major industrial countries; though a large part of this simply reflects the overall difference in GDP per head, it has undoubtedly made overseas employment and emigration increasingly attractive to the more mobile and talented managers. The DoI's contacts with both US and UK multinationals confirm that they are having increasing difficulty in persuading UK nationals to return to the UK after service abroad because of the weight of direct taxation and lower salaries common here.

1.23 International comparisons of income taxation are never straightforward, partly because of the difficulty of establishing an acceptable basis of currency translation and partly because of the variation in the distribution of earnings. Despite the insurance principle which may underlie them, employee's social security contributions are generally regarded by those who pay them as part
of the income tax system, and in other countries are used to finance expenditure on items which in the UK are paid for out of general taxation. Although the UK income tax has a low threshold and high onset rate compared with other countries, the low rate of employees' social security contributions means that a married man with two children earning half the average production workers' wage will be paying out roughly the same percentage of his income in tax and insurance as his counterparts in other countries. However, at average earnings and above his tax and social security deductions together make up a larger percentage of gross pay in the UK. At average earnings, for example, he surrenders 23% of his income in tax and social security payments, at a marginal rate of 34%, while the equivalent tax payer in France pays only 4%, in Germany 22% and in the USA and Japan about 15% (including local income tax where appropriate). At five times average earnings he surrenders nearly 50% of his income in tax and social security payments, at a marginal rate of 75%, while the equivalent tax payer in France pays only 20% and in Germany, the USA and Japan between 35 and 40% (including local income tax where appropriate). At these levels of earnings the Netherlands is closest to the UK with about the same average rate but a slightly lower marginal rate. Only in Sweden are marginal and average deduction rates higher than in the UK.

1.24 The long-term objective must be to restore a situation in which - at all levels - the labour market can operate effectively and provide adequate incentives to work, while continuing to give protection to the poorer members of society. The inter-relation of social security benefits and tax is, however, an area of great complexity, where generalisations can be facile and where solutions may be difficult to find.

1.25 As stated in para 1.17 above the Government is already taking steps to deal with these problems. Moreover, the Chancellor of the Exchequer has given a commitment, as far as circumstances permit, to reduce the burden of income tax at all levels, and to increase the level of personal tax allowances to the point where they stand above the levels of the main social security benefits. The Government intends to give further consideration to the question how far the interaction of the tax and social security system creates disincentives to work at lower levels of earnings.
Mobility of Labour

2.1 The Government remains committed to its efforts to ensure through regional policy that jobs can go to workers in areas of high unemployment. But even in an economy with no regional imbalances, it would remain necessary to ensure that workers with particular skills can easily move to the particular vacant jobs requiring those skills. Even with the present high levels of unemployment, many cases are being reported by SWFs of shortages of key skilled workers. The machinery exists in the Employment Service Agency for circulating particulars of vacancies and of available labour throughout the country and this machinery is at present being modernised using the latest computerised techniques.

2.2 Housing and Industrial Mobility. Housing policy can greatly assist industrial regeneration by making it easier for people to move house to new jobs. This was recognised in the recent Green Papers on housing policy. Many of its proposals will help; in particular, wider access to home ownership; more flexible allocations and transfer policies in the local authority sector (especially the ending of residential qualifications for access to waiting lists); further support for the growth of housing associations and new forms of tenure; and measures to sustain the supply of 'quick access' accommodation in the private rented sector. Local authorities will be encouraged to think comprehensively about the needs of labour mobility in preparing the new local housing strategies each year; and central Government will be able to take their proposals into account in allocating capital resources. A pilot scheme is being set up to link local authority housing with vacancies for key workers so that these can be advertised by the ESA in other areas with an offer of local authority accommodation; and the Royal Commission on Legal Services is examining the cost of conveyancing of owner-occupied houses.

2.3 Transferability of Pensions. While there are no statutory obstacles to voluntary transfer of pension rights, there are certain practical difficulties which may, in some cases, impede occupational labour mobility. The Secretary of State for Social Services intends to invite the Occupational Pensions Board to study the question of transferability as soon as practicable.

Housing Policy: A Consultative Document Cmnd 6851
Scottish Housing: A Consultative Document Cmnd 6852
3. Employment Legislation

3.1 Recent years have seen a large amount of employment legislation, such as:

- Equal Pay Act, 1970;
- Industrial Relations Act, 1971;
- Contracts of Employment Act, 1972;
- Employment and Training Act, 1973;
- Health and Safety at Work Act, 1974;
- Trade Union and Labour Relations Act, 1974 and 1976;
- Sex Discrimination Act, 1975;
- Employment Protection Act, 1975.

Proposals for occupational pensions and industrial democracy legislation are also under consideration (and progress towards industrial democracy in some industries is already well advanced).

3.2 The Government is convinced that its major reforms are both necessary and desirable. If employees - and unions - feel more secure, they are more likely to co-operate to increase productivity and efficiency. However, the Government will take full account of the volume of measures carried by both Conservative and Labour Administrations in considering any fresh proposals which come forward for further legislation in this field. The Department of Employment has also arranged for two pieces of research to be carried out on the impact of recent measures on employers, in particular to establish whether there is validity in the view that these measures have made employers more reluctant to take on new labour.

CAPITAL

4. Cost and availability of capital

4.1 Since last autumn, interest rates have fallen very substantially; by about 10.0% at the short end and about 5% at the long end by October. The main questions relating to the cost and availability of capital are kept under review by the Roll Committee, and the Wilson Committee is examining the whole area of institutional arrangements for providing finance for industry; therefore these are not discussed in this paper.
The Government is, however, concerned that the banks should show a proper understanding of the needs and importance of industry, just as (as is discussed elsewhere in this paper) it is concerned that the civil service and education should show a proper understanding of industry. The Government therefore wishes to see an increasing involvement of the banks in the industrial strategy and welcomes the addition of bank representatives as members of SWPs.

5. Taxation

5.1 Detailed questions on taxation (such as the future of the stock relief scheme) are not appropriate to a discussion of the wider implications of the industrial strategy. However, it is appropriate here to emphasise that the Government's long-term taxation objectives include:

i. maintaining stability and continuity of the corporate tax system, to strengthen business planning and confidence;

ii. reducing the burden of direct personal taxation at all levels, and achieving a better balance between direct and indirect taxation;

iii. reducing the complexity of the tax system (which at present places a heavy administrative burden on industry and on Government).

Moreover, the Government considers it an important objective to create an environment which promotes innovation (eg by measures to assist small firms). These objectives constitute an appropriate fiscal background to the industrial strategy.

5.2 It is worth noting that by international standards the tax burden borne by the corporate sector is comparatively low. The real burden of corporation tax proper is generally not heavy, largely because of the impact of stock relief; and, moreover, the social security contributions payable by the employer in respect of his workforce are much lower than in most other European countries. This contrasts with personal income taxation where the UK levies a high burden by international standards.
6. **Company Reporting**

   6.1 The Government has supported the Sandilands Committee recommendation that current cost accounting should become the basis for the preparation of company accounts, as giving companies a better and more realistic view of their transactions than historic cost accounting. At the same time the Government has emphasised the importance of ensuring that the new system is practicable, which means that it must be kept simple to operate, especially for smaller companies and their accountants. In balancing the requirements for precision and simplicity, the Government will continue to encourage the accounting profession to avoid proposals which place too great a burden on companies.

   6.2 There are also proposals for other aspects of company reporting in the Green Paper just published by the Secretary of State for Trade. This recognises that there may be a case for imposing less onerous requirements on small firms, but again it will be necessary in reaching decisions to balance the case for a particular disclosure requirement against the extra work which companies will face in collecting and publishing the information.

**Production and Distribution**

7. **Infrastructure**

   7.1 **Planning and Land.** A number of SWPs have drawn attention to the danger that planning procedures may obstruct the industrial strategy, either because too little priority is placed on the need for industrial development or because of the slowness and complexity of planning procedures (which, it has been alleged, delay industrial development much more than is the case in other countries). The Government has taken the following steps:

   1. as described in the paper put to the Council in July by the Secretary of State for the Environment, it has asked local authorities now to give industry top priority in the handling of planning applications and in making land available for development and to be particularly sensitive to the needs of small firms in both urban and rural areas;
ii. as far as the Department of the Environment itself is concerned, matters relating to industrial development, including appeals and building regulations jurisdiction, will now be given first priority. While average times for the handling of planning appeals by the Department have almost halved in the last two years, the Government is determined to achieve an even greater improvement. The Department therefore proposes for the future to give priority to the handling of all industrial planning appeals. It also aims to transfer to inspectors all industrial planning appeals relating to buildings up to 1500 sq metres, as opposed to the existing upper limit of 500 sq metres. With these changes, the Department considers that it could work to a period of 5 months as the normal maximum for the handling of most industrial planning appeals, with not more than about one case in five exceeding that figure. That proportion cannot be eliminated because the handling of a planning appeal depends on co-operation by the local authorities and the applicant, and also on the amount of local opposition that may be generated. Highly contentious or large applications for industrial planning permission are often called in by the Secretary of State as the most satisfactory way of handling them. The times for such cases are not included in the references above and they would normally exceed five months. Special considerations apply also to mineral extraction cases. Steps are being taken within DOE to speed up the handling of such cases but many of them are complex and will continue to present difficulties;

iii. the Secretary of State for Scotland has published a consultation paper on the general operation of the planning system in Scotland: this includes possible means of speeding up the handling of planning applications. He also proposes discussions with the local authorities, STUC and CBI on the industrial strategy which will include, among other things, consideration of the ways in which the planning system might assist industry;

iv. similar steps to those of DOE are being taken by the Secretary of State for Wales.
7.2 The Government is considering whether research can be undertaken to monitor the effects of the above measures.

7.3 Industrial Development Certificates (IDC's) and Office Development Permits (ODP's). While the Government is committed to retaining these instruments as an essential part of regional policy, it made relaxations in the IDC scheme in 1976, and has now announced relaxations in the ODP scheme (which also impinges on manufacturing industry). It undertakes to operate both schemes in as flexible as possible a manner in the interests of the industrial strategy.

7.4 Building Regulations. Industry also has a close interest in the speedy handling of applications for building regulations approval. Work is at present being undertaken:

1. to develop a more flexible and time-saving procedure for building regulation;

2. to examine the scope for rationalisation of the building regulations and other legislation relating to buildings, particularly in respect of measures against fire.

7.5 Roads. One of the principal objectives for future transport policy set out in the Government's White Paper (Cmd 6836) is to contribute to economic growth and higher national prosperity by giving industry and other sectors of production an efficient transport service. To this end the Government will give priority within the national road programme to improvements on routes which serve the main industrial areas and the ports. Industrial traffic will also benefit from the road schemes chosen to serve regional needs and those designed to take heavy traffic out of built up areas. As far as local Government is concerned, authorities have been asked by the Government to reflect the priority for industry in their traffic management policies and in their choice of road schemes.

7.6 Public Transport. Adequate public transport services are essential if the labour force is to be properly matched with available employment, and if shift working is to be feasible. In its White Paper on Transport Policy, the Government re-affirms its belief that the maintenance of an effective network of bus services is an important aim of its transport policy and makes provision for a substantial and
continuing commitment to financial support. The White Paper rejects any notion of imposing major cuts in the railway system, and sets out the main tasks for the railways, of which the carriage of people to and from work in London and the major conurbations, and the carriage of bulk freight especially between sidings, are particularly material to this paper.

8. Production and Distribution Costs

8.1 Pollution Policy. The UK's geography and climate gives it an environment which can more easily absorb and disperse pollution than the environments of many continental countries. In order to protect this natural competitive advantage, the Government re-affirms its determination to work for the retention of the existing UK quality objectives approach, which is preferable in the circumstances of the UK on both economic and environmental grounds to uniform emission standards.

8.2 As far as existing UK practices are concerned, the Government does not consider that these in general are imposing an unreasonable burden on industry. However, there may have been cases where too abrupt changes or inconsistent decisions have been to the detriment of industry. The Government:

i. has asked local authorities to cease imposing planning conditions in an attempt to deal with problems which are the subject of controls under separate legislation;

ii. will make greater efforts to keep export industries in touch with international moves towards higher environmental standards.

8.3 Energy Policy. General energy policy issues have recently been the subject of separate discussion in NEDC. A Green Paper on Energy Policy will be published later this year.

8.4 A matter of concern to a number of SWPs has been that of energy pricing policy. In general, the Government considers that the prices to industry of electricity, coal, gas and oil do not compare unfavourably with price levels in other European countries, and that the objective of proper economic pricing is in the best long-term interests of industry as well as the economy in general.
8.5 It is sometimes argued that, in order to hold down prices for the domestic sector, there has in the past been a degree of cross-subsidisation within energy tariffs and prices against industrial consumers. In fact for a number of years both domestic and industrial tariffs were well below economic levels. The move towards proper economic pricing has, however, been accompanied by a better general balance between industrial and domestic prices and tariffs. The Government welcomes this move, and would not wish for the future to see discrimination against industrial consumers.

8.6 The real price of energy is, however, bound to rise over the longer term. The return to industry from energy conservation projects is therefore equally certain to be increasingly large. The Government hopes that the Council will use its influence to persuade industrialists of the benefits for them, as well as for the nation, in undertaking investment in energy conservation.

8.7 Transport Costs. Two EEC issues could have important consequences for transport costs:

i. the new proposals for harmonization of maximum permitted lorry weights and dimensions (which, if agreed, would reduce the costs of road freight and facilitate exports of lorries);

ii. the introduction of EEC rules on commercial drivers' hours (the increase in costs will be severe unless we can achieve the staged programme of implementation for which we are negotiating).

The Government will attach particular importance to the industrial implications in its approach to these two issues.

8.8 The Government's intention to increase taxation on heavy lorries is in line with the principle of covering full economic costs. However, it will continue to give full consideration to the views of industry in deciding on the pace of increase in this taxation.
8.9 Water Charges. Water authorities are under a statutory obligation to set charges high enough to break even. They are also required to fix charges with regard to costs, and to avoid undue discrimination between different classes of consumers. This effectively precludes them from discriminating in favour of industry: nor is it reasonable that they should, since they could only do so at the expense of the domestic consumers for whom water services charges are already a sensitive issue in the context of counter-inflation policy. Some industries have complained of particular difficulties arising from increases in trade effluent charges, especially where charges had been kept artificially low in the past and are now being increased as a result of the general move towards equalisation within regions (agreed in principle with the CBI). These industries are considering jointly with the water industry ways and means of solving these problems.

9. Research and Development

9.1 A number of recent policy initiatives have borne out the Government's determination to encourage R&D in industry. Selective assistance, under Section 8 of the Industry Act 1972, has included provision for product development assistance, and this is being extended under the Process and Product Development Scheme announced on 18 July. On a smaller scale, the Manufacturing Advisory Service announced in April, to which £8 million has been allocated over 5 years, will help smaller and medium sized firms in manufacturing industry, especially those engaged in metal working and assembly, to make better use of proven technologies.

9.2 Through such schemes the Government aims to assist industry to carry through its own research and development. Through the National Research Development Corporation (NRDC) assistance is already available both to industry and to private individuals for research into and development of inventions. The management of the Government's own research and development also has an important role to play. In the research council sphere special efforts are being devoted to the development of research in areas likely to be of special value to industry. For example, in science the resources devoted to "big science" (high energy physics, astronomy and space science) are being cut back by 25% to preserve scope for initiative in other fields (eg polymer engineering, marine technology and mineral exploration).
9.3 The eight Requirements Boards which commission research work on behalf of the Department of Industry aim to increase the number of contracts placed in industry or industry supported research associations, rather than "in-house". In aggregate the Boards plan to commission from industry 40% of the work over the next few years. This can be compared to the following proportions over the last 4 years:

<table>
<thead>
<tr>
<th>Year</th>
<th>1973-74</th>
<th>1974-75</th>
<th>1975-76</th>
<th>1976-77</th>
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<tr>
<td></td>
<td>12.7%</td>
<td>12.9%</td>
<td>17.2%</td>
<td>21.9%</td>
</tr>
</tbody>
</table>

Some work will of course continue to be done by the Department's own Industrial Research Establishments. However, the Government recognizes the importance of getting the fruits of this work out into industry for industry to develop as early as possible.

9.4 Moreover, all Government departments which sponsor technical developments have been asked to review arrangements to ensure that as much as possible of the work is done in industry rather than "in-house".

9.5 The Advisory Council on Applied Research and Development (ACARD) has now been established under the Lord Privy Seal's chairmanship. Its work programme is specifically directed towards the industry-related aspects of R&D. It will, inter alia, be considering the Government's role as a commissioner of R&D and how full industrial benefits can be gained from this.

SALES

10. Marketing
10.1 Metrication. The Government has now put forward a metrication programme as a basis for consultation, and recognizes the industrial importance of the implementation of metrication being completed as rapidly as possible.

10.2 Standardization. The Government is urgently following up the recommendations addressed to it in the Warner Report, which will be the subject of a separate report to the Council.
10.3 Consumer Protection. In general consumer protection measures operate at the point of sale and thus have no direct effect on manufacturing industry. Proposals on product liability, under which producers would be automatically liable for damage caused by their products, may have implications for insurance cover needed by manufacturers in certain sectors (notably pharmaceuticals, machine tools, motor cars), but at present there is insufficient evidence to quantify the effect in relation to other costs.

11. Public Purchasing

11.1 The scope for further increases in the proportion of public purchases made from UK manufacturers is limited, given that nearly 95% by value of current purchases are made from UK manufacturers (excluding raw materials where certain imports are inescapable and international defence collaborative projects which are designed to be self-balancing). However, the Government:

i. is looking for ways of reducing yet further the amount of public purchases which come from abroad;

ii. will consider ways in which the UK content of purchases from UK suppliers can be maximised.

11.2 An area in which greater progress can be looked for is that of the impact of standards and specifications on the export potential of products purchased by the public sector. Attention has been focused on problems here by the Warner and Brown Reports, as well as by SWP reports. The Government is determined to make substantial progress here, and hopes that industry will take every opportunity to draw attention to the possibilities of concrete action in specific areas.

11.3 The Warner Report noted a number of specific areas whose export potential might thus be enhanced. By way of a pilot exercise, the Department of Industry proposes to examine in detail the supply of broadcasting equipment. The Department will discuss with purchasers and manufacturers whether there is scope for export efforts to be improved by action along the lines recommended in the Warner Report.
BUSINESS ENVIRONMENT

12. Competition Policy
12.1 Competition policy has an important role to play, as part of the industrial strategy, in improving the performance of British industry. The Government is reviewing the operation and effectiveness of competition policy in achieving this objective through the existing legislation and institutions.

13. Relations with Government
13.1 Civil service/industry mobility. It is widely held that the British practice of offering a full life career in the Civil Service, and of little mid-life recruitment, leads to a lack of mutual understanding between the Service and industry, and therefore a failure to give enough weight to industry's interests and concerns when policy is being formulated. Recognising that there is a degree of truth in this, the Government and the CBI alike for more than a decade have accepted interchange postings between the Civil Service and industry as an aim of policy. By continuous effort on both sides something has been achieved, but not on a large scale.

13.2 Between 1973 and 1975, for instance, some 35 civil servants have undertaken exchange postings to industry and commerce, and similarly some 70 people from the private sector have done spells in the Service - mainly at middle management level. On top of these figures, some 60 recruits via the direct entry Principal competition have joined the Service in the last 5 years in mid-life after industrial and commercial experience. Despite strong opposition from the Civil Service unions this line of recruitment is being maintained even in present circumstances of manpower cuts. Its benefits are cumulative, and nearly all of those recruited stay in the Service, so the total from this background continues to grow. Further industrial and commercial experience has also been imported by recruitment from outside for posts where specific prior experience is necessary or highly desirable.

13.3 Nevertheless, the Government considers that it is very important to achieve a much higher degree of interchange between the Civil Service and industry, and to promote a much greater degree
of mutual understanding on both sides. Although there are very real difficulties in arranging exchange postings, they represent the best short-term prospect of further improvement. The Government therefore proposes to achieve a sharp and substantial increase in the number of civil servants seconded to industry. More secondments of businessmen into the Civil Service would also be desirable (although the flow of secondments need not balance either locally or generally). This is likely to prove more difficult than secondments in the other direction because able businessmen run greater risks than civil servants of jeopardising their careers if they leave them for crucial periods, and problems of pay and conflict of interest can also arise. To attain these two objectives the Government intends to aim to at least double the number of civil servants seconded to industry by the end of the decade and to ensure that by then the total number of exchanges in operation in both directions at any one time will be approaching 200. This will require the active co-operation of all departments, and hence of a very wide spread of industrial and commercial employers; and the Government proposes to hold talks with the CBI and leading firms to secure their assistance in achieving the substantial increases which are needed.

13.4 There are attractions in making the secondments rather shorter than the usual 2-3 years. This can usefully increase the number of people who have had direct experience in commerce and industry, while also reducing the degree of sacrifice the parent organisation has to make. This change can be associated with linking the secondment to a specific project, which has a number of advantages. This approach has already been tried successfully on a small scale. It could well be a significant component in the further expansion of secondments. The use of joint seminars (which have already proved useful) will be extended. The wider use of training processes, within the Service or in co-operation with the business school, is in hand.

13.5 However, the Government considers that the question of civil service/industry mobility requires further consideration in the longer term. This may involve rethinking of issues which go much wider than the matter of secondments.

13.6 Burdens on industry. It is frequently alleged by industrialists that the cumulative burden of Government requirements – such as
collection of information, the complexity of the tax system, planning delays and legislative requirements - imposes unreasonable costs on industry, particularly on smaller firms, and damages efficiency. The Government therefore proposes, as a first step, to arrange for a fact-finding exercise to be carried out to assess the total burden of Government legislative and administrative requirements on some representative firms.
20 October 1977

CABINET

THE QUEEN’S SPEECH ON THE PROROGATION OF PARLIAMENT

Note by the Secretary of the Cabinet

I attach for the information of the Cabinet copies of The Queen’s Speech on the Prorogation of Parliament in the form in which it has been submitted to the Counsellors of State for approval on behalf of The Queen.

Signed JOHN HUNT

Cabinet Office

20 October 1977
MY LORDS AND MEMBERS OF THE HOUSE OF COMMONS,

My husband and I look back with delight and gratitude on the events which
marked My Silver Jubilee at home and overseas, and the visits which we made to
many parts of the United Kingdom and the Commonwealth.

I was pleased to welcome Commonwealth leaders in London for the 1977
Commonwealth Heads of Government Meeting, for which My Government were
the hosts. The intensive and friendly discussions there strengthened
the Commonwealth relationship and contributed towards the solution of certain
international problems.

My Government played an active and constructive part in the activities
of the European Communities, which included two meetings of the European
Council, one in London, and held the Presidency of the Council of Ministers
for the first six months of 1977.

My Government have played a full and positive role in institutions to promote
international development and efforts to create a more just and stable
economic order, and in discussions on the problems of world unemployment
and inflation; they were hosts to the Downing Street Conference of the
leaders of the seven major industrialised countries.

Legislation has been passed to enable the United Kingdom to ratify amendments
to the Articles of Agreement of the International Monetary Fund and to assist
United Kingdom trade and the provision of aid for the poorest countries.
Special assistance has been given to southern African refugees.

My Government have continued their efforts to promote a negotiated
settlement in Rhodesia.
My Government have been active, in co-operation with other Western members of the Security Council, in working for a settlement in Namibia which will bring the country to independence in a manner which will meet with international acceptance and will give the people a chance to select freely their own government.

My Government have continued to attach importance to the development of detente, and of constructive political and economic relations, with the Soviet Union and the countries of Eastern Europe. They have continued to work for mutual and balanced force reductions in Central Europe. They are participating with the Governments of the United States and the Soviet Union in discussions aimed at the negotiation of a Comprehensive Test Ban Treaty.

My Government were pleased to act as hosts at the Ministerial Meeting of the North Atlantic Council which was attended by Heads of Government in London in May, and which established new programmes of work in the political and defence fields.

MEMBERS OF THE HOUSE OF COMMONS,
I thank you for the provision which you have made for the honour and dignity of the Crown and for the public services.

MY LORDS AND MEMBERS OF THE HOUSE OF COMMONS,
My Government have given continuing priority to their policy of restraining price levels, and of the fullest possible co-operation to this end with both sides of industry. The second round of voluntary pay policy has been observed throughout the economy, and the way has been prepared for an orderly return to normal collective bargaining. Legislation has been passed to make new provision for the scrutiny and effective control of prices, and a new Price Commission has been appointed. Successful steps have been taken to restore confidence in the financial markets and improve the balance of payments.
My Government remain deeply concerned about the continuing high level of unemployment, and have introduced additional employment and training measures to tackle this problem, including the youth opportunities programme.

My Government have maintained their policy of strengthening industry through the development of the industrial strategy, through industrial assistance schemes, and through the work of the National Enterprise Board and the Scottish, Welsh and Northern Ireland Development Agencies.

Legislation was enacted to bring into public ownership the aircraft and guided weapons, shipbuilding and marine engine building industries. British Shipbuilders have acquired by negotiation a major part of the ship-repairing industry.

An Act has been passed to enlarge the Post Office Board so as to allow an experiment in industrial democracy.

Legislation has been enacted to give the National Coal Board additional powers and provide the framework for the further development of the coal industry, and to make further provision for the financing of British Nuclear Fuels Limited and the Radiochemical Centre Limited. My Government are completing the award of licences, all involving majority state participation, under the Fifth Round of off-shore petroleum licensing.

Steps have been taken to ensure further safeguards in the management of nuclear waste, and full and public consideration of the problems relating to nuclear development; a public inquiry has been set up to examine the proposal for the construction of an oxide fuel reprocessing plant at Windscale.

Legislation has been passed extending United Kingdom fishery limits to 200 miles; tribute is due to the hard work of the fishery protection units in enforcing the new limits.
A new and favourable Air Services Agreement with the United States of America has been signed.

An Act has been passed to reform patent law and to make possible the United Kingdom's participation in certain international agreements including the European Patent Convention.

In Northern Ireland the Royal Ulster Constabulary, supported by My Armed Forces, have continued to enforce the law with impartiality and deserve the highest praise for their success in reducing the level of violence. My Government have maintained the aim of a just and lasting constitutional settlement, and they have taken measures to combat the economic and social problems in the Province, including new incentives for investment.

My Government have published Green Papers discussing possible changes in the arrangements for financing local authorities.

My Government have continued to develop a housing policy designed to deal more effectively with the most pressing needs and to broaden housing opportunities. Proposals have been published for a comprehensive housing policy for the longer term, and legislation has been enacted to place statutory responsibility for assisting the homeless on local housing authorities.

My Ministers have announced new initiatives for the regeneration of inner urban areas, including the expansion and adaptation of the urban programme and the offer of partnership arrangements between central government and selected local authorities.

Proposals have been laid before you for strengthening the water industry and for the future of the British Waterways Board.

My Government have reviewed the development programme of new towns in England and have established a new programme for their completion.
My Government have published a White Paper setting out their proposals for the future development of transport policy to meet economic and social needs. An Act has been passed to provide continued financial support to the British Railways Board and the National Freight Corporation.

Provision has been made for increases in social security benefits and war pensions. Legislation was enacted making a number of changes in the field of social security, including supplementary benefit. The new Child Benefit was brought into payment for all children, including the first.

My Government have continued to promote and encourage voluntary effort and a sense of caring in the community and have launched and will sustain a Good Neighbour Campaign aimed at involving the community in the care of its members. I hope that the community spirit fostered by the celebrations of My Jubilee will be strengthened and developed in the years to come.

My Government have published a Green Paper setting out proposals on education in schools, with particular regard to the curriculum, standards of performance, the training and employment of teachers and the preparation of pupils for the needs of adult life.

An Act has been passed to amend the criminal law, particularly in relation to conspiracy, and to improve its administration; and the process of reforming the law has been continued with the Administration of Justice Act and other measures.

My Government welcome the passage of the Unfair Contract Terms Act, which marks an important advance in consumer protection. Grants have been made to maintain the provision of help to consumers.

Among the Acts passed in relation to Scotland were measures concerned with the modernisation of the law of marriage and with the enforcement of planning procedures.

My Lords and Members of the House of Commons,
I pray that the blessings of Almighty God may attend you.
My Lords and Members of the House of Commons,

I was pleased to welcome Commonwealth leaders in London for the 1977 Commonwealth Heads of Government Meeting, for which My Government were the hosts. The intensive and friendly discussions there strengthened the Commonwealth relationship and contributed towards the solution of certain international problems.

My Government played an active and constructive part in the activities of the European Communities, which included two meetings of the European Council, one in London, and held the Presidency of the Council of Ministers for the first six months of 1977.

My Government have played a full and positive role in institutions to promote international development and efforts to create a more just and stable economic order, and in discussions on the problems of world unemployment and inflation; they were hosts to the Downing Street Conference of the leaders of the seven major industrialised countries.

Legislation has been passed to enable the United Kingdom to ratify amendments to the Articles of Agreement of the International Monetary Fund and to assist United Kingdom trade and the provision of aid for the poorest countries. Special assistance has been given to southern African refugees.

My Government have continued their efforts to promote a negotiated settlement in Rhodesia.

My Government have been active, in co-operation with other Western members of the Security Council, in working for a settlement in Namibia which will bring the country to independence in a manner which will meet with international acceptance and will give the people a chance to select freely their own government.

My Government have continued to attach importance to the development of detente, and of constructive political and economic relations, with the Soviet Union and the countries of Eastern Europe. They have continued to work for mutual and balanced force reductions in Central Europe. They are participating with the Governments of the United States and the Soviet Union in discussions aimed at the negotiation of a Comprehensive Test Ban Treaty.
My Government were pleased to act as hosts at the Ministerial Meeting of the North Atlantic Council which was attended by Heads of Government in London in May, and which established new programmes of work in the political and defence fields.

MEMBERS OF THE HOUSE OF COMMONS,

I thank you for the provision which you have made for the honour and dignity of the Crown and for the public services.

MY LORDS AND MEMBERS OF THE HOUSE OF COMMONS,

My Government have given continuing priority to their policy of restraining price levels, and of the fullest possible cooperation to this end with both sides of industry. The second round of voluntary pay policy has been observed throughout the economy, and the way has been prepared for an orderly return to normal collective bargaining. Legislation has been passed to make new provision for the scrutiny and effective control of prices, and a new Price Commission has been appointed. Successful steps have been taken to restore confidence in the financial markets and improve the balance of payments.

My Government remain deeply concerned about the continuing high level of unemployment, and have introduced additional employment and training measures to tackle this problem, including the youth opportunities programme.

My Government have maintained their policy of strengthening industry through the development of the industrial strategy, through industrial assistance schemes, and through the work of the National Enterprise Board and the Scottish, Welsh and Northern Ireland Development Agencies.

Legislation was enacted to bring into public ownership the aircraft and guided weapons, shipbuilding and marine engine building industries. British Shipbuilders have acquired by negotiation a major part of the ship-repairing industry.

An Act has been passed to enlarge the Post Office board so as to allow an experiment in industrial democracy.

Legislation has been enacted to give the National Coal Board additional powers and provide the framework for the further development of the coal industry, and to make further provision for the financing of British Nuclear Fuels Limited and the Radiochemical Centre Limited. My Government are completing the award of licences, all involving majority state participation, under the Fifth Round of off-shore petroleum licensing.
Steps have been taken to ensure further safeguards in the management of nuclear waste, and full and public consideration of the problems relating to nuclear development; a public inquiry has been set up to examine the proposal for the construction of an oxide fuel reprocessing plant at Windscale.

Legislation has been passed extending United Kingdom fishery limits to 200 miles; tribute is due to the hard work of the fishery protection units in enforcing the new limits.

A new and favourable Air Services Agreement with the United States of America has been signed.

An Act has been passed to reform patent law and to make possible the United Kingdom's participation in certain international agreements including the European Patent Convention.

In Northern Ireland the Royal Ulster Constabulary, supported by My Armed Forces, have continued to enforce the law with impartiality and deserve the highest praise for their success in reducing the level of violence. My Government have maintained the aim of a just and lasting constitutional settlement, and they have taken measures to combat the economic and social problems in the Province, including new incentives for investment.

My Government have published Green Papers discussing possible changes in the arrangements for financing local authorities.

My Government have continued to develop a housing policy designed to deal more effectively with the most pressing needs and to broaden housing opportunities. Proposals have been published for a comprehensive housing policy for the longer term, and legislation has been enacted to place statutory responsibility for assisting the homeless on local housing authorities.

My Ministers have announced new initiatives for the regeneration of inner urban areas, including the expansion and adaptation of the urban programme and the offer of partnership arrangements between central government and selected local authorities.

Proposals have been laid before you for strengthening the water industry and for the future of the British Waterways Board.

My Government have reviewed the development programme of new towns in England and have established a new programme for their completion.
My Government have published a White Paper setting out their proposals for the future development of transport policy to meet economic and social needs. An Act has been passed to provide continued financial support to the British Railways Board and the National Freight Corporation.

Provision has been made for increases in social security benefits and war pensions. Legislation was enacted making a number of changes in the field of social security, including supplementary benefit. The new Child Benefit was brought into payment for all children, including the first.

My Government have continued to promote and encourage voluntary effort and a sense of caring in the community and have launched and will sustain a Good Neighbour Campaign aimed at involving the community in the care of its members. I hope that the community spirit fostered by the celebrations of My Jubilee will be strengthened and developed in the years to come.

My Government have published a Green Paper setting out proposals on education in schools, with particular regard to the curriculum, standards of performance, the training and employment of teachers and the preparation of pupils for the needs of adult life.

An Act has been passed to amend the criminal law, particularly in relation to conspiracy, and to improve its administration; and the process of reforming the law has been continued with the Administration of Justice Act and other measures.

My Government welcome the passage of the Unfair Contract Terms Act, which marks an important advance in consumer protection. Grants have been made to maintain the provision of help to consumers.

Among the Acts passed in relation to Scotland were measures concerned with the modernisation of the law of marriage and with the enforcement of planning procedures.

MY LORDS AND MEMBERS OF THE HOUSE OF COMMONS

I pray that the blessings of Almighty God may attend you.
CABINET

PAY POLICY

Memorandum by the Chancellor of the Exchequer

1. Our pay policy has reached a critical stage at which we need to take stock and consider what lines of action we should follow over the next few weeks.

PROGRESS SO FAR

2. From the starting point in July of widespread scepticism about our policy, general expectations of 20 per cent or more as the outcome, and threatened or actual claims of inordinate increases, we have made sufficient progress to avoid the risk of an immediate and dramatic wage explosion. This is on the credit side, and it is backed by:

   - increasing public acceptance that the Government is pursuing its policy with determination (threat of using discretionary powers and their actual use in the Mackie case, and resistance to the Air Traffic Control Assistants' claim in the face of industrial action, are two particular features which have had considerable impact);

   - as far as actual settlements are concerned, approximately nine out of ten are believed to have been broadly "within the guidelines", although that phrase is interpreted as referring to the 10 per cent earnings target published in Cmnd 6882 and not to the desirability of reaching settlements well into single figures;

   - there have been no significant settlements so far which have clearly breached the guidelines.

3. But there is a debit side also:

   - no really important settlements have yet been made at all, and the total of settlements so far is much smaller than at the same time in previous pay rounds;
- ten per cent has come to be regarded as a minimum level, without paying too much attention to elements of drift which are not obviously identifiable;
- some trade unionists seem to be working to establish 15 per cent as a "socially responsible" alternative to the Government 10 per cent;
- no leeway has been created for settlement of any anomalies or special cases where there might be some justification for settlements considerably above any average.

PROSPECTS

4. The tone of the present round is already beginning to be set. The best interpretation one can put on it is that a substantial number of settlements might be achieved at 10 per cent or very little above, not allowing fully for drift, with some settlements a few percentage points above that level and almost none below. This would indicate at best an outcome for the national average over the year as a whole in the 12-14 per cent range.

5. Even this, however, would depend on containing actual settlements or their repercussions, in a variety of important cases and types of cases coming up over the next few weeks. The main ones are probably the following:

i. **Ford:** it is not yet clear whether the offer of just under 12 per cent will stick, or what effect industrial action or the threat of it will have. What is clear is that there will be a widespread tendency to interpret a settlement on the basis of the present offer as being 12 per cent plus, and that many other important negotiations will take that as the standard.

ii. **Local Authority Manuals:** the employers are reckoning to settle "between 9.99 per cent and 10 per cent" on earnings. They are conscious that this will make it difficult to settle within the same limit for the Fire Service, and they would like to settle higher for the police. It would in their view be difficult to justify for any other local authority group less than the manuals get.

iii. **Police:** the Police Federation is intensifying its campaign for an excessive pay increase for the police. The Conservative Party has made such an increase part of its policy. In the course of discussions about a Round Two settlement the Trades Union Congress (TUC) was sounded unofficially about giving the police special treatment and advised strongly against, indicating that anything conceded to the police would be demanded by others. This is bound to be true too in the present situation, where any offer in excess of the 10 per...
cent guideline will be taken as a green light not only by other public sector groups such as the firemen but also by heavyweight industrial unions who are already seeking to break the guideline.

iv. **Miners**: the proposed productivity scheme is due to go to ballot on 26/27 October after a very small majority on the National Executive. The result is expected on 1 November (subject to any delay due to legal action now under consideration by the defeated members of the Executive). It remains to be seen whether it will be approved; and even if it is, whether it will take the steam out of the pay claim for £135 a week as we have been promised.

v. **Vauxhall**: it is reported that they are proposing a reopener clause triggered by any increase in prices exceeding 8 per cent - a figure which comes dangerously near to guaranteeing a reopening.

vi. **Road Haulage**: there is no sign of a reduction in the level of the proposed settlement which seems to involve at least 15 per cent earnings increase.

vii. **Heating and Ventilation**: in the construction industry, in spite of its poor level of activity, the proposed 20 per cent settlement could set a totally unacceptable standard.

viii. **Productivity Deals**: as was always to be feared, there are indications that such deals are being devised wherever there is any colourable excuse for them without questioning if they are self-financing.

ix. **Special Cases**: the current mood of negotiation gives no hope that special cases and anomalies can be dealt with by increases above other settlements without creating resentment.

x. **Low Pay**: in wages councils and elsewhere it is argued that special help should be given to the low-paid, which implies another addition to the average, even if repercussions can be avoided. (A note at Annex A gives the case for and against setting a floor on wage increases for the very low paid.)

6. If any significant number of these problems is left to develop on the lines currently indicated, the pattern of settlements is all too likely to creep gradually higher, and we shall end the year with national earnings increasing by something approaching, or even exceeding, 15 per cent.

**OUTLOOK FOR FUTURE INFLATION**

7. Developments over the next few weeks are likely to determine the position we shall reach early next summer. The alternatives can be starkly illustrated. Assuming no major change in other factors which
influence inflation, we can be confident that the year-on-year rate of inflation measured by the Retail Price Index will fall below 10 per cent around the late spring of 1978, almost irrespective of the immediate prospects on the pay front. But we then have two possibilities:-

a. If we are succeeding in running a relatively tight overall pay policy, with prospects for the national earnings average rising over the year by not much more than 10 per cent, the climate of expectation - and the reality - will be that the rate of price inflation is likely to continue downwards. This will obviously provide us with the best possible basis on which to carry forward the attack on inflation subsequently and to encourage higher growth in the economy.

b. If, however, the earnings increase is towards 15 per cent (and of course particularly if, as would be only too likely in the circumstances postulated, financial confidence weakened, our international competitiveness was being undermined, and the exchange rate was going down) we could expect a renewed increase in the rate of inflation.

RENEWING THE ATTACK ON INFLATION

8. We need to consider what we can do ourselves as Government, and whether we can now resume discussions with the TUC and probably also with the Confederation of British Industry (CBI) for help in securing our objective.

9. As regards our own action, we must show continued determination on each and every case which comes before us, with particular regard to those which threaten repercussions. We need to make sure that our internal procedures secure that significant public sector cases continue to be cleared interdepartmentally and if necessary considered by Ministers before offers are made. More generally, as I have suggested to the Subcommittee on Pay Negotiations of the Ministerial Committee on Economic Strategy, we should try to tighten the current application of policy, building on the degree of relative moderation achieved so far and the falling rate of price inflation. For example, we should:

i. re-emphasise the difference between settlements and earnings and reiterate publicly and frequently the need for individual pay settlements to be well within single figures;

ii. in assessing individual settlements, take a more critical view of the possibilities of wage drift and seek maximum allowance for it;

iii. where there is the chance of securing a below-average settlement, in both private and public sectors, this should be encouraged.
I would now add three further points for consideration:

i. we should continue to use discretionary power to withhold financial benefits, and even possibly some other benefits, in cases arising during the next few weeks; in suggesting this, I am fully conscious of the difficulties of long-term use of a policy of this kind, and the need for extreme care in handling individual cases (a note at Annex B summarises the conclusions on this of the Sub-Committee on Pay Negotiations);

ii. we should avoid making any concessions or accepting any special cases during the next few critical weeks;

iii. we should take particular care to demonstrate firmness in relation to all public sector settlements - there are comparatively few in the coming weeks but our action on them will be taken as exemplary.

I think it is also for consideration whether the time has come to renew discussions with the TUC. If we do so, we should certainly also talk with the CBI, although I regard that in present circumstances as being both less difficult and less important.

There can be no doubt that we have a basis for a new approach to the TUC. We can put the following points to them:

a. The declining rate of inflation has been clearly established: all commentators agree that we are on the road to single-figure inflation.

b. We have decided and are about to announce a package of measures, to be implemented immediately, which will have considerable appeal to the TUC. We are able to show that restraint in wage demands is not only compatible with, but positively helps, an improvement in the standard of living - if wage settlements creep up and bring rising inflation in the second half of 1978, then we will have little chance of bringing unemployment down and of winning the next Election.

CONCLUSION

I invite my colleagues:

i. To endorse the need for further effort to improve the prospects of success in the current pay round.
ii. To consider the possible lines of action indicated in this paper and suggest others which may occur to them.

D W H

Treasury Chambers

20 October 1977
THE APPLICATION OF PAY POLICY TO LOW PAID GROUPS

THE INCIDENCE OF LOW PAY

Some 1.8 million full time adult employees are currently earning less than £40 per week, about 1.5 million of them women. It is not certain how many of the 300,000 men are heads of households; estimates suggest that the number of such workers with families of two children may be up to about 50,000; among the women, also, some will be the main breadwinner in a family group. It is also estimated that there are some 100,000 families where the head is in employment and which are eligible for means tested EIS. The Supplementary Commission have recently pointed out, in their evidence on low incomes to the Royal Commission on the Distribution of Income and Wealth, that low levels of pay are now constraining the scales of benefits which they would otherwise think appropriate for those who are not in work.

SPECIAL PROVISION FOR THE LOW PAID

1. Pay policies have generally made special provision for the low paid. It can be argued that some progress has been made thereby, in that the lowest decile of the earnings distribution, now about £50 per week, is some 68 per cent of the median, when in 1970 it was only 65 per cent. But such progress is at best slow and the need to make further improvements points to a case for making special provision in the current pay round as much as in 1975 and 1976. It is true that the TUC did not pass a NUPE motion for a £50 minimum wage, but this was against a background of a return to free collective bargaining in which negotiators could press a special case for the low paid.

2. In the context of the present pay guidelines, the case for special provision rests mainly on the difficulty of defending a restriction to 10 per cent of the earnings of those who are paid £40 or less for a normal week. This is particularly true for Wages Council rates, the majority of which are around £30, and some well below. Some independent members of important councils are known to feel strongly about this and might move towards recommendations and statutory orders which Government
would have no powers to alter. This could lead to a serious confrontation over pay policy.

4. Proposals for dealing with low pay are to allow freedom for collective bargaining below £40 without any constraint from pay policy; or a modification of the present 10 per cent limit to a limit of £4 or 10 per cent whichever is the higher.

The Case Against

5. These proposals are however open to doubt in two important respects. First, there is evidence that special increases at the lower end of the pay range do not affect more than a small proportion of those who need help because of family poverty; there is also evidence, contrary to that adduced above, that special provision for minimum pay increases does not in fact improve the earnings distribution in favour of the lower paid.

6. On the first point, it has been established that only a very small proportion of the low paid belong to poor households. The figures in Paragraph 1 above show the relatively small number of families in real need who would be affected by special provisions covering nearly 2 million workers. Moreover, the evidence also suggests that even such benefits as might accrue in the short run are not in fact maintained. While the statistics in Paragraph 2 above suggest some slight improvement for the lowest decile in the earning range, similar statistics for the lowest one per cent of the earnings distribution show that there has been no improvement at all over the years. The lowest percentile of the earnings distribution now bears the same relation to the median as it did in 1970, and this suggests that such attempts as there have been to help the low paid have worked right through the earnings distribution, raising the general level of earnings but meanwhile leaving an impression of an attempt by Government to compress differentials. It was one of the aims of the guidelines put forward in Cmnd 6882 to provide for earnings increases in percentage terms, without any suggestion of compression at either end of the scale and special provision now intended to provide a minimum pay increase for the low paid would run counter to this principle.
THE USE OF DISCRETIONARY POWERS IN SUPPORT OF THE PAY POLICY

At its discussion on Friday 14 October (EY(P)(77) 16th Meeting, item 1) the Sub-Committee on Pay Negotiations had before them reports by the Official Committee on Prices and Incomes (attached to EY(P)(77)62) and by the Attorney General (EY(P)(77)65).

The Sub-Committee noted the political and legal difficulties and dangers inherent in the present unsatisfactory position, resulting from the use of measures which were not purpose-built to support the pay policy and from the lack of a precisely defined pay limit. There was general agreement that the Government could not rely on the use of discretionary powers as the sole or main instrument of pay policy and that they were not an effective substitute for the support of the TUC and CBI. They were weaker than the sanctions available in Rounds 1 and 2 and the price sanction was almost non-operative. While it was true that in some instances as in the Mackies case the Government could argue that the pay policy was entirely consistent with the original purposes of the instrument being used, no general system of legal sanctions could operate in the absence of a rigid pay formula and in these conditions the only available course was to handle each case carefully on its merits.

It was therefore agreed that:

(i) while the Government could not rely on discretionary powers as the sole or main instrument to enforce the pay policy it could not afford to abandon their use at this stage;
ii) departments should be given fresh guidance on the policy to be adopted in threatening and using discretionary powers over the coming months. In particular they should avoid making threats which could not be substantiated; seek legal advice in all cases of doubt; and take great care in how they were applied making sure they had legal clearance.

The Sub-Committee noted that the problems raised by the use of discretionary powers and possible options open in the longer-term would be covered in the Chancellor of the Exchequer's submission to Cabinet on the future of pay policy.
CABINET

NINTH REPORT OF THE SELECT COMMITTEE ON EXPENDITURE 1976-77: DRAFT GOVERNMENT RESPONSE

Note by the Chief Secretary, Treasury

1. The Ninth Report of the Expenditure Committee, 1976-77, was published in July and comprised an introduction by the main Committee and chapters prepared separately by the specialist sub-committees. The subjects covered by the chapters were: Defence and Overseas Services; Export Credit Finance; Housing; Employment of Civilians for Police Purposes; Health and Personal Social Services; and HM Stationery Office. The chapters varied considerably in content: some dealt with policy; some with presentation in the public expenditure White Paper; and some contained both kinds of recommendations.

2. The attached response has been prepared by the Treasury and other Departments concerned; and has been agreed at official level. Since it is made on behalf of several Departments, it is proposed to publish it as a White Paper. I am therefore circulating it for the Cabinet's information: subject to any comments I receive by 26 October, I will arrange for the response to be published as a White Paper as soon as possible.

J B

Treasury Chambers

20 October 1977
INTRODUCTION

1. In their Ninth Report of the 1976-77 Session, the Expenditure Committee considered a number of programme chapters in Part 2 of the White Paper setting out the Government’s expenditure plans (Cmnd 621). The Government welcome the contribution which has been made by the Committee in directing public attention in this way to the objectives of selected expenditure programmes.

2. The Government have given careful consideration to the observations made by the various sub-committees. This White Paper gives the Government’s reply to the various recommendations. The Committee pointed out in paragraph 4 of the report that a number of these recommendations concerned the provision of additional information, and suggested that it might often be preferable for such information to be provided in separate departmental papers rather than in the public expenditure White Paper itself. This general observation has been taken into account in the Government’s response to the recommendations concerned.

CHAPTER I: DEFENCE AND OVERSEAS SERVICES

Defence

Recommendation

Treasury and Ministry of Defence to consider carefully inclusion in the Public Expenditure White Paper, and possibly also in the Statement on Defence Estimates, a table setting out details of all changes in the Defence Budget for 1975-76 and subsequent years caused by public expenditure reviews or policy decisions (paragraph 1.4).

3. The Ministry of Defence will be ready to respond, by way of written evidence, to any future requests from the Committee for tabular information of this nature. Inclusion of such information in the public expenditure White Paper would unbalance a document intended to explain changes in the Government’s expenditure plans during the previous year and not to give a full historical record of all changes during a longer period. With the passage of time a financial presentation starting from 1973 would become increasingly inappropriate.
Notification of cases in which compliance with the cash limit on defence spending has been possible solely or largely as a result of slippage or offsetting savings (paragraph 1.5).

4. The Committee will be informed of instances where slippage has played an identifiable significant part in assisting the Ministry to keep within its cash limit or where this has been achieved only by deliberate reductions in the programme. It is often difficult in practice to draw a clear distinction between unexpected slippage and the additional delays occasioned by the pressure of the cash limit.

Overseas aid and other overseas services

Recommendations

Changes since the previous White Paper to be broken down by sub-programme (paragraph 1.7);

Significant changes to be explained in the Part 2 text (paragraph 1.8);

Inclusion of a table in every Public Expenditure White Paper showing the cumulative effect of changes in each programme for each year (from 1973-74 onwards) since the original estimate was drawn up (paragraph 1.8).

5. The Government agree that explanations of significant changes in this programme since the previous White Paper should be included in the text following the table at the head of the programme chapter (table 2.2 in Cmnd 6/21). Inclusion of all the tabular information requested could tend to make the White Papers unmanageably large. This information may best be given annually in the form of regular written evidence to the Committee.

CHAPTER II: EXPORT CREDIT FINANCE

Recommendation

The costs of the interest support scheme should appear in the Trade, Industry and Employment table of the Public Expenditure White Paper (paragraph 2.47).

6. The Government accept the recommendation that interest support costs for fixed-rate export credit should appear separately in the international trade section of the trade, industry and employment table of the White Paper. The corresponding entry in respect of the interest support costs for the home ship-building credit will be made in the general support for industry section of the same table. It is hoped to include the figures in the next White Paper.
7. Paragraph 2.19 of the report states that the Department of Industry do not take part in discussions about the possible mutual effects of trade policy and export credits. The Department of Industry do in fact participate in discussions on the factors to be assessed in the granting of export credit.

CHAPTER III - HOUSING

Recommendations

Figures of public expenditure on housing should be shown in greater detail (paragraphs 3.6, 3.7 and 3.8).

8. The Government accept in principle the recommendations that more detailed analyses should be made available of the figures in the housing table (table 2.7 in Cmd 6/21); that the distinction between capital and current expenditure should be clear; and that expenditure on goods and services should be distinguished from that on transfer payments.

9. The layout proposed by the Committee in paragraph 3.9 will therefore be adopted in general for the housing table in the next public expenditure White Paper. However, local authorities will have greater freedom to determine priorities within the new housing investment programme system and the Government propose to issue block allocations which will cover programmes separately identified at present. Further, even after block allocations for capital expenditure have been made for a particular year, authorities will have the ability within defined limits to increase expenditure of one kind if they reduce expenditure of another. Any detailed government projections for the survey period would therefore be no more than indicative (except in the aggregate) and, particularly for the later years, less detailed expenditure analyses might accordingly be more helpful. Further consideration will have to be given to this point as the new system of capital allocations is developed.

10. To help local authorities to make fuller use of the White Paper, it is necessary to show how the figures in the housing table can be reconciled with those with which they are familiar in the rate support grant settlement and elsewhere. Such a reconciliation was circulated to local authorities in England and Wales in April (DOE circular 37/77) and recent evidence suggests that this is now meeting the need to which the Committee has drawn attention. Subject to further consultation with the local authority associations, the Government propose to issue a similar reconciliation each year in explanation of the public expenditure White Paper figures. In Scotland, information is provided to local authorities through the Convention of Scottish Local Authorities. In view of the bulk of the material involved it seems better to provide it in these ways than in the White Paper itself.
Recommendation

Additional supporting information should be provided in the Public Expenditure White Paper and in an annual Housing White Paper (paragraphs 3.11, 3.16 and 3.18).

11. The Government accept that mortgage interest relief is relevant to consideration of housing policy and will include in future White Papers estimates of the cost of such relief for past years and the year of publication. The results of a study in 1974, to estimate the effect on supplementary benefit expenditure if housing costs were excluded from the calculation of requirements, will be included in the next White Paper. Information will also be provided of the amount of loans outstanding under guarantee by the Housing Corporation. The Government will continue to provide a substantial amount of non-financial information about past performance and will keep under review the possibility of increasing the amount of such information.

12. More generally, the Government share the Committee's view that there is a need for information on housing to be collected together and presented systematically in addition to the regular publication of data as in housing and construction statistics. They accept that the housing chapter of the public expenditure White Paper should include information relating directly to table 2.7 and will consider what further information could usefully be provided. They do not consider, however, that an annual housing White Paper tied to the public expenditure White Paper would be the most effective way of presenting a wider range of material. The Green Paper on Housing Policy (Cmnd 6851) foreshadows the establishment within Department of the Environment of a special unit to analyse information about housing and to monitor progress. It will be one of the functions of that unit to produce from time to time analyses over the whole housing field bringing information together and updating material given in the Green Paper and Technical Volume. This will help to maintain the wide range of background information now available, against which public expenditure decisions and government statements of housing policies can be considered. The comparable arrangements in Scotland and Wales will have to be considered further in the light of the proposals for devolution.
CHAPTER IV: EMPLOYMENT OF CIVILIANS FOR POLICE PURPOSES

Recommendation

The study on "civilianisation" should be completed as quickly as possible, and its results be reported to the House (paragraphs 4.17 and 4.25).

13. This recommendation is accepted. The area covered by this chapter of the report has involved, and will involve, difficult decisions on the best use of resources for the police service. The restrictions on goods and services and on civilian staff were suggested to police authorities as being the least harmful means of keeping within the limits of expenditure laid down by the Government and explained in Cmnd 6/27. The economies in the police service were not designed to secure a reduction in total police expenditure but rather to help accommodate the higher cost of particular items such as police pensions (which mainly reflects an increase in the number of police who have retired); total expenditure on the police service is still planned to rise in real terms.

14. The Government remain of the view that, within the police service, priority should be given to bringing the strengths of police officers up to authorised establishments, even if a small proportion of the additional officers has to be used on tasks normally the responsibility of civilian staff; if the number of police officers exceeds the estimated growth, provision will be made for additional expenditure within authorised establishments. Any growth in expenditure on other parts of the police service has to be limited by the country's general economic position and at present must be kept within the programme in Cmnd 6/27. The local authority associations, with the advice of their financial and professional advisers, accepted the priority for the recruitment of police officers and reluctantly agreed that restrictions on civil staff and cadets would have a less damaging effect on operational policing and force efficiency.

15. Until the current rate support grant negotiations have been completed it is not possible to say what the position will be in the coming financial year. The views of the Committee in paragraphs 4.16 and 4.17 will be taken into account in making any reassessment necessary, as well as any views which may emerge from the study of civilianisation, arrangements for which are now going forward.

Recommendation

A full review should be made of cadet recruitment both from a qualitative and quantitative point of view (paragraphs 4.23 and 4.26).
16. This recommendation is being implemented. The general principles set out in paragraphs 13-15 above apply with equal force to police cadets, who do not make any appreciable contribution to immediate operational efficiency. Although the unit cost of a cadet is £1,607 per annum, this figure does not include the cost of training; the overall cost of passing a 16 year old cadet through to attestation as a police officer at 18½ is of the order of £6,000-£7,000.

17. Consideration was already being given to an enquiry into the need for cadets before the Committee began its work. The Home Secretary proposes to set up a working party of the Police Advisory Board for England and Wales to consider the matter with the following terms of reference:

"To consider the place of a cadet system in contributing towards obtaining sufficient recruits of the right quality to enable force strengths to reach authorised establishments".

It is hoped that it will report in time for any changes to be reflected in the September 1978 intake of cadets.

CHAPTER V:

SPENDING ON THE HEALTH AND PERSONAL SOCIAL SERVICES

Social Security

Recommendation

The Department of Health and Social Security to improve its forecasting of the benefit implications of the levels and patterns of unemployment (paragraph 5.8).

18. Every effort is being made to improve the forecasts of expenditure on benefit. Considerable research has been undertaken, as a result of which revised and more complex estimating techniques have been developed. Past experience is not always a reliable guide and this makes forecasting difficult. The cost of benefit at any unemployment level depends, inter alia, on the number of the unemployed who are women, how many of them are married, and how many of the total men and women on the register have exhausted their entitlement to unemployment benefit or are not entitled to benefit because they fail to satisfy the contribution conditions or for some other reason. Where unemployment benefit is not payable or is insufficient to meet a person's or his family's need, supplementary benefit may be payable. And all of these factors are variable because of the large turnover of people registered as unemployed, even when the level of unemployment is high.
Recommendations

In future the assumptions made when making an explicit provision for uprating improvements should be clearly set out in the White Paper. There is no reason why the social security programme should have its own private contingency reserve (paragraphs 5.11 and 5.13).

19. The Government have noted the Committee's views on the presentation of the social security programme, and this will be kept under review.

20. For the reasons previously given to the Committee, the Government see considerable disadvantages in publishing the economic assumptions underlying the expenditure projections. Future expenditure on the individual benefits was expressed in the White Paper in terms of the average levels of benefit during 1966-77, which amounts to assuming increases from year to year at the same rate as prices. In practice, total expenditure on the social security programme is determined by a number of factors which cannot be provided for with certainty in advance. The commitment to increase pensions and other long-term benefits in line with the increase in earnings, where this exceeds that in prices, implies a trend of improvement in these benefits in real terms; and the real cost of benefits in the event will also be affected by the actual movement of prices. In addition, the demand for benefits will be substantially affected by demographic and economic factors.

21. In place of the broad allowance described as providing simply for uprating improvements in previous White Papers, it was, therefore, decided to make a general provision for variability in the factors likely to affect the cost of the social security programme. This provision could have been added to the contingency reserve and not shown separately in the social security programme. But since it represented the Government's judgement of the most appropriate provision for the cost of the social security programme taken as a whole, its inclusion within the contingency reserve would have been less informative, and impeded the function of the contingency reserve as an instrument of operational control.
Health and personal social services

General comment

22. The Committee lay emphasis in their Report on the need for more detailed analysis of the costs and benefits of the health and personal social services, for more specific criteria for measuring progress towards objectives and for indicators of performance of different kinds. The Government wish to improve and develop such measures, which provide the basis for the proper distribution of resources and planning of services. This work is subject to two constraints: there is great difficulty in defining and measuring the final output of health services, and a limit to the capacity of the Department to undertake the analysis and refinement of data. Of necessity, therefore, measures of an intermediate kind – levels of provision of facilities, throughput, etc – often have to be used and the Department must concentrate its efforts on what will serve practical purposes most directly and immediately. But the Government acknowledge the need for the longer-term to improve analysis and to develop new indicators, and within the resources available will continue both their own work and support for research by others.

Recommendation

The Department should make sure that it is in a position to monitor unplanned cuts that may result from the operation of the cash limits system and to check that they are implemented in the least damaging way (paragraph 5.15).

23. The Department guides and controls the health authorities primarily through the planning system. The authorities are responsible for implementing their plans within the resources provided. The Department looks to the authorities themselves to secure any economies that may be necessary to comply with cash limits in whatever way they judge least damaging to the planned pattern of their services. The effect of the authorities' decisions can be monitored by the Department in the subsequent planning round when any measures necessary to deal with imbalances in the provision of services can be considered. If the operation of the cash limits system appeared likely to have serious and immediate effects on standards of patient care during the current year, the Department would expect to be consulted by the authorities concerned about the action required.

Recommendation

Details of the income from personal social services charges should be included in the White Paper (paragraph 5.17).

24. This recommendation is accepted.
Opportunity and information should be given for more discussion in the House of Commons and elsewhere of the policy options when imposition of NHS and personal social services charges is being considered (paragraph 5.19).

Opportunity for discussion and for the provision of information about the imposition of NHS charges is presented when the necessary statutory instruments under the NHS (Consolidation) Act, 1977 are laid before Parliament. Charges for personal social services are essentially a matter for individual local authorities. As indicated in the Green Paper on Local Government Finance (Cmd 6813), the Government have accepted the Layfield Committee's recommendation for a joint review of central and local government policies towards charging for local services. This review will cover the personal social services and the Department of Health and Social Security will take part in it.

The priorities between current and capital spending should be reviewed without delay to ascertain whether an imbalance which ought to be corrected has been created (paragraph 5.24).

The balance between current and capital spending is one of the issues to be considered in a review of the use of health capital and of the revenue consequences of capital investment now being undertaken.

The Department should set in train studies to examine the relationship between management costs suitably defined and patient care (paragraph 5.26).

The Government believe that efforts to secure the most cost-effective use of management skills must be based on careful and objective appraisal by individual health authorities, who will have to take account of many local factors in deciding where management costs can be reduced without damage to patient services. The outcome of these reviews will be monitored both in the annual planning cycle and by the Department against the national target of a 5 per cent reduction to be achieved by the end of 1979-80. This continuing and close examination of management costs will take account of the need to keep in reasonable balance the costs of services for patients and of management. Further studies would be unlikely to establish any clear-cut and generally valid relationship between management costs and such indicators as level of provision, throughput, waiting lists and unit costs, especially as a variety of local factors would have to be taken into account.
The Committee should receive regularly figures from DHSS which distinguish between increases in unit costs that reflect lower manpower productivity and increases that reflect improved resource provision for patients (paragraph 5.31).

28. The Committee will be provided with regular figures derived from the Department's monitoring of unit costs. Where there has been improvement in the conditions of service of staff it is not easy to determine to what extent increased costs should be ascribed to this, rather than to improved patient care. For example, if junior doctors were to work fewer hours this might benefit doctors (by increased leisure) and also patients (by having less tired doctors attending them). The Department is studying historic data with a view to improving the method for analysing the causes of increases in unit costs, and will keep the Committee informed of the results.

Recommendation

The expenditure planning and priority-setting of DHSS should be synchronised so as to enable Parliament to examine the relationship between the two (paragraph 5.32).

29. The Department's annual reassessment of priorities is in fact linked with the expenditure forecasts in the White Paper. In future years the aim will be to issue planning guidelines annually to health authorities in March, indicating resource assumptions for the forthcoming public expenditure period and to provide regularly for a forward year within the survey period an illustrative projection of the average level of provision and current expenditure on various services that is consistent with priorities and with planned public expenditure. Local authorities will receive similar guidance as respects the personal social services. It is hoped that this timing will facilitate examination by Parliament.

Recommendation

The Department should publish its analysis of the regional responses to the 1976 Consultative Document, and an explicit statement of the criteria used in deciding whether or not local divergencies from national priorities are justified (paragraph 5.33).
Revised policy guidance published by the Department in September 1977 included a summary of comments on the Consultative Document (including those by regional health authorities) and also a brief analysis of the main points emerging from the strategic plans submitted by the regional health authorities this year. A judgement as to whether local divergencies from national priorities are justified can only be made after discussion between the Department and the particular region, and it is not possible to lay down rigid criteria for this. A fuller analysis of the regional plans will be published early in 1978, following discussions with individual regional health authorities.

**Recommendations**

1. Clearly set out the cost of policies so as to allow Parliament to identify costs which arise from new commitments as distinct from those arising from on-going commitments;

2. Specify criteria for measuring the progress towards achieving the policy objectives implicit in new commitments;

3. Provide a more detailed analysis of who benefits in what ways from public expenditure.

(Paragraph 5.35)

The commentary in Cmd 6721 (Part 2) on the health and personal social services programme gave some indication of how far expenditure plans catered for new as distinct from on-going commitments. The Department will continue to provide this information and consider how it might be improved. Most of the developments in the health and personal social services programme do not take the form of specific new commitments, but are developments of existing services. For these, the annual planning guidelines and the programme budget issued regularly by the Department give a better indication of the projected development of services than can be provided in the public expenditure White Paper. They will also give a measure of progress towards policy objectives, and an indication of the projected distribution of resources between different groups as a result of these developments. Copies will be placed in the Library of the House. Further information on the distribution of resources and on benefits in terms of services and facilities will be available from the analysis of regional plans, and from other material published from time to time, such as the annual Volume of Health and Personal Social Services Statistics and the Hospitals In-Patients Enquiry.
The Department should begin now to develop, for the longer-term, indicators of performance. The Department should in particular develop:

(a) Measures of access to show how far people in different areas have the same chance of obtaining treatment of care and whether access is improving over time. And

(b) Measures of quality provision to show improvements (or deteriorations) in the physical environment, amenities and patient satisfaction (paragraph 5.36).

32. The Government recognise the importance of measures of the kind suggested. Some indicators are already in use within the Department and in the NHS to monitor the development of services and to establish targets for the distribution of financial resources. Planning the best use of resources available for the health and personal social services will always involve decisions and judgement that cannot be precisely quantified. The levels of provision of specific facilities and the length of time on waiting lists are also used as indicators, monitored regularly and published in DHSS Annual Reports and statistical publications. Indicators of relative need for resources for hospital and community health services have been developed by the Resource Allocation Working Party. Through the NHS planning system the Department will be able to analyse progress towards greater equality of provision between regions, areas and districts and changes in the balance of provision of different types of service for different patient groups. In the personal social services levels of provision are similarly monitored, and attempts are being made to refine the indicators of need and to improve the distribution of the rate support grant.

33. As indicated in paragraph 22 above, there are difficulties and constraints in the further development of indicators. The methodological problems of measuring performance and patient satisfaction are considerable; the work is costly and uses scarce staff resources. But some work is being undertaken within the Department and research elsewhere is being supported. The Department will continue these efforts.

CHAPTER VI - STATIONERY AND PRINTING (HOME)

Recommendation

The introduction in principle of repayment and a trading fund for HMSO (paragraph 6.16).
As was stated in evidence the main objective in the period immediately ahead must be the development of the new management accounting systems and trading accounts. These will enable more information to be made available to Parliament and the public. These developments will not prejudice the question of introducing general repayment and a trading fund; indeed they are a pre-requisite of these developments, decisions on which will need to be taken in the light of experience gained in operating the new management accounting procedures. The views of the Committee will be taken fully into account at the time.

Recommendation

Pricing policies should be considered and any price reductions adequately advertised (paragraph 6.19).

Pricing policy for government publications is kept under continuous review, and any price reduction will be advertised as the Committee recommends. The Government agree with the Committee that the financial aim (break-even taking one year with another) conflicts with the widest possible readership of publications. The price of the daily parts of Hansard is already below the marginal cost. The number of copies sold to the public is small (currently about 2,000) and has been declining over the last 20 years.

A price reduction could stimulate some increase in sales, but would increase the overall cost to the Government. As regards other HMSO publications, if the price to the public could be reduced, additional sales might follow, the revenue from which could suffice to offset the cost of producing the extra copies. But if the price reductions were brought about by making the copies produced for official use bear all the initial publication costs, the overall effect would again be to increase the net cost to government of government publishing.

Recommendation

The annual report should give a detailed account of all Stationery Office activities. The General Sub-Committee should be consulted before decisions are taken about the form of the accompanying accounts (paragraph 6.22).
56. The Government will take account of the Committee's views in reaching final conclusions about the content of the annual report, and in determining the form of accounts.

57. The Committee also suggested that the cash limits fixed for HMSO for 1977-78 appeared to be lax, in that they amounted to £116 million against expenditure in Main Estimates of £90 million. The cash limits covered some expenditure on behalf of the National Insurance Fund which in the Estimates, unlike the cash limits, is offset by receipts from the Fund. The amount provided in the Estimates, comparable with the figure of £116 million in the cash limits, is therefore £100 million and not £90 million.
1. The Chancellor of the Exchequer refers in paragraph 5x. and Annex A of his paper (CP(77) 96) to the case for some modification of the general limit on the level of settlements for the low paid.

2. This case was set out more fully in the paper attached to my minute of 30 September to the Prime Minister which was circulated to my Cabinet colleagues. My proposal is that we should not seek to limit any increase to less than £4 for a normal week.

3. This would be more than 10 per cent for the 1.8 million full-time adult employees currently earning less than £40 for a normal week, up to 13 per cent for those earning £30. 29 per cent earn less than this. More details of the distribution are given in the Annex to this paper.

4. If fully taken up, which is unfortunately doubtful, this would of itself add only 0.1 per cent to the national wage and salary bill additionally to the current policy. I do not believe this very modest flexibility for the relatively small numbers of workers at these very low levels would have any significant repercussions. It is of a quite different order from the £2.50 minimum attached to the 5 per cent Stage 2 limit which benefited the much more substantial proportion of the labour force who were then earning less than £50 a week, and by far more than 5 per cent.

5. Moreover in reality we have very little choice in the matter. Over half those concerned are covered by Wages Councils. The independent members of the most important Councils have already indicated to me in the strongest terms that they propose to support workers' representatives' claims exceeding 10 per cent for those on these levels of earnings, which they regard as quite consistent with the Government's national earnings objectives.

6. Unless I am able to dissuade them from their cause, which is I think very unlikely, the Councils will accordingly confirm statutory orders, which I have no power to delay or override, in contravention of the Government's policy. My colleagues have already agreed that in such circumstances there could be no question of applying sanctions to the employers affected.
7. In my judgment the repercussions of such clear breaches would be more damaging than a well-defined concession on the lines proposed in paragraph 2 above.
### Estimate Numbers of Employees in PAYE Schemes with Gross Earnings Excluding Overtime Pay of Less Than £1 per Hour in April 1977

<table>
<thead>
<tr>
<th>Age Group</th>
<th>Full-Time</th>
<th>Part-time</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Percentage</td>
<td>Number</td>
</tr>
<tr>
<td></td>
<td>(000's) of all employees</td>
<td>of all employees</td>
<td>(000's) of all employees</td>
</tr>
<tr>
<td>Over 18</td>
<td>290</td>
<td>3</td>
<td>100</td>
</tr>
<tr>
<td>Male</td>
<td>290</td>
<td>3</td>
<td>100</td>
</tr>
<tr>
<td>Female</td>
<td>740</td>
<td>19</td>
<td>1020</td>
</tr>
<tr>
<td>16 to 18</td>
<td>220</td>
<td>88</td>
<td>10</td>
</tr>
<tr>
<td>Male</td>
<td>220</td>
<td>88</td>
<td>10</td>
</tr>
<tr>
<td>Female</td>
<td>220</td>
<td>87</td>
<td>10</td>
</tr>
</tbody>
</table>

### Estimated Earnings Distribution of Full-time Employees in PAYE Schemes with Gross Earnings Excluding Overtime Pay of Under £40 per Week in April 1977

<table>
<thead>
<tr>
<th>Earnings Range</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under £30</td>
<td>29%</td>
</tr>
<tr>
<td>£30-£32</td>
<td>11%</td>
</tr>
<tr>
<td>£32-£35</td>
<td>19%</td>
</tr>
<tr>
<td>£35-£37</td>
<td>16%</td>
</tr>
<tr>
<td>£37-£40</td>
<td>25%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
</tr>
</tbody>
</table>

### Notes
1. Between April and July 1977 average earnings generally increased by a little over 1%.
2. The estimates do not include:
   a. people on the margins of the labour market with earnings below PAYE limits.
   b. those off work and receiving no pay at all for the relevant pay-period.
   c. others who did not receive full pay for the whole of the pay-period.

Source: DE New Earnings Survey.
I circulated under cover of CP(77) 95 for the information of the Cabinet a copy of The Queen's Speech on the Prorogation of Parliament in the form in which it had been submitted to the Counsellors of State. The Speech has subsequently been revised to take account of The Queen's wish to have the opening paragraph transferred from the Prorogation Speech to the Opening Speech and has accordingly been resubmitted to the Counsellors of State.

Signed JOHN HUNT

Cabinet Office

25 October 1977
CABINET

THE QUEEN'S SPEECH ON THE OPENING OF PARLIAMENT

Note by the Secretary of the Cabinet

I attach for the information of the Cabinet a copy of The Queen's Speech on the Opening of Parliament in the form in which it has been approved by the Counsellors of State on behalf of The Queen.

Signed JOHN HUNT

Cabinet Office
31 October 1977
DRAFT OPENING SPEECH

MY LORDS AND MEMBERS OF THE HOUSE OF COMMONS,

My husband and I look back with delight and gratitude on the events which marked My Silver Jubilee at home and overseas, and the visits which we made to many parts of the United Kingdom and the Commonwealth. I look forward to paying a State Visit to the Federal Republic of Germany next May and to opening the Commonwealth Games in Edmonton in August.

In pursuit of peace and collective security, the United Kingdom remains committed to the aims of detente, disarmament and the prevention of the spread of nuclear weapons. My Government reaffirm their policies in international relations and defence, and will contribute fully to the work of the United Nations, the Commonwealth and the North Atlantic Alliance.

While working for policies which fully reflect the interests of the United Kingdom, My Government will play a full and co-operative part in the activities, the development and the enlargement of the European Economic Community.

They will continue to contribute modern and effective forces to the North Atlantic Treaty Organisation, and to play their full part in the current Alliance studies of East/West relations and of the Alliance's defence programmes. They are participating constructively in the important meeting in Belgrade which is being held as part of the follow-up to the Final Act of the Conference on Security and Co-operation in Europe; they will abide by the provisions of the Final Act, and continue to seek fulfilment of all its provisions by other signatories. They remain committed to the pursuit of detente in their relations with the Soviet Union and the countries of Eastern Europe.

My Government will continue to take part in international efforts to combat recession and promote a more stable world economic order, and a fairer distribution, within an expanding world economy, of the world's wealth between rich and poor nations; they will maintain their special efforts to help the poorest countries and the poorest people.
They will work for a just and lasting peace in the Middle East, and the further improvement of relations between the United Kingdom and all the countries in the area. They will continue to co-operate with all concerned in the search for a lasting settlement in Cyprus, where they welcome the resumption of intercommunal talks.

Efforts will be maintained to achieve a negotiated settlement in Rhodesia, on the basis of my Government's proposals published in September this year, which are designed to provide a secure future for people of all races. My Government will be ready during the current session to introduce legislation to enable Rhodesia to proceed to independence on this basis.

MEMBERS OF THE HOUSE OF COMMONS,

Estimates for the public service will be laid before you.

MY LORDS AND MEMBERS OF THE HOUSE OF COMMONS,

The strengthening of the country's financial position and balance of payments opens the prospect for a continuing improvement in the economy and the maintenance of financial stability. My Government's main objectives are the speediest possible return to full employment and a sustained growth of output. In order to achieve these objectives they will give the highest priority to further reductions in the rate of inflation.

My Government will continue to take action to reduce high unemployment through manpower measures and to promote industrial training.

They will ensure that the benefits of North Sea oil are used to achieve a lasting improvement in our industrial performance and therefore to provide more jobs, higher real incomes and improved public services.

My Ministers will continue to work in close co-operation with the Trades Union Congress and the Confederation of British Industry.

Internationally My Government will continue to urge that the stronger economies should take the load in promoting a sustained growth in the world and that adequate official finance should be made available on appropriate terms to countries with continuing deficits in the balance of payments.
My Government remain firmly committed to establishing directly elected assemblies for Scotland and Wales. Separate Bills will be introduced for this purpose.

In Northern Ireland My Government will maintain their aims of establishing a devolved Government acceptable to both parts of the community; and eradicating terrorism by the prosecution through the courts of those responsible for violence and by continuing to develop the effectiveness of the Royal Ulster Constabulary, supported by My Armed Forces. My Government attach special importance to co-operation on matters of security with the Government of the Republic of Ireland. They will continue to seek measures to strengthen the economy of Northern Ireland and improve its social environment.

Legislation providing for the election of United Kingdom members of the European Assembly will be re-introduced.

Further consultations will be held on industrial democracy, with a view to producing proposals which should command general support, and My Ministers will continue directly to encourage the development of industrial democracy in the nationalised industries.

There will be a review of the legislation and institutions governing competition policy, to see that this makes its maximum contribution to improving industrial efficiency.

My Ministers are considering further measures to assist small firms.

They will also hold consultations about encouraging profit-sharing through the tax system.

Legislation will be brought forward to amend company law.

A Bill will be introduced to provide public funds to finance payments to redundant shipbuilding workers in the public sector.
Legislation will be introduced providing for changes in the structure of the electricity industry and other matters affecting the industry.

Continued encouragement will be given to the efficient production, processing and distribution of food with the aim of meeting a greater proportion of our national needs from United Kingdom agriculture. My Ministers will seek improvements in the operation of the Common Agricultural Policy.

My Government will continue to seek major reform of the Common Fisheries Policy. They will aim to secure conditions which will meet the needs of the British fishing industry, conserve fishing stocks, and ensure adequate supplies to the consumer.

A Bill will be laid before you to increase the borrowing powers of the Civil Aviation Authority and British Airways, to provide for a levy to finance aviation security and to amend the civil aviation Acts.

Legislation will be introduced for the further development of transport policy to meet economic and social needs, including those of rural areas.

Legislation will be brought before you to provide assistance for first-time home buyers.

A Bill will be introduced to renew and revive the inner urban areas.

Legislation will be introduced on the composition and certain functions of the General Medical Council.

In addition to My Government's full programme of constitutional and other reforms for the present session, they remain committed to bringing forward at the earliest opportunity a number of further highly desirable measures of reform. These measures include improvements in safety and discipline at sea and other aspects of merchant shipping, and the right of Post Office staff to take industrial action.

Legislative proposals will be brought forward for the reform of section 2 of the Official Secrets Act 1911.
Following the Report of the Committee on the Future of Broadcasting, My Government will bring forward proposals on the constitution, structure and organisation of broadcasting in the United Kingdom.

An increase in the limit on public funds for the National Film Finance Corporation will be proposed before the present limit expires.

Measures will be brought before you to reform public sector housing subsidies in Scotland; to improve criminal procedure and reform the criminal justice system in Scotland; and to extend the powers of Scottish local authorities in relation to their direct labour organisations.

Further progress will be made with My Government’s programme of law reform.

Other measures will be laid before you.

MY LORDS AND MEMBERS OF THE HOUSE OF COMMONS,

I pray that the blessing of Almighty God may rest upon your counsels.

31 October 1977
THE QUEEN'S SPEECH ON THE OPENING OF PARLIAMENT

THURSDAY, 3RD NOVEMBER, 1977

MY LORDS AND MEMBERS OF THE HOUSE OF COMMONS,

My husband and I look back with delight and gratitude on the events which marked My Silver Jubilee at home and overseas, and the visits which we made to many parts of the United Kingdom and the Commonwealth. I look forward to paying a State Visit to the Federal Republic of Germany next May and to opening the Commonwealth Games in Edmonton in August.

In pursuit of peace and collective security, the United Kingdom remains committed to the aims of détente, disarmament and the prevention of the spread of nuclear weapons. My Government reaffirm their policies in international relations and defence, and will contribute fully to the work of the United Nations, the Commonwealth and the North Atlantic Alliance.

While working for policies which fully reflect the interests of the United Kingdom, My Government will play a full and co-operative part in the activities, the development and the enlargement of the European Economic Community. They will continue to contribute modern and effective forces to the North Atlantic Treaty Organisation, and to play their full part in the current Alliance studies of East/West relations and of the Alliance's defence programmes. They are participating constructively in the important meeting in Belgrade which is being held as part of the follow-up to the Final Act of the Conference on Security and Co-operation in Europe; they will abide by the provisions of the Final Act, and continue to seek fulfilment of all its provisions by other signatories. They remain committed to the pursuit of détente in their relations with the Soviet Union and the countries of Eastern Europe.

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CABINET

CROWN AGENTS: FAY REPORT

Note by the Secretary of the Cabinet

1. The Cabinet will shortly consider a draft White Paper to be published at the same time as the publication of the Report by the Committee of Inquiry under Judge Fay appointed in April 1975 "to inquire into the circumstances which led to the Crown Agents requiring financial assistance from the Government". It is proposed to publish the Report of the Advisory Committee of Enquiry into the Crown Agents appointed in 1971 (the Stevenson Report) at the same time. The publication date is at present expected to be 18 November.

2. I attach for the information of the Cabinet Chapter XXV (Summary and Conclusions) of the Fay Report (Annex A) and Chapter 2 (Summary, Conclusions and Recommendations) of the Stevenson Report (Annex B).

3. Copies of the complete version of both Reports are available from the Cabinet Office for any Ministers who would like to read either or both in full.

Signed JOHN HUNT

Cabinet Office

4 November 1977
We have now detailed the "circumstances" which our terms of reference required us to inquire into, and we can look back and summarise what has happened. Our inquiry has been twofold, firstly into what the Crown Agents did (or did not do), and secondly into the efforts, largely unsuccessful, of different organs of government to detect and check the Crown Agents' activities.

In outline we can say that the losses have been due to incompetence rather than to misconduct. The causes have been the actions (and inaction) of individuals, coupled with a defective system. The system was defective in (a) lack of accountability, (b) absence of expert procedures, (c) absence of managerial supervision, (d) bad accounting. Outside agencies contributed to the failure to prevent the losses.

What the Crown Agents did was between 1967 and 1974 inclusive to conduct on their own account a substantial secondary banking activity and in the course of conducting it to engage in investment and lending which was unwise both in character and in degree. They embarked upon this course without seeking independent advice and we find that they possessed neither the skills nor the organisation necessary for such an enterprise. Accountability was lacking. It was unfortunate that the operation developed at a time when it was believed that those deploying funds could hardly avoid making money, and there was thus engendered in the officials concerned an undeserved degree of self-confidence. When crisis came they were totally unprepared, their lack of real banking experience was exposed and they allowed themselves to be locked into situations engendering further losses.

We have no reason to doubt the genuineness of the desire to secure a reserve which was the main reason advanced for the origin of the own-account activities. But there was another factor in this origin, the factor of realisation of the facts that the Crown Agents had large funds to deploy and that there were money-making opportunities open to those with large funds at their command. They had had for many years an embryo "bank" in the shape of the principals deposits taken by the Joint Consolidated Fund and the Joint Miscellaneous Fund, which they deployed in safe investments. Once the eyes of those concerned were opened to the opportunities presented by the management of these and other funds,
they embraced the prospect with enthusiasm. One of the remarkable features of the story is the speed with which the enterprises developed. They started in the first quarter of 1967 and by 30 September 1968, when Sir Stephen Luke retired, the Finvest operation had reached the order of £50m, and investment in equities, secondary banks and property companies had started, together with investment in subsidiary companies and in Australian property development. Some of the wilder enterprises, such as unsuccessful speculation in silver and in mining shares, had already been carried out. Thereafter we have the impression that the mainspring of the own-account activities was not the securing of a reserve but the satisfaction of money-making for its own sake.

392 There was thus a substantial secondary banking enterprise in being at the time when Sir Claude Hayes succeeded to the Chairmanship of the Crown Agents. Mr Challis, who had played an important part in its inception, had been chosen to head the Finance Directorate. After Sir Stephen's departure Mr Challis was virtually supreme in his field. He had a newcomer as Chairman, and Boards which he could dominate - the Crown Agents' Board because none of his colleagues possessed the ability to challenge him, and the Four Millbank Investments' Board because its majority were his subordinates. Sir Claude told us that he had been assured by his predecessor "that the one thing I need not worry about was finance. I was told that it was in perfectly good hands and that I could concentrate on other things". At Crown Agents' Board meetings, he said, two of the members, Mr Morris and the Managing Director of Millbank Technical Services Ltd, Mr Roe, would argue with Mr Challis, "but nonetheless his mind was so powerful that he won the arguments". Mr Newman, the Crown Agents' Managing Director, told us, "we were not welcome if we raised questions". Mr Challis would consult his Chairman insofar as he thought it necessary or desirable and, not surprisingly, was successful in eliciting his support. Mr Newman said this of the FMI Board meetings:

"It was quite clear at those meetings that a lot went on between Mr Hayes and Mr Challis - discussions outside the meetings - and we were merely being informed ... what was going on."

Thus the responsibility for the way in which the own-account activities developed rests fairly and squarely on Mr Challis because he conducted them, and on Sir Claude Hayes because he knew, or ought to have known, what was going on.
Mr Challis with his subordinates - and indeed with his equals and with all the Crown Agents' personnel save the Chairman - imposed his authority and brooked no interference, as witness his treatment of Mr Nowers (para 121) and Mr Blundell (para 273) and his contemptuous minute repelling Mr Morris's criticisms (para 161). Mr Challis would have us believe that he did not influence the courses taken by the money market managers, and said to us more than once that he had not ever ordered that a loan be granted. We do not believe him. It may well be that he did not direct the day to day operations of the managers; there was no reason why he should. But we have no doubt that the major decisions were his and that, for example, the loans to Stern and the GCA Capital Corporation were made at his behest. It was upon Mr Challis that the lack of accountability worked its effects. His subordinates were accountable to him, but he was in practice accountable to no-one. In theory he was accountable to the Chairman, but the Chairman exerted no effective control over him, and joined forces with him to repel any accountability to external bodies. Lack of discipline undermines morale, and we are sure that the absence of constraints upon Mr Challis played a part in producing and perpetuating the characteristics we discuss below.

Much of the own-account activity was satisfactory and calls for no comment. But alongside the run-of-the-mill deposit operations there were transacted the schemes we have dealt with. And throughout we find that the characteristics of the Finance Directorate under Mr Challis included (i) unjustified risk-taking; (ii) a lack of regulation and control and an aversion from taking advice; (iii) secretiveness; (iv) a low standard of commercial ethics; (v) a haphazard choice of associates.

Mr Challis has been described to us as adventurous. The risks he ran stemmed from two causes; the nature of the investment and the extent of the involvement in them. We have been reminded by witnesses of the fact that the Crown Agents were not alone in suffering misfortune in 1974; the crisis of confidence of that year caused the collapse of many fringe banks, and the over-extended property companies inflicted losses upon the most cautious of the clearing banks as well as upon the Crown Agents. It is true that the Crown Agents were not alone in that time in
imprudent financing, and probably many of the fringe banks that collapsed will be found to have suffered from features similar to those exhibited by the Crown Agents. But the prudent banks, though they lent to the Mr Sterns of the time, did so with a proper regard to security and in such proportions as to ensure that losses could be accepted without affecting their own solvency. With the Crown Agents on the contrary it was a case of too many eggs in too few baskets - particularly the baskets labelled English and Continental, Australia and Stern.

396 We were also pressed with the argument that some of the risks incurred were taken in order to enhance the service afforded to principals. To a limited extent this is true. A number of the associated companies had among their objectives the improvement of the facilities on offer to overseas governments. Thus we accept the evidence that the investment in Mr Abrahams's Television Recordings (para 31) included this motivation. But when this argument is used to explain investments such as that in overseas merchant banks it begins to lose credibility and indeed becomes one of the armoury of propaganda weapons so often used by the Crown Agents in their dealings with Whitehall. An extension of this argument is the assertion that all the financial operations were designed to secure expertise to offer to principals. Other propaganda weapons were the representation that the joint funds belonged to the principals (para 126) and the use made of the existence of the Equity Investment Advisory Panel (para 114).

LACK OF MANAGEMENT PROCEDURES

397 One can understand the own-account operations starting in a small way and needing little by way of rules and regulations at the outset. But a time must come when a properly conducted business grapples with the problem of management and control. In relation to the Crown Agents' business this would involve the monitoring of performance, the accurate reporting of events, and the setting up of a regulatory framework. When Mr Challis became Director of Finance and when Sir Claude came fresh to the organisation, an opportunity was afforded for either or both to take stock, to identify the problem and to take appropriate measures. The opportunity was not taken. Mr Challis was not good at detail. Mr P Matthews, his colleague for a year at First National Finance Corporation, found his methods disappointing:

"He had a tremendous gift for dealing with a problem. I thought he
had no gift at all for following it through and tying up the loose ends."

This seems to be the reason why there was such a lack of sound management procedures within the Finance Directorate. There were the monthly reports to the Director showing the state of the money book, and monthly reports of a general nature to the Board but there were no banking rules - certainly no written banking rules; there were supposed to be unwritten rules, eg about the percentage of security which could be lent, but they were vague and often honoured in the breach. Above all there was no systematic management accounting. Thus it was that the Crown Agents fell into such errors as borrowing short and lending long, and lending on insufficient security and the like. The dislike of management procedures probably explains the fading away of the office of Controller (para 91) when it was set up in response to Urwick Orr's advice. And even when the Credit Committee was set up with such formality after the Vehicle & General losses, its scope was limited and its decisions were frequently disregarded (paras 247, 356).

SECRETIVENESS

The secrecy in which the Finance Directorate conducted its affairs was a manifestation of the ingrown spirit found within the Crown Agents at the time in question. It was a closed-in body, training up its Personnel from youth and rarely recruiting from outside. We have commented upon the strange results of this policy at paras 42 and 43 above. Amongst other things it resulted in the ludicrous situation of this complex trading organisation having only one qualified accountant on its staff until November 1970. The uncertainty in the 1960's over the continued existence of the office intensified this inward-looking attitude, as did the "you are on your own" theory (para 12). Under Sir Claude Hayes communication at other than top level with the Ministry was discouraged (para 367). In the Finance Directorate the prevailing atmosphere of secrecy had the result that no one but Mr Challis could comprehend the state of affairs as a whole, and he at no time shared the complete picture with the Chairman. With secrecy went a rooted disinclination to take advice unless forced to. The Urwick Orr report, commissioned by Sir Stephen Luke, was an exception, but after his time no advice was taken upon management, banking or investment, and Price Waterhouse were brought in to advise only when the accounting system was breaking down.
LOW ETHICAL STANDARDS

Though they may have been uncertain of their exact status, the staff of the Crown Agents had no doubt that they were Crown servants. As such, one would expect their conduct to conform with the high standards consistent with their positions in the public service, as indeed Sir Claude pointed out (para 174). But, as we have seen, there were fallings-off from these high standards. Some were personal, such as the taking of the Gramco shares (para 198) and of the gifts bestowed by Mr Stern (para 262). Others were commercial, such as the secret underwriting commission (para 73), the support buying of shares (para 139), the elaborate device employed in window-dressing a balance sheet (para 140), the attitude to Exchange Control (para 127) and the Nation Life affair (para 249). In a class of its own, in our view, stands the bargain between Mr Challis and Mr Walker to avoid the payment of UK taxation both by the Crown Agents and by Mr Walker and Mr Greene (para 233). Mr Rowers spoke no less than the truth when he said (para 168) that the office had lost its sense of direction in the spiritual sense.

HAPHAZARD ASSOCIATES

A feature emerging from the history we have explored is how fortuitous was the Finance Directorate's choice of associates. Mr Abrahams meets Mr Wheatley by chance, and becomes the Crown Agents' estate agent; he introduces Mr Walker, who becomes their property consultant, and his firm becomes their property solicitors; Mr Walker introduces Mr Caplan, who becomes their valuer. No doubt the Crown Agents did not have to go out to look for business opportunities; when the news got around that they had large funds for investment they did not lack for applicants eager to do business with them especially as they became known in the City, according to evidence given to us, as "an easy touch." But it is a strange organisation which allows a junior official, as Mr Wheatley was at the time, to recruit its professional advisors, and to recruit them not from nationally known firms but from young men making their careers. Let us say at once that we have no reason to suppose that in the main the Crown Agents got other than proper advice from the gentlemen we have named. Mr Walker in particular, who bulks large in this story, not only gave sound advice, as to Australia and otherwise, but also saved the Crown Agents from losses upon their uninstructed plunge into the real property world (para 51). But the solicitors, Davies, Arnold and Cooper, were responsible for losing some security in the Stern case.
THE LOSSES

401 The losses which we have listed above at paragraph 373 may be classified as due to (i) unsecured lending to borrowers now unable to repay fully or at all; (ii) secured lending where the security has proved insufficient or defective; (iii) support lending in cases where rescue failed; (iv) equity investments in associated companies which have failed; (v) participation in property development and dealing. The equity investments form a small proportion of the whole because the Crown Agents injected money into their associates by way of loans rather than by shareholding. The lending is both in sterling and in other currencies. Sterling lending was the province of the Sterling Money Market Manager, the late Mr. Wheatley, whom we did not see for the reasons mentioned in para 3. Mr. Wheatley seems often to have made advances upon what has proved to be insufficient security; some of the property valuations relied upon were unduly optimistic and in some cases an unduly high proportion of the valuation was advanced. The non-sterling lending was the province of Mr. Blundell, and it is satisfactory to be able to note that despite his unpromising background as a banker (para 43) Mr. Blundell succeeded in avoiding major investment errors. The large non-sterling loans to Wilstar (Stern), GCA Capital Corporation, and Tulone were cases where he was required to lend against his better judgement (paras 246, 273, 350), and he can hardly be blamed for the Israel British Bank loss (para 359). Within his personal responsibility come the losses on Galico Investments, Great South West Corporation and Republic Corporation. The first named was a syndicate loan, within a syndicate led by the Crown Agents' banking partners, Continental Illinois, and the other two were small losses incurred early on in his time in charge of the section (para 160). Mr. Blundell comes well out of our investigation.

PROPERTY SPECULATION

402 As to financing property, a bank or finance house has broadly two options, one to lend at proper rates on ample security, the other to lend with less security and less, or delayed, return on the loan, but as
a quid pro quo to take “a slice of the action” by holding a stake in the equity. The former is a banking operation, the latter an entrepreneurial operation. The former has little risk, the latter produces high profits in boom time and large losses in slumps. The “adventurous” Mr Challis chose the latter course for major investments. It produced a £17m profit on the first English and Continental operation and other lesser sums elsewhere, and now has produced enormous losses.

The sharing and the amount of the E&C profits reaped by Mr Walker and Mr Greene has been criticised by Sir Matthew Stevenson and others (para 216). But if an undertaking is predominantly financed by loans from one lender, that lender becomes locked in to the situation and in adverse conditions may have to find more money in the hope of preserving his investment, and in such conditions it is no more than a recognition of the facts to give him a stake in the equity. Moreover, if it is one lender’s money that enables a concern to make profits, it is sensible for the lender to have a share in those profits. What that share should be must be a matter for negotiation and bargaining. Partnerships between capital and expertise are not unknown in the property world, and we are satisfied that it is not uncommon for the partnership to be on a 50-50 basis. In E&C Mr Walker and Mr Greene contributed their expertise not only to policy decision making but also to the running of the companies.

On the other hand, at the outset their experience was limited and they had yet to make their reputation. In the case of the other major partnership venture, both Mr Fensom and Capital & Counties were well-known and were expected to enhance the enterprise by their reputation. It has been suggested that the bargain with the Fensom syndicate was disadvantageous to the Crown Agents in that the syndicate did little except set the situation up. We are not disposed to find fault with the 50% share in either case. What in our opinion was wrong with these transactions was the going into them in the first place, not the proportions of the split. In the Australian venture there was the added fault, as we see it, of the Crown Agents binding themselves to provide finance far into the future. A body like the Crown Agents, it may be thought, should avoid speculative ventures; it is one thing to be involved in property as an income producing asset or to lend a proportion of a property company’s needs against valid security, but it is another sort of transaction altogether to buy Bush House not for its revenue but to re-sell at a profit, or to bind oneself by contract to furnish great sums for re-developing urban sites in Australia for years ahead.
Sir Claude Hayes inherited the own-account dealings situation. He could not be expected to oversee in detail the operations of the Finance Directorate, and that directorate was one among many in the organisation he headed. But he had asserted at the outset that Finance was his personal concern (para 91 above), he had the opportunity through presiding at the Crown Agents and Four Millbank Investments Board meetings of amassing information about the Directorate's activities, and moreover as time went on warnings started coming in (paras 161-164). His minutes of February and May 1971 (paras 172-174) show his awareness of some of the Directorate's failings, and by August 1972 he was mentioning one of Mr Challis's major shortcomings to the Permanent Secretary - his readiness to do business inconsistent with the standing of the Crown Agents (para 317). Sir Claude would have known more if he had been more approachable to his subordinates, none of whom among our witnesses, save Mr Challis, found him other than forbidding. In particular if Mr Nowers had had a Chairman to whom he felt able to voice his apprehensions and who would have been able to assess the weight of the complaints, this history would have been very different (para 170). This attitude of his was one of the reasons why internal warnings decreased as time went on; other reasons were the apparent success of the Finance Directorate's operations and the apparent approval given by the Stevenson Committee to those operations. Sir Claude's unapproachability was also partly responsible for the remarkable delay in grappling with the Stern crisis (para 340).

An equally important feature of Sir Claude's outlook was his determination to assert and maintain a position of independence for himself, the Crown Agent, and for the Crown Agents' organisation in his charge. This led to a running battle with the Ministry from the time in 1969 when they discovered Finvest down to the day in September 1974 when he departed. As against government Mr Challis's actions were supported and justified and the attempts of the Ministry to obtain information or to impose some constraints were treated as sinister attacks on the independence of the Crown Agents' office. In a minute written on his last day in office and addressed to his successor, Sir Claude said: "By 1968 the Crown Agents were still alive and kicking and beginning to be profitable. Treasury and CDU officials suddenly realised this and started a long process of getting direct control over the Crown Agents, including their operations, their assets, their reserves and their property."
Sir Claude's partisanship blinded him to the Ministry's real motives in making their inquiries and led him into actively misinforming them upon such matters as the Crown Agents' involvement in the second LEC set-up (para 302). His antagonism, coupled with his vigour and ingenuity in argument, played its part in protracting discussion and prolonging the status quo - and with it the own-account operations in their risky form.

One special feature of Sir Claude's conduct was his failure to replace Mr Challis when he left (para 324). This was because he thought it premature in view of the impending changes in structure. It was a serious error. It led to the Crown Agents being wholly unprepared for the change in the financial climate and wholly unequipped to deal with it. Had a new mind come to the direction of the Crown Agents' finances in November 1973 a great deal of money would have been saved. And had the out-of-depth Mr Hewins felt able to approach his Chairman at the start of the troubles, many further millions also could have been saved.

CORRUPTION

We have had evidence that rumours of corruption in the Finance Directorate have persisted in the City for many years. This is not surprising, because the manner of the Crown Agents doing business was often such as to invite suspicion. We have referred in paras 382-386 above to the various allegations made at different times against the late Mr Wheatley, the Sterling Money Market Manager. At the date of his death he was awaiting trial on criminal charges of corruption in regard to matters with which we cannot deal in a published report for the reasons mentioned in para 3. It is not for us to speculate whether Mr Wheatley entered into some of the loss-making transactions of his section for improper reasons. We can only report that, apart from the subject-matter of the criminal charges, we have found no evidence of corruption, nor has any witness come forward with any specific allegations.

We have however found, in the case of Mr Stern's Christmas gifts (para 262) instances of the Crown Agents staff accepting favours which might be thought to place them under an obligation to a person with whom they had to deal in their official capacity. These gifts were in our view unfortunate. The Crown Agents' staff handbook does not deal clearly with the topic, but it hardly needs a rule to expound the unwisdom of a
Crown servant accepting gifts or favours from persons with whom he is doing business. The recent Report of the Royal Commission on Standards of Conduct in Public Life (Cmd 6524) recognised that minor gifts and hospitality are part of the normal courtesies of life but regarded them as "always potentially dangerous". The Royal Commission approved the DoE rules forbidding inter alia the acceptance of gifts other than simple tokens bearing the name of the organisation that gave them (Report, Cmd 6524 paras 214, 217). Mr Challis is especially blameworthy in the case of the Stern gifts in that he should have set an example to his staff. There is a conflict of evidence between him and Mr Hewins over whether he knew of the gift to the latter; we accept Mr Hewin's account and think that when consulted Mr Challis should have ordered the immediate return of the gift to Mr Stern, as well as returning his own.

EXTERNAL CONTROL

409 Turning to the second strand of our Inquiry - the question of external checks - it is satisfactory to note that at the outset the alarm mechanisms worked efficiently. The inception of own-account dealing was recognised by the Exchequer and Audit Department in October 1969 as a departure which should be brought to the Treasury's attention (para 92); in February 1970 the other auditor, the Director General of Overseas Audit Service, reported to the Ministry his misgivings over the operation of the JCF (para 102); and in May 1970 the Bank of England, having picked up items causing them concern, expressed that concern to the Treasury (para 107). The Treasury was the correct department to be approached by the Bank and the E&AD, but it was the Ministry of Overseas Development which would have to come to grips with the situation. The Ministry was at once informed of the E&AD's report, but unfortunately did not learn of the Bank's concern (para 109). The Treasury did pursue their own interest and lent impetus to an investigation of the situation.

410 An investigation rather than action was the keynote of the ensuing transactions. What clearly bedevilled the matter was the uncertainty over the Crown Agents' status. The Crown Agents had outlived their original function, and no one knew quite how the transformed organisation fitted into the constitutional framework. If control of the Crown Agents was called for, it was logical to ask whether the power to control existed and to what it extended. This was initially a legal and constitutional question, and, if answered favourably to control, a second question opened out, namely how far it was prudent or politic to exert control.
An examination of the problem at once threw up these questions, and unfortunately they were allowed to dominate thinking and obscured the initial practical problem, i.e., what to do about the own-account activities. With hindsight it can readily be seen that there was an urgent need to ascertain accurately what the Crown Agents were doing, to assess the validity of the reason given (the creation of the reserve), to evaluate the risks being run, and to restrain some if not all of the own-account operations. Without hindsight two officials at the Ministry perceived this; we have quoted sufficient of Mr. Smith’s and Mr. Burr’s minutes to illustrate the accuracy of their appreciation of the situation (eg paras 94-96, 104, 106, 298). Unfortunately the Permanent Secretary disagreed: he saw no reason to interfere, although he sanctioned inquiries into the Crown Agents’ status (para 98). Thus there was lost the first and best opportunity of controlling or stopping the own-account activities. By early 1970 both the Ministry and the Treasury were thinking in terms of investigation of what the Crown Agents were and what they were doing generally, and when in April 1970 events prodded the Ministry into further action, it was towards inquiry that the officials’ minds turned (para 104).

Once an inquiry was contemplated (1970) or decided upon (January 1971) action was postponed; it was further postponed until the Stevenson Committee reported (March 1972) and thereafter while its report was being considered. The more time passed, the more firmly established became the own-account operations and the more difficult it became to control them. These difficulties were enhanced by the approval conferred by the Stevenson report; the fact that this approval was conditional on re-structuring the Crown Agents so as to diminish the risks (para 210) lost its urgency under Sir Claude’s reassurances (para 303). Not until August 1973 was action taken in the shape of the statement of principles then imposed (para 304). But even then nothing happened. No doubt the Ministry expected the Crown Agents to take action at once to observe the principles in the conduct of their affairs, e.g., imparting of information, reform of the quality of investment business. In fact Sir Claude Hayes did little about them. They were left to be put into practice by the new companies mentioned in the principles, and the process of setting up those companies had hardly started when the government changed in March 1974 and further time became needed for the formulation of a new policy.
412 Once the decision had been taken to investigate first and act afterwards - a logical enough sequence - it is difficult to see how any chain of events other than those which took place could have been brought about. What however is plain is that the process could have been accelerated. We have the feeling that the setting up of investigative machinery and the consideration of the constitutional status of the Crown Agents were subjects more congenial to Government than the taking of financial control decisions. But while condemning the delay from October 1969, when the Ministry was first alerted, to August 1973, when the principles were laid down, and to October 1974, when management changed, we recognise that the Stevenson findings were bound to set matters back, that Sir Claude Hayes's vigorous and disingenuous defensive campaign was bound to protract matters, and that the Ministry were never able to obtain a full picture of the own-account scene, owing to the delay in the accounts and the way in which the Crown Agents furnished information which was sparse and sometimes misleading. In particular it is plain that a reason for the Ministry's failure to act on financial control at a critical point in time (end 1972) was their belief that the need for outside control had passed with Sir Claude Hayes declaration that the Crown Agents intended to close down on further venture investment after collecting the POSSFUND profit (para 303). It was open to Sir Claude to use his authority to impose this new investment policy on his finance directorate. If he had done so many of the losses that we have recorded would not have been incurred. As our narrative has shown he did not do so and risk investment went ahead but was not disclosed to the Ministry.

413 In spite of repeated experiences of misinformation, or action promised and not taken, the Ministry maintained, almost to the end of his tenure of office, their belief that Sir Claude Hayes was to be trusted to carry out his undertakings to the Ministry. Although exasperated by his intransigence, the Ministry treated Sir Claude remarkably gently, as witness their anxiety to secure his agreement to the form of inquiry (para 190), their handling of the matter of the Gramco shares (para 183), their prolonging his term of office to secure his pension rights (para 365), and their patience with his opposition generally.

414 We think attention should be drawn to the handling of the crisis of 1974. The Crown Agents' optimistic statements (paras 338, 345) had for long concealed the parlous state of their finances, but at last on 13 May 1974 Mr Hewins's rough balance sheet was disclosed and it became
Apparent to the Ministry, the Treasury and the Bank of England that the Crown Agents were insolvent; yet the only action taken was the preparation of the statement of government guarantee, to be released if there was a "run on the bank" (para 346). The organisation which had brought about this lamentable state of affairs was allowed to run on under the same management until Sir Claude retired. His retiring date had just been extended from 30 June 1974 to 30 September 1974. What could and should have been done has been discussed at para 364. In the end the own-account activities were not examined and disciplined until the expiry of the Chairman's term of office.

THE ROLE OF THE AUDITORS

415 The Crown Agents' accounts, as audited and reported on by the Exchequer and Audit Department, ought to have served, inter alia (a) as an annual public record of the own-account activities; (b) as a management tool for the use of the Crown Agents in the performance of those activities and (c) as a means of providing the Treasury, the Ministry and the Bank of England with information and the opportunity to take any appropriate measures of control or otherwise. For various reasons the accounts failed to perform these functions.

416 In October 1969 when the E & AD identified the size and nature of the Finvest operation, and reported thereon to the Treasury and the Ministry, they passed to the proper quarter the question of what authority the Crown Agents had for own-account operations. We note that it might have been possible for the E & AD to make this report a year earlier when first told about Finvest (para 92) but we doubt whether this would have materially altered the course of events.

417 When in October 1971 the Treasury directed that the accounts should be so prepared "as to conform to the standards of disclosure required by the Companies Acts where these are appropriate" (para 117), they were recognising that the accounts were those of a large and complex trading organisation. We think that in some respects the accounts, as audited by the E & AD fell short of those standards. The principal shortcoming was as regards delay. We have mentioned the inordinate delays at paras 280-291. The statutory requirement that the E & AD should make their examination "with as little delay as possible" was lost sight of, and it was plain to us that no one in the Crown Agents,
and few outside, felt a need for the accounts or an obligation to furnish them in good shape and in good time (pars 281-285). When at length each year's accounts came out they were next to useless as an informative record because so seriously out of date. Some of the delay may have been due to inadequate audit staff allocated to the Crown Agents (para 283). More important in our view was the apparent lack of concern over the delay on the part of the E & AD higher directing staff, and the failure to report it as a departure from the accounting standards prescribed by the Treasury.

As to other audit shortcomings, our narrative has shown situations where the audit process might have, but did not, expose imprudence, irregularity, or even deception on the part of the Finance Directorate in the conduct of the own-account business. Examples are the absence of provision for losses, actual or potential (para 290) and the concealment of massive contingent liabilities incurred by the issue of comfort letters (pars 148-149). But the most significant impression that we gained of the part played by the E & AD in the rise and fall of the Crown Agents as bankers and investors was that they never recaptured the spirit of alertness and perceptive inquiry so clearly shown in Mr Long's report on Finvest to the Treasury in October 1969. We were told that the Treasury valued the E & AD audit especially because of the detailed private report made when needed. One of the great might-have-beens of our inquiry is the remedial action on the part of the government that would surely have followed if the Treasury had asked for, and the E & AD had used their audit scrutiny to supply, further information on the quantity and quality of own-account operations as these developed after 1969.

Finally, we must notice the apparent indifference of the E & AD to the failures of the Crown Agents' internal accounting system. The published accounts may have lost their relevance through delay, but at least they were eventually completed and certified. It is not too much to say that internal accounts for effective management purposes were non-existent. Conditions may have been different in other branches of the Crown Agents which we have not examined: our scrutiny of the Finance Directorate has shown that in this field, higher management, from the Senior Crown Agent down, felt no need of such accounts, indeed preferred to be without them. The Crown Agent and his Finance Directorate must answer for the consequences in terms of failure to control the financial
transactions that figure in our narrative. But a contributory factor lies in the apparent omission by the E & AD to perform for the Crown agents the recognised auditor’s function of advising management of defects and weaknesses of financial system, a matter they might also have included in their reports to the Treasury.

THE ROLE OF THE TREASURY

420 We have drawn attention above to opportunities that were missed by the Treasury to use their responsibility for the Crown Agents' accounts to inform themselves and the Ministry about the state of the Crown Agents' own-account finances. We appreciate that the Treasury took the view that it was for the Ministry, as the Department of State responsible for the Crown Agents, to deal with the latter over the organisation of their affairs. Nevertheless we think that the Treasury, as custodian of the public purse, might have been expected to press harder for government action to control the Crown Agents, including action to reform their internal management, and to have been less acquiescent in the policy of confining action to the revision of the Crown Agents' constitution. It is ironical to observe that while the Ministry were to the end labouring under misapprehensions over the nature and extent of the own-account dealing, government did not utilise its auditing arm to secure accurate information. Not until Mr Cuckney commissioned Coopers & Lybrand in October 1974 was any accountancy investigation carried out.

THE ROLE OF THE BANK OF ENGLAND

421 The Bank of England is the national central bank. Although not a government department it is publicly owned. It possesses the practical skills and contacts enabling it to detect flaws in the financial world and to provide assistance in remedying them. These attributes are lacking in a government department such as the Ministry or, indeed, the Treasury. We appreciate that the Bank is independent of government, but it is government's major contact with the City, and we think it would not have been unreasonable for the Bank to have played a greater part in this affair than it did. It was astute to detect signs of trouble and its initial warnings were correctly passed to the Treasury. But after that it played a minor role. It would have preferred a different type of inquiry from the one mounted (para 189) and in consequence played little part on the Stevenson Committee's deliberations, whereas fuller
information from it might well have modified that Committee's views (paras 218-9). Thereafter the Bank, although frequently consulted (paras 342, 346, 363) remained on the sidelines (para 310). It is unfortunate that it was not invited to take a larger part in the post-Stevenson deliberations. The Banks inquiries by direct contact with the Crown Agents was limited to the pre-Stevenson period.
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IN CONCLUSION

422 The sums granted out of public funds to the Crown Agents will either be lost to the taxpayer, or if repaid out of the future profits of the Crown Agents will be a clog on their competitive position. These unfortunate results flow from (i) an unwise decision to operate as financiers on own-account, (ii) the folly and euphoria with which some of the operations were conducted, compounded by lack of expertise and neglect of accounting systems and professional safeguard controls and (iii) the failure of government to inform itself of the developments, to appreciate the risks and to grasp the need for quick action. Against this sombre finding it is satisfactory to be able to note that no criticism has been made to us of the Finance Directorate's handling of principals' portfolios and that, judging by their continued success in their traditional procurement role, the Crown Agents orthodox activities have not suffered from the publicity accorded to the subject matter of our inquiry.

423 In conclusion we wish to reiterate that we have received complete co-operation from the present staff of the Crown Agents and from the various government departments with which we have dealt. Our research has been conducted with great competence by a team of accountants put at our disposal by Whinney Murray & Co and led by Mr Michael Taylor-Jones ACA and Mr George Elwes ACA. Mr Taylor-Jones has also been our painstaking and efficient Secretary and has earned our especial gratitude by his industry and skill.

E S FAY
EDMUND COMPTON
P GODFREY

N K TAYLOR-JONES
Secretary

10 August 1977
Extract from the report of the Stevenson Committee
2.1 The Crown Agents carry on a large and multifarious business including procurement, advisory and personnel services, fund management, banking and ancillary investment (3.1 to 3.3). They employ over 1,700 people, assets of over £400m and they manage principals' investments of over £300m (3.2, 3.1h). Their gross earnings (mostly overseas) amount to about £5m in a year (3.2). The overall result over the four or five years to 1970/71 is that profits on financial activities have been used to offset losses on other activities (3.2).

2.2 The Crown Agents confine their services almost entirely to overseas governments and public bodies. Over 90% of their non-financial business and 70% of their financial business derives from independent countries. The Crown Agents carry on business as agents for their principals overseas; and acting themselves as principals they provide services for overseas clients. An important new element over recent years is the growth of activities otherwise than as agents, particularly in money markets, banking and ancillary investment (3.1, 3.3).

2.3 The Crown Agents office is not a Government Department and the officials are Crown, and not Civil, Servants, although their terms of employment are linked to those of the Home Civil Service (3.6, 3.1h). The Crown Agents have no formal constitution nor are they incorporated. They are individuals appointed by the Secretary of State (3.7). They are responsible to each principal for that principal's business; but there is no collectivity of principals to whom they answer for the totality of their business including business done otherwise than on an agency basis (3.11).

2.4 When the Crown Agents acted mainly on behalf of Dependencies the Secretary of State for the Colonies exercised close supervision over them. Such supervision stemmed from his appointment of the Crown Agents and his responsibility for the Colonies. Such supervision and direction withered away as the Crown Agents services were increasingly provided to independent countries (3.8).

2.5 By virtue of his appointment of the Crown Agents, the Minister has certain powers of direction over them. These have not been exercised in modern times. They are not properly applicable anyway to matters within the Crown Agents banking and agency relationships with independent governments. There are arrangements for informal consultation between the Crown Agents and the Minister,
in regard to matters which the Crown Agents consider likely to be of public or political concern and thus involve the Minister. These informal arrangements are not wholly satisfactory, and in practice the accountability of the Crown Agents to the Minister is vague and the Minister’s responsibility to Parliament for the Crown Agents affairs is similarly indefinite (3.9 to 3.12).

2.6 The usual apparatus of governance and accountability which is found in the public - and to a lesser extent in the private-sector is missing. The Crown Agents are unincorporated; they have no terms of reference such as are prescribed by statutes or other instruments of incorporation; and they have no prescribed limits for activities or borrowing; they have neither shareholders nor the usual kind of board of directors. The Minister (and his Department) are not by themselves well placed to make good these deficiencies (3.13).

2.7 By reason of their status the Crown Agents at present enjoy Crown immunity from taxation, although they pay SET and the limited companies in which they are interested are liable to corporation taxes etc in the usual way. The Crown connection improves their standing with clients overseas and in the UK. A disadvantage is that in the last resort HMG would probably be liable at least in respect of liabilities arising out of the Crown Agents activities otherwise than as agents, in so far as these could not be met out of the Crown Agents funds. No such call on Exchequer funds has ever arisen; its avoidance depends on the continuing viability of the Crown Agents and the adequacy of their reserves (3.15 to 3.19).

PROCUREMENT AND ALLIED SERVICES: CHAPTER 4

2.8 In 1970 procurement orders placed by Crown Agents amounted to over £90m. The volume of this business has grown moderately over the past decade; but not as rapidly as UK exports generally, and the proportion of non-UK procurement has risen significantly with increasing international competition and the pressure of principals for purchases in the best market. Even so the Crown Agents provide facilities for about 1% of UK exports (4.2 to 4.6).

2.9 Overseas earnings of the Crown Agents procurement business (including stamps and currency business) amount to between £2m and £3m a year - a useful contribution to UK invisible income. But these activities incurred a net loss of £281,000 (general £374,000, stamps and currency £110,000) in 1970, following similar losses in 1968 and 1969 (4.7, 4.26).
2.10 The Crown Agents have a standard list of agency charges for orders of varying sizes. The scale of charges is revised at infrequent intervals. The last review was in 1968 and another is taking place in 1972. Infrequency of review of charges in periods when the Crown Agents own costs rise exceptionally fast is a source of difficulty (h.8 to h.10).

2.11 The Crown Agents risks as agents in procurement and allied services are limited to claims for gross negligence, against which they have normal insurance cover (h.39).

2.12 We conclude that the Crown Agents are providing through their agency procurement work an efficient and valuable service to their principals: they are also helpful to UK suppliers and they make a useful contribution to UK visible and invisible exports; without them some of the benefits would be jeopardised (h.40).

2.13 In order to prevent uneconomic expansion of activities and complaints of unfair trading, we recommend that: these procurement activities should be required fully to pay their way, including appropriate contributions to overheads, reserves and UK taxes. The management may have to make more frequent or more substantial increases in charges, revise charging policy to bring about a closer relationship between full costs and charges for individual orders, or secure further economies in operation - eg through the contraction of the geographical area of their procurement (h.41, h.42).

Engineering Inspection and Engineering Advisory Services

2.14 The Crown Agents provide both in the UK and overseas inspection services for goods whether or not they have procured them. They provide engineering advisory services sometimes in collaboration and sometimes in competition with the private sector (h.14 to h.25).

2.15 The gross earnings from these services is growing (over £700,000 in 1970) and they are clearly valued by principals - especially the inspection services. But they are quite small in relation to the gross overseas earnings of British consultants generally - £30m to £35m a year. The services have been run at a net loss (although we understand that the loss in 1971 will be small). The risks here are similar to those in the procurement business generally and the Crown Agents have normal insurance cover (h.14 to h.25).

2.16 We conclude that there is no sufficient ground for curtailing these services which though small are important to overseas principals especially the smaller Dependencies. As in the case of procurement activities we recommend that: these
services should be required fully to pay their way: and in order to preserve the appearance as well as the fact of impartiality, they should be formally separated from purchasing activities, eg in a separate limited company (h.25).

Hillbank Technical Services Ltd (MTS)

2.17 This 100% subsidiary of the Crown Agents was formed in 1967 with a capital of £1m (£800,000 uncalled) and is in operational and staff terms closely co-ordinat with the Crown Agents. It is a merchanting concern - placing orders as a principal with suppliers and arranging complete packages, which it sells as a principal to customers under a contract designed to earn an overall profit. The packages so organised are mainly defence equipment but they also include civilian items like agricultural machinery (h.30 to h.34).

2.16 Turnover which fluctuates greatly from year to year was over £10m in 1969 and £8m in 1970; it seems likely to grow significantly over the years ahead. It made a modest profit (£30,000) in 1970 (h.31, h.34).

2.19 We conclude that: this company is filling a gap in UK arrangements for certain exports: the relationship between the Crown Agents and the Ministry of Defence is useful to both; MTS is substantially protected against risks through insurance with the Export Credits Guarantee Department, through cover from MOD in respect of that Department's element in any package, and through provisions in contracts with suppliers and customers: the Crown Agents are alive to the undesirability of shouldering risks in large contracts beyond the cover which they can obtain. Subject to this point we have no comment on the Crown Agents assessment that the reserve backing against risks should be of the order of £1m (h.35, h.36).

Marine Insurance

2.20 This business, which makes a small profit, is carried on by the Crown Agents partly as agents and partly otherwise than as agents. Crown Agents insure only goods they procure. They re-insure 75% of the risks and hold a special reserve against excess claims (h.37, h.38).

PERSONNEL SERVICES : CHAPTER 5

2.21 These include recruitment and engagement of expatriates on behalf of overseas governments and public bodies, the arrangement of passages, and the making of certain payments such as pensions (5.1).
2.22 This is a substantial business in terms of numbers recruited and of transactions. Gross earnings amount to rather less than £700,000 a year; but aggregate losses, after charging a due proportion of overheads, have been incurred over recent years (5.2).

2.23 We conclude that in this field the Crown Agents are performing a necessary and valuable function for which they are well fitted and to which there is no obvious satisfactory alternative; there would be advantages in concentrating as much of this work as practicable in a single organisation like the Crown Agents (arrangements have already been made for certain transfers of work from ODA to the Crown Agents and other transfers are under consideration): these Crown Agents activities could be usefully increased and this should make for economy, efficiency and better financial results. As in the case of procurement activities we recommend that personnel services should be required fully to pay their way (5.3 to 5.7, 5.11).

FINANCIAL AND INVESTMENT ACTIVITIES : CHAPTER 6

2.24 In terms of capital employed, and of profits earned, but not of numbers of staff, these are the largest activities of the Crown Agents. Managed funds (including £200m in banking deposits) amount to over £1,000m. The banking business deploys assets of over £1bn. The operational links between the financial activities and the procurement activities are not very close although there is a wide area of overlap between clients for both. These financial activities earn substantial profits which are used to offset losses incurred on most other Crown Agents activities (6.1, 6.2).

Fund Management

2.25 The aggregate managed funds of about £1,000m consist of over 1,000 separate funds of varying sizes. Over 70% of the managed funds come from independent countries and the bulk of the balance comes from Hong Kong. The funds consist of currency reserves, general reserves, and special funds (eg pension funds), of overseas principals. Over 70% of the invested funds are in British Government securities (6.3 to 6.6).

2.26 The funds are managed in accordance with the particular or general instructions of the principals, who receive regular reports and copies of the Crown Agents' Annual Report and Accounts. The Crown Agents maintain the usual internal apparatus for fund management including research unit, investment managers etc. There is also an advisory panel of outsiders but it has very restricted terms of reference (6.7 to 6.9).
1.27 The Crown Agents' charges for fund management are very low, and profits correspondingly modest. The risks involved are limited to those of professional negligence against which Crown Agents have normal insurance cover. The Crown Agents consider that a general reserve of £1m should be adequate to cover claims beyond this. We accept that this is reasonable (6.10 to 6.13).

1.29 We conclude that this is an economical service, which gives general satisfaction to the principals, but the performance of the funds might be improved if Crown Agents were able through suitable salaries to recruit and retain more experienced investment managers (6.12).

Banking

2.29 Banking funds of about £1,000m consist broadly of £200m on current accounts, £100m on deposit accounts and £100m which Crown Agents got from the money market. Banking — including income and proceeds from invested banking funds — makes the major contribution to the profits of financial activities as a whole (6.15).

2.30 The Crown Agents' banking services are rendered mostly to persons who are principals on the procurement side of the Crown Agents' business. On the banking side, the legal relationship is that of bank to depositor; and the profits or losses on banking (and ancillary investment) are on the Crown Agents' account. This position is not altered by the existence of the Joint Consolidated Fund and the Joint Miscellaneous Fund which are administrative and not legal entities (6.16, 6.17).

2.31 The Crown Agents employ their banking funds mainly in the money market; they also invest in marketable securities and in advances to companies and overseas clients. They maintain a liquidity ratio of 25% of current accounts and they match appropriately 70% of other maturing liabilities. The liquidity ratio of 25% is higher than that prescribed for banking institutions in the UK but reflects the special nature of the Crown Agents' banking business. We conclude that the Crown Agents' liquidity ratios and matching arrangements are reasonably prudential (6.19, 6.20).

2.32 Reserves and risks. Crown Agents judge that a suitable reserve against losses would be about £1m, being about 20% of their unsecured lending in the money market. We do not question this specific judgement but we look at the reserve position as a whole in Chapter 8 (6.21 to 6.23).
Sterling balances and foreign currency deposits. Over the years 1962 to 1971 the Crown Agents have held 23\% to 28\% of the total sterling reserves of overseas countries and organisations. At 31 December 70 the amount so held - in the banking and managed funds - was £710m. They also accept foreign deposits for overseas clients (6.21 to 6.26).

We conclude that: the Crown Agents offer very competitive rates of interest on deposits by clients; their ability to do so derives in part from the aggregation of funds which they utilise profitably and it owes something also to freedom from taxation; with increasingly competitive conditions in the banking world the Crown Agents may have to increase their efforts if they are to maintain the volume of profitable business (6.27, 6.28).

Ancillary Investment

The Crown Agents total investment experience in 1970 was unfortunate. On investments of some £35m, depreciation and losses amounted to about £6.5m. It would be wrong to attribute too much weight to results at one particular date; and there has been a substantial recovery in 1971. We conclude that the investment performance has not been outstandingly good but that over the years the Crown Agents' management has on the whole been competent and conscientious although we have some specific criticisms (6.29, 6.44, 6.45).

The Crown Agents invest a fraction of banking funds in 'hard-core' investment: which are not readily realizable. They have a working rule to limit such investment to 20\% of their deposits and money market borrowing, other than those in JCF and JHF ie the current account business. This seems to us a sensible enough rule; but on occasions they have been operating at or above their self-imposed limit (6.31 to 6.33).

In July 1971 the Crown Agents had invested a total of over £31m in English and Continental Property Co Ltd (a Crown Agents sub-subsidiary) and the First National Finance Corporation Ltd. A more conservative management might have regarded such concentration as excessive even although most of the investments were short-term and secured. This position was somewhat corrected by 31 December 71. Even so we conclude that there was some risk here (6.34).

English and Continental Property Co Ltd. The biggest single item among the Crown Agents investments (shares and loans) has been the investment in their sub-subsidiary English and Continental Property Co Ltd. At 31 December 71 E & C
indebtedness had increased to £13m of which Crown Agents were creditors for £13m secured by a floating charge; there were other loans secured by fixed charges (£10m) and other borrowings unsecured of £23m. At the peak the Crown Agents lendings to their sub-subsidiary amounted to £23m (6.36).

2.39 We commissioned Price Waterhouse and Company to report on the history and development of E & C and the Crown Agents involvement in it. Their report will be forwarded to the Minister but we do not think it necessary to delay our Report on that account (6.37).

2.40 Our conclusions are as follows. This Crown Agents venture grew more quickly and substantially than originally envisaged. We do not think that the process of informal consultation enabled the Minister to be fully seized of this. We think that the Crown Agents took rather too great a share of the risks in relation to the rewards; and that at the peak this investment involved an excessive proportion of Crown Agents resources in a single concern. The size of the Crown Agents stake in E & C has now been substantially reduced. Although Crown Agents advances were secured by a floating charge on the assets (professionally valued) they might in the event of misfortune have found themselves under pressure not to exercise such rights in front of unsecured lenders to their own subsidiary company (6.30).

2.41 Associated companies. The Crown Agents have also invested in and made advances to a number of associated companies – some of which have but a slight connection with services to Crown Agents clients. In one or two cases their associates were perhaps not of a quality and standing which matched that of the Crown Agents. Moreover the proliferation of trading and dominant investments tends to create management problems and there are in them greater risks as well as the prospect of greater rewards (6.41 to 6.43).

2.42 We conclude that too great a burden for investment policy and major investment decisions has to be shouldered by the Finance Director under present arrangements; and that a normal board, consisting largely of suitable independent (ie non-executive) directors could be of assistance in minimising lapses and losses (6.46).

Concluding Commentary

2.43 Our general conclusion is that: subject to the withdrawal of taxation privileges and to appropriate organisational and status changes, the Crown Agents financial activities as a whole should continue; they offer an economical and
advantageous service to overseas clients: they play a responsible part in the
money market, the gilt-edged market, and in the handling of large sterling
balances and sterling investments; disruption could cause damage and loss to the
Crown Agents and their clients as well as to the UK (6.47 to 6.51).

THE DEPENDENCIES: CHAPTER 7

2.44 The Dependencies’ share of the Crown Agents total business is now small­
about 6% of non-financial and 25-30% of financial business, the bulk of which is
for Hong Kong. The Dependencies (other than Hong Kong) can be only a minor factor
in determining the future shape and functions of the Crown Agents as a whole (7.6).

2.45 The Crown Agents business is essential to many Dependencies and especially
the smaller ones. This is true of all the services provided by the Crown Agents
with the possible exception of financial business which could be provided, if not
so cheaply, by other institutions in the City (7.7 to 7.11).

2.46 We have not had a comprehensive view of the importance the Dependencies
attach to the Crown connection. We are told that the smaller Dependencies would
prefer the continuance of the present relationship but we have heard some
dissentient voices. We believe the important thing in the minds of clients is
the quality and price of the services and the ethos of the providing body (7.12).

2.47 We conclude that there should be a duty on any successor body - as on the
Crown Agents (7.5) - to provide services to the Dependencies, subject to its
obtaining a reasonable proportion of the total business of the Dependency, and
that the continuance of the Crown connection would not be essential for the
discharge of this duty (7.13).

MISCELLANEOUS: CHAPTER 8

RESERVES

2.48 Apart from minor specific reserves the 1970 balance sheet shows major
reserves approximately as follows:

<table>
<thead>
<tr>
<th>Reserve Type</th>
<th>Amount</th>
<th>Classification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment reserve</td>
<td>£3.1m</td>
<td>specific</td>
</tr>
<tr>
<td>Pensions etc reserve</td>
<td>£6.7m</td>
<td>specific</td>
</tr>
<tr>
<td>Reserve</td>
<td>£1m</td>
<td>general (8.1 to 8.3)</td>
</tr>
</tbody>
</table>
2.19 The investment reserve of £3.1m was created out of the excess arising on property revaluation and was to cover the difference between cost and market value at that date. With the recovery in the Stock Market in 1971 some of this reserve has since become free (6.2).

2.50 The general reserve at 31 December 70 stood at about £1m as compared with about £1.1m at 31 December 67. The increase over the intervening years was due mainly to substantial revaluation of property and similar adjustments. We are informed that there were hidden reserves of £1m - £3m at 31 December 70; these consisted of the excess at that date of the value of owned and occupied premises over the then balance sheet figure. On this basis general reserves at 31 December 70 amounted in total to £2m - £3m (6.3 to 6.7).

2.51 In the context of our Enquiry Crown Agents estimate of the desirable minimum level of general reserves varied between £17m and £20m in all. The figure and its detailed make-up is very much a matter of judgement and we do not quarrel with these considered estimates which the Crown Agents have put to us (8.8 to 8.11).

2.52 We conclude that in the years up to 1970 and at 31 December 70 the general reserves were substantially below the desirable level: the Crown connection and Crown status with its implied warranty have helped to offset the insufficiency of reserve strength and have enabled the Crown Agents to enjoy a credit rating which they would not have enjoyed on the strength of their balance sheet position alone (8.12).

Pension Scheme and Reserve

2.53 A separate account is kept for the pension scheme and its liabilities are revalued regularly by the Government Actuary. The assets earmarked to the scheme are managed by an office committee including staff representatives, chaired by the Crown Agents (8.14, 8.15).

2.54 In 1968 the Crown Agents executed a Declaration of Trust whereby the Crown Agents stand possessed of the Office Reserve Fund with discretion to crystallise the trust by alienating the necessary assets to secure the discharge of pension liabilities. A note about the existence of the trust is included in the notes to the 1970 Crown Agents accounts (8.16).
2.55 We conclude that: the present position is unsatisfactory in that the trust extends to the whole Office Reserve Fund and this extension might weaken the confidence of clients in the Crown Agents financial strength: an awkward situation might arise if in time of difficulty the Crown Agents were to crystallise the trust by alienating assets to the pension scheme thus putting them beyond the reach of other claimants. We recommend that the situation of the pension scheme be clarified (8.17).

Accounts

2.56 There has in 1970 been some consolidation of the Crown Agents accounts and fully consolidated accounts are being produced for 1971. We are impressed by the complexity of the various company structures through which the Crown Agents conduct some of their activities. We conclude that: it is desirable that there should be a single auditor experienced in the commercial and banking sphere for all the main Crown Agents activities; and that reconstitution on the lines we recommend would provide an opportunity for further consolidation of audit and accounts (8.18 to 8.20).

Salary Levels

2.57 The Crown Agents activities consist predominantly of business and not administration in the governmental sense and top officials in the Crown Agents office bear greater personal responsibility than counterparts in the Civil Service. The present responsibilities of the Director of Finance would in commercial circles command a salary of perhaps twice as much as his present salary. We think there is a significant degree of underpayment in the Finance Directorate which extends down as far as the investment managers, and this affects the Crown Agents ability to recruit and retain suitable staff. There may be implications here for other top posts in the organisation (8.21 to 8.24).

Taxation

2.58 The Inland Revenue has hitherto treated the Crown Agents in effect as the Crown and thus entitled to Crown immunity from taxation; although limited companies in which the Crown Agents have interests are liable to tax in the ordinary way. We have received representations that the tax privileges allowed to the Crown Agents give them an unfair advantage over their private sector competitors. This applies particularly to the Crown Agents financial and banking activities which have grown
rapidly over the last few years and are the main source of profits. I recommend
that on the grounds of taxation principle and fair competition the Crown remain
from taxation should be eliminated; this could be done through the various models
discussed in Chapter 9 (9.25 to 9.27).

Relationship between Crown Agents, CDC, and CDPC

2.59 Relations between the Crown Agents and CDC (a nationalized body) and CDPC
(a private sector body) have hitherto been minimal. There are large geographical
and some functional overlaps. There may be possibilities for some rationalization
among these bodies and we suggest that some further examination of this might be
justified (9.20).

STATUS, CONSTITUTION AND OBJECTIVES: CHAPTER 9

2.60 We have noted the following defects in the present situation:

Arrangements for accountability in respect of the totality of the business
and especially the business done otherwise than as agents are less than
adequate (9.2);

The present Crown status is a source of ambiguity, anomaly and risk and of
complaints of unfair trading. There is an implied Crown warranty behind
Crown Agents and this is of particular significance in their activities
otherwise than as agents (9.3, 9.4);

The normal apparatus of governance is absent - ie incorporation with stated
objectives and limited powers, shareholders' meetings, a proper Board and
the discipline of the profit motive (9.6 to 9.8).

2.61 Although we cannot say that any significant damage has been done we cannot
in view of these defects and associated risks recommend the continuance of the
Crown Agents with their present status, composition and range of functions
(9.9).

A Solution through Change of Functions

2.62 We have examined the possibility of minimising the defects and the risks by
contracting the field of Crown Agents activities - eg by return to the boundaries
of their activities in 1967, the reduction of money market activities, or by
confining them to their traditional role of serving only the Dependencies. We
conclude that these courses are impracticable or undesirable. Severe contraction
or liquidation would be highly disturbing and damaging to the interests of overseas
countries and the UK (9.10 to 9.15).
We develop and examine some new model structures, involving different degrees of IMG involvement. We do not doubt that under present arrangements the Minister has certain powers of direction over Crown Agents, though they have for practical reasons not been exercised in modern times. In view of the independence of most of the clients, the necessity of observing the integrity of principal/agent and banking relationships, and the nature of the business, we conclude that arrangements which minimize the involvement of IMG and Parliament would be the most appropriate (9.17).

We examine in our report four models all of which would incorporate Crown Agents activities, eliminate Crown immunity, and reduce all or some of the other defects and risks in the present arrangements. In essence these models are:

Model 1 A Nationalized Corporation (9.19 to 9.24)
Model 2 A private sector body with minority governmental interest (9.25 to 9.35)
Model 3 A limited company with IMG (or IMG and Dependencies) as a majority shareholder and independent countries as minority shareholders (9.36 to 9.43)
Model 4 A limited company with shares owned by IMG (9.44 to 9.51).

We do not seek to summarize all the characteristics of these models but we note these points. Model 1 would have the advantage of clarity but would make IMG fully responsible for the business and would almost certainly be unacceptable to the independent countries (9.24). Model 2 would remedy all the defects in the present situation but its feasibility would depend entirely on private participation which seems unlikely (9.34, 9.35). Both Models 2 and 3 envisage shareholding participation by overseas countries which we regard as important but may be difficult to realize (9.29, 9.30, 9.33). Model 4 would involve IMG more closely than now; it is in effect an informal version of a nationalized body; but it could be used as a stage to Models 3 or 2 (9.51).

Conclusions and Recommendations

Choice among the models would depend significantly on the results of consultations with overseas clients of Crown Agents and their reactions. Our impression is that the Crown connection in the Crown Agents activities is not of prime importance (9.54) but this needs to be tested in concrete discussions with
overseas clients. Another factor is the need for legislation. As far as we can judge all models - with the possible exception of Model 4 - would require legislation (9.55). We cannot evaluate these factors at this stage. We would regard Model 1 at best as a solution of last resort (9.2h). On intrinsic merits we recommend the other models in the following order:

Model 2
Model 3
Model 4

(9.56).
CABINET

CROWN AGENTS: THE FAY REPORT

Memorandum by the Lord Chancellor

1. The Committee under Judge E S Fay which was appointed in April 1975 to enquire into the causes of the financial problems of Crown Agents has now reported. (A summary has been circulated with CP(77) 101). A group of Ministers under my chairmanship has considered the Government's reaction to the Report.

2. The Fay Report is a thorough and well-balanced study which reveals a deplorable state of affairs in the past. Their main criticism is directed at the investment operations undertaken on their own account by the Crown Agents but there are also criticisms of Government Departments, the Exchequer and Audit Department and the Bank of England.

PUBLICATION OF THE FAY REPORT AND THE GOVERNMENT'S REPLY

3. Publication of the Fay Report to which the Government are committed will attract much publicity and criticism of Government under both Labour and Conservative Administrations, although the main responsibility for inaction must rest with the latter. We think it is essential that a White Paper giving the Government's comments on the Fay Report should be published at the same time as the Report itself. A draft is annexed. It states unequivocally that the Government accept the conclusions of the Fay Committee (paragraph 1) and then deals with the steps which have already been taken to reorganise the Crown Agents (paragraphs 5 to 10 and 21) to define clearly their relationship with the Minister (paragraphs 16 to 19 and 22) and to disengage them from their property and secondary banking activities (paragraphs 20, 23, 25 and 26).

STEVENSON REPORT

4. It is proposed to publish as an Annex to the White Paper the Report in April 1972 of a Committee under Sir Matthew Stevenson which examined the status, functions and financial operations of the Crown Agents. (A summary has been circulated with CP(77) 101). The then Minister
(Mr Richard Wood) told the House of Commons on 8 November 1971 that it would not be appropriate to publish the Report of the Committee since most of the work of the Crown Agents was for independent Governments. It is possible that some witnesses may have had this statement in mind in giving their evidence. However with minor editing which has now been done the Report can be published without prejudice to the principals of the Crown Agents and without risk of breach of confidence. The Fay Report quotes from it at length and comments that an edited version could have been published with beneficial results. The Chairman and two of the three other members of the Stevenson Committee have said that they think that the references to it in Fay make it desirable to publish the Stevenson Report. Mr Richard Wood has been consulted and considers that it is right in the circumstances to publish.

ACTION AGAINST CULPABLE INDIVIDUALS

5. Criminal proceedings have been started against two of the people involved in the Crown Agents affair - Mr Bernard Wheatley, the former sterling money market manager of Crown Agents who has since died and Mr Sidney Finley, a financier whose companies had dealings with Crown Agents. Civil proceedings for recovery of moneys are being taken in three cases and the possibility of taking them in other cases is under examination. In addition the Ministerial group thought that there should be an enquiry by an independent Committee with the terms of reference in paragraph 14 of the draft White Paper to establish the gravity of any neglect of duty by people in the public services and to assist those concerned in deciding whether disciplinary action should be taken. The Ministerial group thought that this enquiry should cover the Bank of England and the Exchequer and Audit Department as well as the Crown Agents and Government Departments: for this it will be necessary to secure the co-operation of the Governor and before the enquiry is announced it will also be advisable to consult the Chairman of the Public Accounts Committee and the Comptroller and Auditor General. This procedure would follow the precedents of Crichel Down in which Sir Andrew Clark's Inquiry (Cmd 9176) was followed by the Woods Committee Report (Cmd 9220, July 1954) and the Bossard case, in which the Security Commission's report was followed by the Wilson Smith Inquiry (Cmd 2773, September 1965). It is quite likely that this enquiry will result in little or no disciplinary action because those who appear most culpable have left the public service and their pensions cannot be forfeited or abated unless they are convicted of a criminal offence in connection with their job. While a minority of us thought that in the circumstances the setting up of a disciplinary committee would be futile, the majority felt that public opinion would not be reassured if no further inquiry were conducted.
LEGISLATION ON CROWN AGENTS

6. At their meeting on 11 October (CM(77) 30th Conclusions, Minute 1) Cabinet asked the Ministerial group to consider the degree of urgency which should be attached to legislation to give the Crown Agents corporate legal status. The group took the view that with the action already taken to reorganise the Crown Agents and to define their relations with the Government, legislation was not essential immediately for constitutional or administrative reasons. Parliament could probably be satisfied that the necessary remedial action had been taken and the Crown Agents' house already put in order. Further consideration might however have to be given to the timing of legislation in the light of Parliamentary and public reaction to the Fay Report.

CONCLUSIONS

7. I invite the Cabinet -

1. To agree to -

   a. publication of the annexed White Paper at the same time as the Fay Report is published;

   b. publication of the Stevenson Report as an annex to the White Paper;

   c. the establishment of an external enquiry into the extent of neglect of duty on the part of individuals in the public services.

2. To take note that the Ministerial group considered that immediate legislation to give the Crown Agents corporate legal status was not essential but that this question might have to be reconsidered in the light of Parliamentary and public reactions to the Fay Report.

E-J

Lord Chancellor's Office

7 November 1977
CROWN AGENTS: FAY REPORT

Draft White Paper

Introduction

1. The Report of the Committee of Inquiry on the Crown Agents is being published today as ............ It is published in full. The Government and the Crown Agents accept the Report as a fair and searching investigation into the facts; and accept the Report's conclusion that there were serious shortcomings on the part of the Crown Agents and that Departments and other outside agencies contributed to the failure to prevent losses. The Minister for Overseas Development, to whom the Report is addressed, has conveyed her thanks to Judge E.S. Fay, Q.C., Sir Edmund Compton, G.C.B., K.B.E., and Mr. P. Godfrey, F.C.A., for their thorough and exhaustive work on a most difficult and complex subject.

2. The terms of reference of the Committee of Inquiry, which was appointed on 23 April 1975, were:

To enquire into the circumstances which led to the Crown Agents requesting financial assistance from the Government.

It will be recalled that in December 1974 the Crown Agents received from the Government a recoverable grant of £35 million. However, the Committee was not specifically asked to consider those aspects which bear directly upon the exercise of proper control over public bodies, although its Report touches upon some of these.

3. The Government therefore wishes to provide certain additional information, and believes it will be of
assistance to Parliament to set out in sequence the Parliamentary consideration of these matters. This is done in Annex I which contains all the major Ministerial statements about the Crown Agents since November 1971. The Government also wishes to state its policy in relation to the Crown Agents, and to reaffirm its confidence in, and support for the present Board of the Crown Agents and for their work.

4. In view of the relevance of the report of the Stevenson Committee to the history of subsequent events, the Government has decided that it also should now be published. It is printed in a separate volume (House of Commons return Number 000) as Annex V.

The Future of the Crown Agents

5. Before making its comments on the clear failures of the past, the Government wishes to place on record its view of the future of the Crown Agents. The Fay Report explores and elucidates a phase in the conduct of the Crown Agents' affairs which ended, and ended decisively, three years ago. It is, in effect, an essential account of conduct and events which are now a question of historical concern rather than present anxieties, although their financial consequences are still with us.

6. The Crown Agents are now performing their invaluable services on behalf of their Principals, who include 67 Commonwealth Governments, Associated States and Dependencies; 152 Commonwealth public bodies; and 57 non-Commonwealth governments and agencies, in the secure confidence that the Government stands behind them during a period, which will inevitably last for some time, of gradual disengagement from the ill-advised and disastrous speculative involvements of 1967 to 1974. Since December 1974, the Crown Agents have been undertaking an orderly and phased
withdrawal from property and secondary banking. The Government's assurance means that the position of all depositors is fully safeguarded.

7. The Government wishes to make clear beyond doubt its unequivocal and firm support for the Crown Agents. It has created a service to developing countries which at the same time provides a channel for traditional and new supplies of goods and services to the wide and expanding market of the third world. Its origins lay at the heart of nineteenth century colonialism, when its role (from 1833 onwards) was to procure goods from Britain for the colonies. In the last 20 years, it has built and transformed the past into a confident and greatly appreciated relationship with the countries and public agencies of developing countries all over the world. The Crown Agents serve them; and in doing so, they are a crucial element in Britain's relationship with countries overseas.

8. The Crown Agents functions will be the traditional services of procurement, recruitment, technical advice and management. The exact pattern of such future development cannot, of course, be predicted, for it will be determined by the degree of expansion of the Crown Agents' own relationship with their overseas Principals, and by their response to new needs for goods and services as they emerge and are identified. The Government believes that all concerned can be confident that the Crown Agents have ahead of them a future of promise and achievement.

9. The Government is reinforced in this belief by its awareness of the capabilities of the present Chairman and his Board. The seriousness of the situation which we and they faced in the autumn of 1974 was not one which they could have expected, in the absence of up-to-date financial information. That so much that was wrong has been and is being put right, and that activity on behalf
of overseas Principals has increased in the last three years is a tribute to them, and particularly to the Chairman, Mr. John Cuckney.

10. The Government will introduce as soon as possible a Bill to incorporate the Crown Agents: a commitment made to Parliament in October 1975. This will not affect the Crown Agents' relationship with their overseas Principals. But it will clearly define the relationship between the Crown Agents and Ministers which was obscure after the rapid move to independence of the Colonial territories in the early 1960s; and will provide for the proper exercise of public accountability. Meanwhile the Government has taken the administrative action detailed below, designed to secure these objectives pending legislation.

11. It is manifest from the inquiries of the Committee that during the period from 1967 to 1974 the conduct of the affairs of the Crown Agents, and, in particular, the actions of certain of its staff, lacked competence and good judgment. As the Committee explain in paragraph 3 of the Introduction, they have made a separate report on matters relating to the late Mr. Bernard Wheatley, the Crown Agents' former sterling money market manager, and Mr. Sidney Finley. That Supplementary Report is not being published, because these matters are sub judice, but has been referred by the Minister of Overseas Development to the Director of Public Prosecutions. With the possible exception of matters covered in that Report, the Committee found no evidence of corruption among the Crown Agents' staff. As regards exchange control, investigations by the proper authorities are proceeding. The Committee's report on the Crown Agents' acquisition of shares in the First National Finance Corporation Limited in 1969 to 1970 (paragraph 73) was referred to the Director of Public Prosecutions, who found no grounds for proceedings against the individuals in question. However, it is clear that
the own-account activities of the Crown Agents did not accord with the proper standards of behaviour of public bodies. It is to be noted that the other activities were properly conducted.

12. It is evident that during this period, there was a lack of clarity concerning the constitutional relationship between Ministers and the Crown Agents, and that the information made available to Ministers was incomplete. It is recognised by all concerned that for much of the period between 1967 and 1974 the growth of the Crown Agents' own-account business, and the pattern of its investments, as outlined in the Report, was inadequately monitored and scrutinised. The Government accepts that this represented a failure to apply the normal principles of public accountability.

13. The Government believes that its efforts to explore the causes of this failure; its decision to lay all the facts before Parliament; and its efforts and success in re-establishing the Crown Agents on a sound footing, will be regarded as firm evidence of its determination that the conduct of public affairs shall be honourable, and shall be seen to be do.

14. The Government has decided to set up a Committee of Inquiry with the following terms of reference: "To examine the facts and assess the nature and gravity of any neglect of duty on the part of those employed in the Crown Agents, the Ministry of Overseas Development, the Treasury, the Bank of England and the Exchequer and Audit Department, so as to assist in deciding whether appropriate action is required". This follows the precedent of the Committee which reported in July 1954 on persons involved in the Crichel Down inquiry (Cmnd. 9220) and the Board of Inquiry which reported in September 1965 following the report of the Security Commission on the Bossard and Allen cases (Cmnd. 2773).
15. At the same time, it is important to emphasise that the traditional activities of the Crown Agents in providing services to their overseas Principals have continued, and are continuing successfully. As the Fay Committee has pointed out, what went wrong was a part only of the Crown Agents' financial activities, and those activities themselves formed only a part of the Crown Agents' total business. Judging by the continued success of their traditional role, the Crown Agents' orthodox activities have not suffered from the publicity accorded to their own-account business, and in 1975 and 1976 the traditional agency services produced gross income of £11 million and £17 million respectively. These services had for nearly 150 years past been the reason for the Crown Agents' existence; they will now be the basis for a continuing future.

The Constitutional Position

16. The Committee of Inquiry outlines the progress of efforts to establish the constitutional relationship between the Crown Agents and Governments from February 1970 onwards. This was not an easy matter. The Crown Agents, from 1833 onwards, were an agency under the direct control of the Secretary of State for the Colonies. They supplied the goods and services required by the Colonies. Their role was not questioned or examined until a Select Committee of the House of Commons investigated and reported in 1909, following which it appears that their role continued as before, under the firm control of the Secretary of State for the Colonies.

17. The constitutional relationship was well understood and worked satisfactorily until the process of decolonisation occurred. The Crown Agents then began to undertake procurement of goods and services for independent governments and their parastatal agencies. Their formal responsibility continued to be to the Secretary of State for the Colonies.
until 1961 when it passed to the Secretary for Technical 
Co-operation, and from him to the Minister of Overseas 
Development in 1964. It will be of interest to Parliament 
to note that during the 64 years from 1909 to 1973, only 
18 PQs touching upon aspects of the Crown Agents' work 
were tabled and answered.

18. The enquiries into the constitutional relationship 
which were initiated in 1970 were necessary. The exercise 
of effective control, and public accountability, cannot 
be divorced from a clear definition of Ministerial 
responsibilities and powers. It is an important element 
in the history of the relationship that no such clear 
definition existed between about 1960 and 1974.

19. The Government's White Paper (Cmnd. 6445) on "The 
Future of the Crown Agents", promised in October 1975 
and published in April 1976, outlined proposals for 
legislation to give the Crown Agents a corporate legal 
status, to define their functions, and to define the powers 
of the Minister. The Government believes it to be 
establish that the constitutional relationship shall be 
clarified, defined, and given legal status. Legislation 
will ensure a continuing basis for the traditional role 
of the Crown Agents in providing procurement, recruitment, 
technical, advisory and financial management services to 
their overseas Principals.

The Present Financial Position

20. All new own-account investment of the kind described 
in the Committee's Report has ceased. Since December 
1974 the Crown Agents have undertaken an orderly and 
phased withdrawal from property and secondary banking. 
In February 1975, the Minister of Overseas Development 
(Mrs. Hart), after consultation with the Board of the 
Crown Agents, set out in a directive the main principles 
which were to govern that withdrawal and the Crown Agents'
future investment and lending policy. This directive is reproduced in Annex II. Special accounting arrangements have been agreed to ensure that the Crown Agents account separately for those investments from which they are disengaging, and proper accounting provisions have been made against bad and doubtful investments on past own-account activities.

21. Since October 1974 the Crown Agents have had a proper Board structure including independent part-time members appointed by the Minister and directly responsible to her. A complete internal reporting system has been established, with clearly defined levels of authorisation and control. In this connection, the Crown Agents' management accounting and financial information system has been completely reorganised and professionally qualified people have been appointed from outside the organisation to bring in the necessary expertise. The accounts are now published in accordance with Ministerial direction agreed with the Treasury governing their timing and their form so as to give the fullest measure of disclosure. New legal advisers and independent valuers have been engaged. In particular, the Crown Agents have sought independent professional advice on the management of their disinvestment programme. A special London Advisory Committee has been set up to advise the Board on the Crown Agents' Australian interests, and includes two property consultants and a representative of Morgan Grenfell and Co. Limited.

22. Close working relations have now been established between the Crown Agents and the Ministry of Overseas Development. The Ministry and the Treasury have been kept fully in touch with the Crown Agents' position and policies relating to financial matters, and progress in realising their own-account investments. The Bank of England has been consulted in appropriate cases. Arrangements have been agreed under which the Chairman makes regular
reports to the Minister on matters of special interest, and the Ministry and Treasury receive comprehensive management accounts every quarter. These arrangements are recorded in a set of guidelines issued in July 1977, which are reproduced at Annex III.

23. The withdrawal from property and secondary banking activities must necessarily take time. Much progress has been made, as is shown in the account given of individual investments in Annex IV. But some of the concerns in which the Crown Agents have invested money have gone into liquidation, and the Crown Agents have had to await settlement of their claims along with those of other creditors. In other cases, the problem has been to strike the right balance between disengaging quickly on the one hand, and recovering as much as possible of their investment, thus minimising the final loss to the taxpayer, on the other. This has been particularly important in regard to the Crown Agents' Australian investments. A broad strategy for the management of the Australian operations has been agreed with the Minister. She is also consulted about other major decisions on disengagement.

24. The traditional relationship between the Crown Agents and their overseas Principals is in no way brought into question by the own-account operations of the past. It is essential that the customary standards of confidentiality should continue to be strictly observed in respect of transactions undertaken as agents on behalf of overseas Principals.

25. The Crown Agents now have complete control over their property investments in Australia, from which a lengthy period of disengagement appears to offer the best prospect of reducing any demand on public funds. They are no longer involved with their former partners in the English and Continental Group. They are in the process
of disengaging from their merchant banking investments in the Caribbean. Following the bankruptcy of the Stern Group, they are participating in a Scheme of Arrangement approved by the Court with an independent Administrator, as the most effective way of recovering as much as possible of their investment. Civil proceedings have been instituted to recover some of the moneys lost and the possibility of further such action is being considered.

26. The Crown Agents' Accounts for 1976 show that as at 31 December 1976, the deficit on the own-account investments in property and secondary banking (the Realisation Account) was in total some £212 million. The ultimate loss will not be known with certainty until the complete disengagement of the Crown Agents from the property and secondary banking activities of the past have been completed; this process may take some years. But it is already clear that the final deficit may well be in excess of £200 million. Should the need arise, the Government's undertaking that it stands behind the Crown Agents will be fulfilled by putting proposals to Parliament for further financial assistance. Given the experience of the recent past the Government believes it wise to reassert its commitment to the Crown Agents, to give its present quantitative assessment of that commitment, and to undertake to inform Parliament if the degree of that commitment requires revision.

27. There has been a most severe failure of public accountability. The causes of this are made clear by the Report of the Committee of Inquiry, and are supplemented by the additional information presented here.

28. The Crown Agents are now on a different and better footing. Their constitutional position and their relationship with Ministers have already been clarified and will be established by legislation. Accountability is now established, and the disasters of their own-account
activities of the past are being gradually remedied, at the cost of Government financial support. The Crown Agents' senior staff most criticised by the Report are no longer with the Organisation.

29. The Government places firmly on record its confidence in the Board of the Crown Agents and in its traditional activities now and in the future on behalf of its overseas Principals. It stands behind the Crown Agents.
On 8 November 1971 the Minister for Overseas Development (Mr Richard Wood), in reply to a question from Mrs Judith Hart, announced the appointment of a Committee under Sir Matthew Stevenson to consider the need for any changes in the status, functions and financial operations of the Crown Agents. The full text is given below.

Mr. Morris is a director in his official capacity of Sterling Industrial Securities, in which the Crown Agents have a financial stake. In the summer of 1970 he told his chairman, Mr. Hayes, of his wish to purchase some shares in this company with the gratuity he would receive on retirement in September, 1970. Meanwhile my Department, who had no knowledge of the proposed share transaction, agreed to the chairman's request that Mr. Morris should remain in temporary employment as a Crown Agent for a period after his retirement from pensionable service. Mr. Morris acquired shares in the company in October, 1970.

Last February Mr. Morris became chairman of, and also purchased shares in, a private company which includes Sterling Industrial Securities among its bankers.

Looking back on this whole sequence of events, and taking account in particular of Mr. Morris's retention as a Crown Agent for longer than was originally contemplated, I consider that the Crown Agents should have recognised that these arrangements might not be wholly compatible with Mr. Morris's continuing employment as a Crown Agent. I have discussed this with Mr. Morris, who is coming to the end of a long and devoted career in public service, and, in recognition of this difficult situation, he has undertaken to dispose of the shares without profit to himself.

Mrs. Hart: I thank the Minister for that statement and recognise that it needed to be as long as it has been.

May I, first, say that we shall want to study this very carefully, in particular some of the implications of what he has said? Second, may I say that we are glad that the question of Mr. Morris's shareholding has now been cleared up, but that this clearly indicates how important it is to get the constitutional relationship between Government and the Crown Agents right?

Why is he so determined not to publish the report of the inquiry when it is complete? I must tell the right hon. Gentleman that we shall press him on this. I should find it quite wrong if a report on such an important constitutional matter were not to be made available to Parliament. Second, why has it taken so long to make this statement?

As the right hon. Gentleman said, I asked for the official departmental look at this in the spring of 1970, yet it is only now—in the summer—that he has set up the Committee.
Lastly, will the Committee, whose names he is about to publish, include representatives of Commonwealth Governments or of the Commonwealth Secretariat, recognising the key role that the Crown Agents play in the economic relationship between trade in Britain and Commonwealth countries?

Mr. Wood: On the first of the right hon. Lady's points, on publication, I have taken the view that the relationship between the principals, most or many of whom are independent Governments, and the Crown Agents themselves on the other side, is of immense importance, and that it would therefore be unwise and wrong to publish a report which could possibly badly affect that relationship. That is why I announced the decision that I have.

As for delay, I suppose, that perhaps we have all been rather slow in getting round to this. The Crown Agents have now existed since 1833—therefore, for about 140 years. The Labour Party, the Conservative Party and the Liberal Party perhaps could have acted a little earlier in considering what should be the proper relationship between the Crown Agents, in new circumstances, and the Government. But in comparison with those 140 years, the period between the right hon. Lady's initiation of this examination and the report of the Stevenson Committee will probably be a little less than two years, and therefore rather insignificant beside the length of life of the Crown Agents over the centuries.

As for the members, I will publish their names, as I have said, in the Official Report. This is a small committee, which does not contain the membership which the right hon. Lady suggested, but it will, I hope, satisfy the House of Commons that these matters will be very carefully looked into.

Mr. Dalyell: For what reason did the Department not have knowledge of the share transactions?

Mr. Wood: Because they were not reported to them.

Mr. Arthur Lewis: Could the Minister tell us whether this arose as a result of the scandal which was revealed by the Sunday Times and Private Eye? If so, will the right hon. Gentleman pay a tribute to the Sunday Times and Private Eye for starting this scandal? After all, Private Eye is very rarely praised in this House, and it might make a change to do so.

Mr. Wood: If the hon. Gentleman will show me the reports which appeared in the Sunday Times and Private Eye, I will see whether they deserve a tribute.

Mr. George Cunningham: Will the right hon. Gentleman bear in mind that, despite this regrettable incident, the Crown Agents have a very high reputation throughout all aid donors in the world for providing facilities in developing countries which no other donor can equal?

Will the report, if it is not to be published, at least be given to the overseas principals which use the Crown Agents so that they can be sure that things have now been put right inside the Agency?

Mr. Wood: I am glad that the hon. Gentleman made the first point. I should like to have made it myself. I think that the confidence of the principals in the activities of the Crown Agents is shown by the amount of business that they place with the Crown Agents.

As I explained to the right hon. Lady, I have taken the view that the report should not be published. As the report is about the desirable relationships for the future between the Crown Agents, on the one hand, and Her Majesty's Government, on the other hand, I have naturally kept the various principals fully in the picture so that they will know what is happening, and I am certain that the existence of the Committee will not impair the relationship between the Crown Agents and their principals.

Mrs. Hart: May I press the right hon. Gentleman a shade further on the question of publication. As he will appreciate, my concern was that the constitutional relationship in this case between a Minister and the Crown Agents whom he appointed but who had no other responsibility whatever, either financial or otherwise, to government seemed unsatisfactory. To the extent that the inquiry is
directly concerned with this constitutional relationship, I believe that this is a matter which it would be perfectly proper to make public knowledge. We do not have other constitutional relationships between Ministers and inside bodies or public bodies which are not known fully to Parliament.

Mr. Wood: The right hon. Lady will understand that the committee will have to consider in some detail the relationship between the Crown Agents and the principals as well as the relationship between the Crown Agents and Her Majesty's Government. That is why I promised to make a further statement to the House when I receive the Committee's advice in the light of what the Committee thinks should be the future relationship between the Crown Agents and Her Majesty's Government. However, I do not think it right to publish the report. I do not think the report could be nearly as useful if I did not make that statement.

Following is the information:

The Committee's terms of reference are to consider whether there is a need for any changes in the status, functions and financial operations of the Crown Agents, including particularly their relationship to Her Majesty's Government, having regard to:

- Developments which have taken place in recent years in the nature of their functions and in the constitutional status of their principals;
- and to the United Kingdom's own interests including the needs of the remaining dependencies;

and to make recommendations on the nature of any such change. The Chairman is Sir Matthew Stevenson, K.C.B., C.M.G., and other members are:

- Sir Glyn Jones, G.C.M.G., M.B.E.
- Mr. M. J. Verey.
- Sir Charles Whishaw.
Mrs. Hart: Amongst the investment subsidiaries of the Crown Agents have been a 51 per cent. controlling interest in the English and Continental Property Company and substantial interests in Metropolitan Properties Limited, and many of the property companies they have invested in during the last few years have certainly been speculative. The right hon. Gentleman says that the trustee arrangements are proposed to hold good, and the question is whether he proposes that those arrangements will or will not exclude property dealings. [Hon. Members: "Oh."] I think hon. Members opposite are a little less informed about this matter than are some of my hon. Friends.

What matters here is whether the right hon. Gentleman is prepared to say to the Crown Agents that these new arrangements on the trustee analogy should exclude investments in speculative property developments. This is the point about which the Opposition are rightly concerned. The right hon. Gentleman has said that the Crown Agents will finally be answerable to him, but he is, of course, answerable to this House. What is to be the relationship between his answerability and their answerability to him, because the situation is profoundly unsatisfactory? Finally, what is to be the position about the personal shareholdings of nominee directors?

Mr. Wood: I hope I can remember all the right hon. Lady's questions. The question of answerability is dealt with in the fact that the Crown Agents are appointed by the Secretary of State or by myself and therefore they are answerable to us in the final analysis.

I am sorry, but I cannot remember the right hon. Lady's next question.

Mrs. Hart: How is the right hon. Gentleman to be answerable to Parliament for them?

Mr. Wood: I am answerable to Parliament. That is obvious at the moment, when I am being asked so many questions.

Mr. Cunningham: The first time in three years.

Mr. Wood: It is not the first time in three years. I have been bombarded by questions and I have done my best to give as full answers as possible. That deals with the question on answerability.

Perhaps the right hon. Lady will remind me of her other questions. I am afraid that I did not write them down.

Mrs. Hart: There were two other questions. The first was whether trustee shareholdings should exclude speculative property investment, and the other concerned the position of personal shareholdings of nominee directors.

Mr. Wood: On the question of trustee shareholdings, I said that the policy should be carried out... in accord with the trustee analogy and should be fully consistent with their name and standing.

I think the right hon. Lady would be wrong to get this matter entirely out of perspective. The percentage of the Crown Agents' investment at the present time in property is 1 per cent. and therefore—

Mr. Cunningham: How much money?

Mr. Wood: Not very much. As I was saying, the right hon. Lady is over-estimating the problem.

I made a fairly full statement about the personal holdings of the Crown Agents in the investment companies concerned on a previous occasion, and I do not think I can add to what I said then.
On 24 July 1972, the Minister for Overseas Development (Mr Richard Wood) gave the following reply to questions from Sir Bernard Braine and Mrs Judith Hart. He also circulated a written statement reporting on the advice given him by the Stevenson Committee.

Crown Agents
(Stevenson Report)

36. Sir Bernard Braine asked the Secretary of State for Foreign and Commonwealth Affairs if he has received the report of the committee, under the chairmanship of Sir Matthew Stevenson, which has been inquiring into the status and functions of the Crown Agents; and if he will make a statement.

38. Mrs. Hart asked the Secretary of State for Foreign and Commonwealth Affairs if he has now received the Stevenson Report on the Crown Agents; and if he will reconsider his decision on its publication, in view of the public importance of the relationship between Her Majesty's Government and the Crown Agents.

Mr. Wood: I have received the committee’s advice and with permission I will circulate a statement in the OFFICIAL REPORT. Briefly, the committee found that the interests of the Crown Agents' principals and others concerned would best be served by the continuation of the whole range of services which the Crown Agents provide. I welcome these findings, which reinforce my confidence in the Crown Agents' work for their overseas principals. I also accept the committee's recommendations that there should be a clearly defined status, structure and responsibility for the Crown Agents and that they should bear appropriate liability to taxation. I am considering how these conclusions can best be given effect and I will later make a further statement. I would like to record my gratitude to the committee for its advice. Since most of the Crown Agents' work is for independent Governments, it would not be right to publish the report.

Sir Bernard Braine: Will my right hon. Friend assure the House that the changes he has in mind are in the best interests of the overseas principals? Secondly, bearing in mind the very long and valuable service that the Crown Agents have given their Commonwealth principals over very many years, will my right hon. Friend confirm the impression that a good many of us have had for a long time that the Crown Agents are continuing to serve their principals with skill and integrity?

Mr. Wood: I have every confidence in the integrity of the Crown Agents, and I agree with my hon. Friend about the value of the work they do for their overseas principals. In my opinion the value of that work will be enhanced by changes of the kind I have in mind to make.

Mrs. Hart: Is the right hon. Gentleman aware that when I spoke to him on the telephone last week and he told me that his reply might be too long to give orally, I had no idea that in addition to refusing to publish the report he would issue a statement of the results of the report only in a Written Answer? This is quite disgraceful and it astonishes me. May I put this point to the right hon. Gentleman? Is he aware that in the light of recent discoveries about relationships between civil servants and Governments and between Ministers and Governments following the Poulson investigations, it is irresponsible and inconceivable that a full report should not be published, though not necessarily containing the evidence given by other countries? One can understand that that would not be possible. But is it not irresponsible on behalf of the Government not to publish the findings of this report since they relate to the relationship between employees of the Government and the Government itself?

Mr. Wood: Perhaps I might begin by setting the right hon. Lady's fears at rest about the longer statement that I mean to issue. I assure her that it will contain no surprises. I have summarised it adequately in my shorter answer. As for what she terms the irresponsibility of not publishing the report, I think it would be utterly irresponsible to publish a report which I undertook at the time that I set up the committee would not be published, for reasons that the right hon. Lady knows. What is more, knowing what the right hon. Lady does about the relationship between the Crown Agents and their principals, I am certain that if she were standing at this Dispatch Box she would take the same view.
Mr. Cunningham

Does the right hon. Gentleman intend to say anything about the fact that Crown Agents' money has gone into the notorious property empire of John Chalk and Timothy Gwyn-Jones? Will he recognise that there is a scandal which is waiting to blow? Unless we investigate the matter fully with sufficient openness but with confidence to reflect the circumstances, the traditional work of the Crown Agents, which is of enormous value throughout the world, will inevitably be prejudiced.

Mr. Wood: The purpose of the Crown Agents inductive in the activities to which the hon. Gentleman refers is largely to build up the reserves of the Crown Agents, which are largely to the benefit of the principals themselves, and the principals have shown their confidence in this policy. I understand that the hon. Gentleman has a Question to put to me next week about the appointment of Mr. Challis, but, having made this statement today, I should tell the hon. Gentleman that the Chairman of the Crown Agents, when the appointment was mooted, considered Mr. Challis in the way in which a civil servant would be considered. He consulted me, and I consulted others. I therefore share the responsibility for it. I had no reason to object to this appointment because I believed that it was in line with the rules that apply to the Civil Service.

Mr. Holdern: Is my right hon. Friend satisfied that he has the consent and approval of the Crown Agents' principals to these proposals? Would he agree that nothing should be done that could impair the close confidence which the Crown Agents' principals of various Commonwealth countries have in the operation of the Crown Agents' themselves? Would he also accept that the Commonwealth countries are perfectly capable of deciding who should look after their own affairs?

Mr. Wood: I am entirely in agreement with my hon. Friend. I believe that the assent of the principals to these arrangements is of immense importance, and that is the reason why I took the opportunity to tell them what was happening. I believe that my statement will do nothing to damage the confidence that exists between the principals and the Crown Agents.

Mr. Dalyell: In relation to the trustee analogy, may I confirm that the Minister used the phrase "if the companies so decide"? Does this mean that speculative investment can go on without his Department being told?

Mr. Wood: It means purely that the trustee analogy will not be wholly restrictive, that the Crown Agents can make investments, if they so choose, outside the trustee analogy, and would be guided in doing so not only by the executives of the Crown Agents' staff themselves but by the non-executives, who would be appointed after consultation with me.

Mr. Skinner: The right hon. Gentleman go even further and issue an instruction to the Crown Agents to stop any investment in these slum property speculations?

Mr. Wood: No, Sir.

Mr. Costain: Does my right hon. Friend see any different relationship between the Crown Agents and Millbank Services?

Mr. Wood: No, Sir. There is no connection.

Mr. Freeion: The Minister gave a scandalous answer to my hon. Friend the Member for Bolsover (Mr. Skinner), who asked whether any instruction would be given by the right hon. Gentleman to the Crown Agents to cease investments in slum property. Is the right hon. Gentleman aware that there is critical concern about activities in this direction? Is he further aware that in such a matter there is a balance of responsibility and confidence between the principals overseas and this House and this country? Surely any decision he takes should reflect that as well? Will he think again about his answer to my hon. Friend?

Mr. Wood: I said, "No" to that question because the Crown Agents have neither made nor contemplated making such investments.

Mr. George Cunningham: Nonsense.

Mr. Wood: I will elucidate. I think the hon. Member for Islington, South-West (Mr. George Cunningham), with his great interest in this matter, has in mind certain investments made in the First National Finance Corporation. This is a company in which the Crown Agents have a limited financial interest. The Crown Agents have not made investments in slum property. There were investments made by the First National Finance Corporation. I have no doubt, and never have had any doubt, about the integrity of the Crown Agents. We can all have our judgment of their judgment. The hon. Gentleman has his judgment about their judgment. The principals also have their judgment about the Crown Agents' judgment and have expressed their confidence clearly.

CONFIDENTIAL
Mrs. Hart: As one who initiated this report towards the end of the period of the Labour Government, I must tell the right hon. Gentleman that I should not take the view he is now taking. I accept that evidence given by other countries should remain confidential but I do not see why that should preclude publication of the conclusions of Sir Matthew Stevenson and his colleagues, and I do not see why the House and the public should be kept in the dark about the reasons why they have come to the conclusions they have.

Mr. Wood: When the committee was set up, with the concurrence of my right hon. Friend, so that the whole relationship between Her Majesty's Government and the Crown Agents could be examined—which, incidentally, impinges on the Crown Agents' relationship with the principals—I undertook that the report would not be published. It is on that basis that the inquiry has taken place. Therefore it would be utterly irresponsible if the report were now to be published.

Following is the statement:

I told Parliament last November that I had appointed a Committee under the chairmanship of Sir Matthew Stevenson to consider the need for any changes in the status, functions and financial operations of the Crown Agents. I now have the committee's advice.

It surveyed all the Crown Agents' activities, which include a very wide range of services on behalf of nearly 300 overseas principals. The committee found that the Crown Agents are providing competent and economical services, of great value to their principals overseas, and that their interests and those of Her Majesty's Government and the remaining British dependencies, are best served by the continuation of this full range of services. I welcome these findings, which reinforce my confidence in the Crown Agents' work for their overseas principals.

The committee, however, commented on the constitutional position of the Crown Agents, and the Government's undefined residual responsibility for them. The committee recommended that there should be a clearly defined status, structure and responsibility for the Crown Agents, and made some suggestions for consideration. The Crown Agents, but not their subsidiary companies, have Crown exemption from taxation. The committee recommended that they should bear an appropriate liability to it. I accept these recommendations and am considering how best they may be given effect. I will later make a further statement.

The main overseas principals have been told of these conclusions, which I believe will further strengthen the Crown Agents in their special relationship of trust with overseas Governments, built up by their long-established activities on behalf of all their principals. I will get in touch with the main overseas principals again as plans develop.

I am extremely grateful to Sir Matthew Stevenson and the members of his committee for their thorough work and wise advice.

Since most of the Crown Agents' work is for independent Governments, it would not, as I made clear in my statement last November, be right to publish the report.
On 21 November 1973 the Minister for Overseas Development (Mr Richard Wood) made a further statement announcing the Government's agreement to the establishment of subsidiary companies to deal with financial services, and guidelines for investment policy.

CROWN AGENTS

The Minister for Overseas Development (Mr. Richard Wood): With your permission, Mr. Speaker, and that of the House, I would like to make a further statement on the Crown Agents. In my statement last year, I said that I welcomed the findings of Sir Matthew Stevenson's Committee, that the interests of the Crown Agents' principals and others would best be served by the continuation of the whole range of services which the Crown Agents provide. I also accepted recommendations that the status, structure and responsibility for the Crown Agents should be clearly defined, and that they should bear an appropriate liability to taxation.

The Crown Agents originally came into being primarily to provide certain financial and purchasing services in Britain for countries which were then dependent. The range of their services, conducted on a non-profit making basis and contributing to the development of the countries concerned, has been progressively made available to a large number of countries, most of them now independent. The scope of their activities has also been extended to cover a wide range of technical and financial services.

The Crown Agents have adapted their organisation and structure over the years in order to meet these widening requirements, and in particular have established certain of their services on the basis of fully-owned subsidiary companies staffed by Crown Agents' personnel. In the light of the Stevenson Report, I have agreed that this process should be extended by the establishment of further wholly-owned subsidiary companies to deal with the specialised financial services of the Crown Agents. The boards of management of those companies will include non-executive directors appointed after consultation with me, as well as executive directors drawn from the Crown Agents' staff. The Crown Agents intend that the investment policy pursued by these companies should be generally in accord with the trustee analogy and should be fully consistent with their name and standing. These subsidiary companies will be subject to taxation in the normal way, and arrangements are also being made to bring any profits which may be made by the headquarters' organisation itself within the scope of normal taxation.

The Crown Agents will, as in the past, be appointed by the Secretary of State, or by myself acting on his behalf, for the purpose of carrying out the various services on behalf of the overseas principals. They will thus remain answerable finally to Ministers, but it is neither my intention nor my desire to disturb the traditional practice under which the operations of the Crown Agents on behalf of their overseas principals have been discharged on a basis of non-intervention by Ministers.

In the future, as in the past, the scale and scope of the Crown Agents' operations will depend on the confidence which overseas governments and authorities repose in the organisation. That confidence is fully reflected in the present scale of operations, and I am particularly anxious that the arrangements I have mentioned, which are designed to produce a more readily comprehensible structure and to define the various functions more clearly, should in no way disturb that confidence. I have made this clear to the main overseas principals when I told them the outline of the new arrangements.

Finally, I should once again like to take this opportunity of thanking Sir Matthew Stevenson and his Committee for its report, and of sincerely endorsing the tributes which it paid to the work of the Crown Agents.

Mrs. Hart: I thank the right hon. Gentleman for his statement. As he knows, we have waited for it for a long time. First, I endorse what he said about the confidence which principals may continue to have in the work of the Crown Agents. It is important to say that that is endorsed by both sides of the House.

The Opposition are aware that the present financial operations of the Crown Agents involve them in at least £50 million worth of investment in equities and
Mrs Hart

that some of the equities had rather unfortun-
ate results last year. It seems from his
statement that he is proposing to change
basically the relationship between himself
and the Crown Agents. The right hon.
Gentleman will continue to appoint
but, as he knows, one of the great
problems—this was my opinion when I was
his predecessor in office—is that the
power to appoint Crown Agents has no
Corresponding responsibility on the part
of the Crown Agents to report to Govern-
ment. Will there be any change in that
respect?

The right hon. Gentleman said that the
Crown Agents will remain answerable
finally. In what way will they be answer-
able? Will they report to him? Will the
report be published? Will it be available
to hon. Members? Will it be subjected to
parliamentary questioning?

The right hon. Gentleman says that
in the new extended financial operations
of the Crown Agents there will be non-
executive directors appointed after con-
sultation with him. What precisely will
be their non-executive functions? He says
that the companies will have to act, will
be expected to act or will be intended to
act in accord with the trustee analogy.
Will he tell us precisely what he means?
Does he mean that they are not to have
equity shares or equity shares of a specu-
lative character? How does he propose
to prevent that happening? Will they no
longer invest in property companies?

Depending on the right hon. Gentle-
man's answers, it may well be that we shall
wish to explore the matter in greater
depth.

Mr. Wood: The suggestion which I
have made to the Chairman of the Crown
Agents is that he should be willing—and
he agrees—to discuss with me any im-
portant developments or changes in the
policy of Crown Agents.

The function of non-executive directors
will be similar to the functions of such
directors of other companies of all kinds
—namely, to give advice and to help in the
taking of decisions by the companies with
which they are connected.

The investment policy pursued by the
companies should be carried out in accord
with the trustee analogy and should be
fully consistent with the Crown Agent's
name and standing. That means that they
will be guided largely by the trustee
analogy but not prevented from making
investment outside that analogy if the
companies so decide.

Sir Bernard Braine: Is my right hon.
Friend aware that his statement will be
welcomed by all who recognise the im-
portance of the Crown Agents' work,
who have been concerned about critical
comment which has recently appeared in
the Press? So that we may get the
matter into perspective, will he confirm
that the success of the Crown Agents' investment policy on behalf of the gov-
ernments of many developed countries
has contributed to those governments
placing additional funds and additional
orders with Great Britain?

Mr. Wood: I entirely agree with my
hon. Friend. The confidence that is
shown by the principals in the Crown
Agents is unmistakable. I believe that
as a result of my statement the principals
will take the view that the Crown Agents
are strengthened to do the job for the
principals which they have been doing
and which they will continue to do.

Mr. David Steel: While the right hon.
Gentleman's statement may strengthen
the Crown Agents, will he answer the ques-
tion posed by the right hon. Member for
Lanark (Mrs. Hart) about parliamentary
answerability and the link between the
Crown Agents' work and the Minister's
role?

Mr. Wood: I do not think that it
would be right for discussions between
myself and the Crown Agents about the
development of their policy to be reported
to Parliament. I do not believe that
that would be in the interests of the
relationship between the Crown Agents
and the principals. To an extent that
must be a confidential relationship. It
would be wrong for such matters to be
discussed in Parliament because this
relationship between the Crown Agents
and the principals would be gravely
undermined.

Mr. George Cunningham: Will the
right hon. Gentleman acknowledge that
nothing in his statement reflects the fact
that apart from the operations which the
Crown Agents have undertaken on behalf
of principals overseas, they have raised
on the market £34 million and invested
that as they pleased without being answer-
able to their own chief principals? Will
the right hon. Gentleman acknowledge
that there will be amazement in the
Parliament and elsewhere that he has made his state-
ment without mentioning that the direc-
tor of finance of the Crown Agents until
a few weeks ago has been appointed the
deputy chairman of East National
Finance Corporation, a company in which
the Crown Agents have an 81 per cent.
ordinary share holding, 6 per cent. of it
being held on behalf of overseas
principals?
On 31 July 1974 the Minister of Overseas Development (Mrs Judith Hart) announced her intention to appoint a Board of Crown Agents and to give them directions about the conduct of their own-account business.

Crown Agents

Mr. George Cunningham asked the Minister of Overseas Development if she will make a statement on the future role and structure of the Crown Agents.

Mrs. Hart: The House will recall that in 1970 I instituted inquiries into the constitutional relationship of the Crown Agents. The right hon. Member for Bridlington (Mr. Wood) took the matter further and appointed the Stevenson Committee. In the light of my own further study, I would like to tell the House what I now propose.

As background, I emphasise that the Crown Agents have a long history of efficient and comprehensive services to countries overseas in the fields of procurement, inspection, engineering, finance and a variety of personnel services. During the nineteenth century and for most of this one they acted essentially for the Colonies who were, of course, within the responsibility of the Secretary of State. In the last 15-20 years they have acted mainly for independent countries, mostly members of the Commonwealth, and also for the remaining dependent territories. For a historical perspective I recommend the 1909 Report of the House of Commons Committee chaired by Colonel Scely, the Parliamentary Under-Secretary of State (Cd. 4473).

The services they provide are excellent, and are very much appreciated by their overseas principals. They have an efficient and dedicated staff. It is important that their relationship of confidence with their overseas principals remains undisturbed, and that the customary standards of commercial confidentiality will continue to be observed in their transactions. This was the right hon. Gentleman's conclusion, and it is mine also.

Procurement this year is running at the rate of about £160 million annually. Deposits from principals are about £300 million and funds managed on their behalf are valued at about £850 million. These figures give some indication of the scale of the work of Crown Agents. In recent years, as is, I think, well known, they have extended their financial operations on their own account with the objective of building up their reserves. Some of these, particularly those concerned with property, have become the subject of public comment. Given the ultimate responsibility of the Crown Agents to Government, I have therefore decided to make changes in their structure which will not however affect their relationship with overseas principals.

Sir Claude Hayes, who is now and has for some time been the sole Crown Agent, has carried an extremely heavy burden. He would normally have retired earlier this year and I am grateful to him for his willingness to continue in office for a little while longer in order to ease the transition to the new arrangements I now propose.

I am appointing a Board of Crown Agents which will have a full-time chairman and will include up to seven part-time members. I shall announce names shortly.

The board will be required to transmit to me an annual report and accounts which I propose to make available to Parliament. The board will be responsible to me for the organisation and general administration of the Crown Agents' business and I reserve the right to give them directives from time to time.

I shall of course continue the practice of non-intervention in the activities of the Crown Agents on behalf of their overseas principals. In such matters they will continue to act strictly according to the instructions of their principals.

In their own account business I shall direct that the board pays due regard at all times to the best standards of banking prudence and does not engage in transactions which might embarrass Her Majesty's Government or conflict with the interests of its overseas principals. It should not engage directly in the property market, other than in respect of property for its own occupation, any extension in the property field being subject to my prior approval. Of course, I do not intend that existing obligations should be called in question or interfered with.

As the House will appreciate, this is not an easy area in which to achieve the best balance between commercial activities, responsibility to overseas principals, and responsibility to the Minister who appoints the Crown Agents. But I believe that the new structure and guidelines I have outlined will allow the Crown Agents to operate effectively on their own account with a full sense of social responsibility and without in any way disturbing the confidence placed in them by countries overseas, which is so well merited.
CROWN AGENTS

The Minister of Overseas Development (Mrs. Judith Hart): With permission, I wish to make a statement about the financial position of the Crown Agents.

The House will recall that on 1st July I announced my arrangements for the restructuring of the Crown Agents. There is now a Board of Crown Agents, including up to seven part-time members with a full-time chairman. After discussion with the new chairman I agreed as an interim measure to appoint only three part-time Crown Agents in view of the immediate and pressing problems facing him. While continuing the practice of non-intervention in the activities of the Crown Agents on behalf of their overseas principals, I reserve the right to give the board directives, and indeed have already done so in relation to their own account business.

The new chairman of the Crown Agents, John Cuckney, who took up his appointment on 1st October, appointed Coopers and Lybrand as consulting accountants to review the present financial position and the future financial requirements of the Crown Agents and their subsidiary companies. Morgan Grenfell and Company Limited have since been appointed to advise on general banking matters.

The chairman, supported by the three members newly appointed to his board, has now reported to me that a decline in market value of some of the assets of the Crown Agents has led to an immediate problem of reserves and liquidity. He has made a formal request to the Government for financial assistance.

The Government have agreed to provide £85 million, subject to parliamentary authority, which will be recoverable, by direction, from future earnings or appreciation of assets. Standby facilities have been arranged by the Bank of England.

These arrangements will demonstrate beyond all doubt that the Government stand behind the Crown Agents so that the position of all depositors is fully safeguarded; that the confidence of their overseas principals is fully maintained; and that the important services provided to the principals are continued. In the right of the history of the relationship between Government and the Crown Agents in the last four years, involving, as it has, my own initiations of inquiries in 1973, followed by the Stevenson Report to my predecessor, the right hon. Member for Bolton (Mr. Wood), which was unpublished, and the inquiries made by a Select Committee of this House, hon. Members clearly want to know how the circumstances necessitating this financial support have arisen. I have asked the Chairman of the Crown Agents to send me a full report on this, and I shall keep the House informed. Thereafter I shall consider whether any further action is necessary.

I have also asked to be informed in detail of outstanding longer-term commitments of the Crown Agents, including certain property investments in Australia, and of any suggestions which the new board may have for the organisation and management of its financial business in the future. I have reserved the right to direct that monies now being advanced shall be repaid from Crown Agents' resources in the course of any reconstruction of the business.

The House will, I know, appreciate that the present Chairman, John Cuckney, and the three members of his board, John Goble, John Gordon and Leslie Kirkley, have had only a very short time to assess the position and report to the Government. On taking office they were confronted with most difficult circumstances, as the House will clearly understand.

This situation, which I am sorry to report to the House, is one which we are seeking to correct. I am immensely grateful to them and would like to take this opportunity to tell the House that I have complete confidence in them. Their prime concern, as it is mine, and, I am sure, that of the House, too, will be that the Crown Agents, with their long history of service and capability, are able to continue to provide for their overseas principals the full range of their services.
Mr. Rippon: I thank the right hon. Lady for making her statement at the earliest opportunity. May I also express a welcome for the Government's determination to maintain full confidence in the Crown Agents? As the statement says that parliamentary authority will be required for the £85 million, does the right hon. Lady expect a debate to take place so that we may have the opportunity of a fuller discussion?

Can the right hon. Lady say a little more about the terms and conditions on which the £85 million is to be provided? In particular, what is meant by the phrase "recoverable, by direction"? Is it to be a loan, or a grant, or what?

Not only do I welcome what the right hon. Lady said about a full report being made by the chairman in due course and further statements being made by herself, but I associate the Opposition with what she has said about the confidence which we should have in the new chairman. He has had great experience in public service and outside it, and we fully share the sentiments which the right hon. Lady has expressed about him.

Mrs. Hart: I am grateful to the right hon. and learned Gentleman. As to whether it is a loan or a grant, the position is that the money will be advanced to the Crown Agents but, given the reconstruction of the business that they would contemplate carrying out, there are clearly possibilities that much of it can be recoverable as their assets increase in value or as they make certain changes. Therefore, the position is a little flexible, but we hope that there will be the possibility of recovering some of the money. Nevertheless, it is not precisely a loan, but a grant which we hope will be recoverable. [HON. MEMBERS: "Oh."] Right hon. and hon. Gentlemen opposite must understand that a situation which has been in the making for at least four or five years is not so easily recoverable by a single stroke of the pen on one day. That is the arrangement we have made, and I think that the right hon. and learned Gentleman will agree that on the whole it is the best arrangement to be arrived at.

The question whether there will be a debate is a matter for the House. I shall be reporting further, and it will be necessary to consider what kind of inquiry should take place. I hope that the House will have a little patience about this because the overseas principals are involved and they, too, will need to be consulted about the form it should take. There is no doubt that the House will be more fully informed and will have a full opportunity to consider the position which has arisen.

Mr. George Cunningham: Will the Minister agree that these enormous difficulties are exactly the difficulties which many of us have been predicting for a long time in the light of the odd constitutional relationship between the Crown Agents and the Government? This is characterised by at least one hon. Member on the Opposition benches for attack as a phoney campaign. Will my right hon. Friend say roughly how much of the loss sustained on the investment side of the Crown Agents' business is attributable to the fall in the value of shares of First National Finance Corporation, one of whose present deputy chairmen was, immediately before he took up that position, Financial Director of the Crown Agents?

Finally, will my right hon. Friend say whether the Government of the day ever gave to the Crown Agents approval to go into this business of investment by comparison with their traditional buying and selling rôle, which I am sure continues to have the full support of everyone in the House?

Mrs. Hart: My hon. Friend and I, as I know one or two other hon. Members appreciate, have had a continuing and deep concern about the position of the Crown Agents and their involvement particularly in the money market and the property market. That may not be known to some hon. Members, but it is so, and the Select Committee on Overseas Development gave some consideration to these matters.

I cannot give my hon. Friend a precise answer as to the involvement of a particular company. I can tell him that one of the factors involved, which is not unexpected, is that the Crown Agents had considerable investments in property. The decline in property values over the last year has intensified the problems that might concern any organisation that put a great deal of money into property, and this is a matter which is dealt with in the report which I have had from the Chairman of the Crown Agents. The further report which I shall hope to make available to the House, at least in summary, will show that clearly.

As to the member of the Staff of the Crown Agents to whom my hon. Friend referred, that is a matter which is perhaps better not discussed in the House at the moment, as my hon. Friend will appreciate. If there is an inquiry, whatever form it takes, it might well be a proper subject for the inquiry.
Mr. Pardoe: Is the right hon. Lady aware that the House will be somewhat mystified, in that the Government appear to have agreed to provide £85 million but have only now asked for a full report into the circumstances which make this financial support necessary? Does not the Minister think that it might have been better to have asked for the full report first and to have provided the finance thereafter?

Although many will welcome the fact that the Government stand behind the Crown Agents, is the right hon. Lady aware that if this kind of nonsense goes on the world will want to know who stands behind the Government?

Mrs. Hart: I am afraid that the hon. Gentleman is falling rather short of his own standards here. He might be well advised to do a little research into the reports of the proceedings of the House in HANSARD over the last four years. It is all there.

I was the first to express serious concern early in 1970 when I was Minister of Overseas Development. That led to my asking my Department for a paper on the constitutional relationship between the Crown Agents and the Government, which was somewhat obscure. That led my predecessor the right hon. Member for Bridlington (Mr. Wood) to ask for the Stevenson Inquiries which, reported, but that report despite pressure from the then Opposition, was not published. That led to the Select Committee's inquiries which, as soon as I came back into Office in March, led to my initiating changes in the structure which in turn led to the revelation of what has been going on.

The hon. Member for Cornwall, North (Mr. Pardoe) would do better to do some research.

Sir G. de Freitas: Will my right hon. Friend recognise that many of us who have followed for some time the affairs of the Select Committee and the Crown Agents were highly critical in the past? However, that may be, there are many of us now who give full support to the present Crown Agents and their chairman?

Mrs. Hart: I am grateful to my right hon. Friend. I must be absolutely frank with the House. This is an unfortunate report to have to make to the House. It follows a series of events and a history of some years. I think that we are now doing the right thing, and I am certain that the Government's duty is to give full backing to the Crown Agents because of their importance and value and because the name of Britain is involved.

Sir Bernard Braine: Does the right hon. Lady accept that there are some Opposition Members—myself included—who were anxious about the financial activities of the Crown Agents precisely because they cut across the superb, unique record of service to the Crown Agents' principals in the Commonwealth and to the British economy? I very much welcome, although with some sadness, the statement which the right hon. Lady has made today. May I ask whether at any stage any of the principals have been critical of the conduct of the Crown Agents in their carrying out of their normal business?

Mrs. Hart: The answer to the last part of the question is "No". What emerges is that the matter is not as simple as the right hon. Gentleman might suppose. The answer is "No". The overseas principals still have every confidence in the Crown Agents, and I should like to reinforce what the right hon. Gentleman said. What we are talking about today is the consequence of operations in the money market and the property market which left undisturbed the complete efficiency and good faith of the operations of the Crown Agents in procurement and in service, which are the real bases of their operations.
On 23 April 1975 the Minister of Overseas Development (Mrs Judith Hart) made a further report to the House about the Crown Agents' financial position, and announced her decision to set up a Committee of Inquiry under Judge E S Fay QC.

CROWN AGENTS

The Minister of Overseas Development (Mrs. Judith Hart): With permission, I wish to make a further statement about the Crown Agents.

The House will recall that just before it rose for the Christmas Recess I explained the immediate problems of the Crown Agents' reserves and liquidity which had been reported to me by the new Chairman and board, and announced the Government's agreement to provide immediate support of £85 million and the agreement of the Bank of England to provide standby facilities.

So far the Crown Agents have found no need to draw upon either the £85 million or the standby-facility at the Bank of England to meet liquidity problems. We shall all hope that this will continue to be the case. But the support of the Government stands firm and ready. The grant is there to cover prudent writing down of assets as necessary, and to provide a capital base.

I would also like the House to know of the confidence I have in Mr. John Cuckney, the new Chairman of the Crown Agents, and in his board. In the most difficult circumstances, they are overcoming the problems they faced on appointment with considerable success. Since December, overseas principals have increased the scope and scale of their business with the Crown Agents. Confidence has increased, and it is right that this should be so, for the steady and gradual withdrawal from property investments and secondary banking, according to my directive, is restoring a fundamental financial soundness in their operations.

I have now made further appointments to the board. I have appointed Mr. Harry Hoff, Mr. James Jack and, with effect from 1st July, Mrs. Hester Boothroyd to join Mr. Leslie Kirkley and Mr. John Gordon as members of the board. I have also appointed Mr. John Goble, at present a member of the board, as Deputy Chairman.

I promised to keep the House informed. I can now make an interim report— not yet a final one, for reasons I shall make clear. In doing so, I know the House will understand and appreciate that it concerns not the present but the past.

The chairman has provided me with his board's views on the circumstances which led to the need for financial support, which have been assisted by the investigations carried out by Coopers and Lybrand, the consulting accountants. These are not yet complete. They have had to work on a very large number of transactions made over a long period of time.

The principal factors which the board considers to have contributed to the problems are: first, the operation of a substantial banking business without an adequate capital base; second, over-dependence on the property and secondary banking sectors, and commitment of an unduly large proportion of the total banking resources to a small number of borrowers; third, inadequate controls and procedures for approving and monitoring loans to subsidiary and associated companies, for security for advances, and for the delegation of authority; fourth,
The Government have reached two major conclusions in the matter. We believe it important and necessary, and the board of the Crown Agents recommends to arrange for an independent inquiry into past events and the circumstances giving rise to the need for Government support. Accordingly, I have decided to set up a committee of inquiry with the following terms of reference:

"To inquire into the circumstances which led to the Crown Agents requesting financial assistance from the Government."

The inquiry will be conducted by Judge Fay, sitting with Sir Edmund Compton and an accountant. There will, of course, be complete protection of the confidential interests of the overseas principals.

We also propose to give further consideration to the relationship between the Crown Agents and the Government. I shall present a White Paper to the House at a later stage—I hope during this Session—with my detailed proposals, along with the necessary background information about past custom and practice.

Now that I have presented those two major conclusions, I know that hon. Members will wish to join with me in expressing their confidence and support in the present chairman and his board, and in congratulating them on their very great success in the last few months.

Mr. Wood: Does the right hon. Lady recall chiding me, in that gentle way she has, with delay in these matters? Does she recognise that she started these investigations in the 1960s and they now look like going into the late 1970s if, indeed, she is still responsible for conducting them?

In the statement in which the right hon. Lady has announced the setting up of the inquiry has she not to a large extent prejudged the findings of the inquiry? Finally, what powers is the committee of inquiry to have? Amongst other things, will Sir Claude Hayes and others closely concerned have full freedom to state their views in accordance with the recommendations of the Salmon Committee?

Mrs. Hart: I confess that I am a little surprised at the right hon. Gentleman's lack of outside commercial banking experience among senior staff. These defects of the past are rapidly being remedied.

The Government have reached two major conclusions in the matter. We believe it important and necessary, and the board of the Crown Agents recommends to arrange for an independent inquiry into past events and the circumstances giving rise to the need for Government support. Accordingly, I have decided to set up a committee of inquiry with the following terms of reference:

"To inquire into the circumstances which led to the Crown Agents requesting financial assistance from the Government."

The inquiry will be conducted by Judge Fay, sitting with Sir Edmund Compton and an accountant. There will, of course, be complete protection of the confidential interests of the overseas principals.

We also propose to give further consideration to the relationship between the Crown Agents and the Government. I shall present a White Paper to the House at a later stage—I hope during this Session—with my detailed proposals, along with the necessary background information about past custom and practice.

Now that I have presented those two major conclusions, I know that hon. Members will wish to join with me in expressing their confidence and support in the present chairman and his board, and in congratulating them on their very great success in the last few months.

Mr. Wood: Does the right hon. Lady recall chiding me, in that gentle way she has, with delay in these matters? Does she recognise that she started these investigations in the 1960s and they now look like going into the late 1970s if, indeed, she is still responsible for conducting them?

In the statement in which the right hon. Lady has announced the setting up of the inquiry has she not to a large extent prejudged the findings of the inquiry? Finally, what powers is the committee of inquiry to have? Amongst other things, will Sir Claude Hayes and others closely concerned have full freedom to state their views in accordance with the recommendations of the Salmon Committee?

Mrs. Hart: I confirm that what my hon. Friend said in the last part of his question is indeed so. I hope and believe that it will not prove necessary to draw on the £85 million. Indeed, it is very gratifying to be able to say that this has not needed to be drawn on up to
now. I hope that that situation will continue. However, should there be drawings, this would be a matter in which the accounting officer of my Department would hold responsibility and it would be a matter for the Public Accounts Committee.

On my hon. Friend's first point, he will know that as from now—I think I have given this information before, and certainly the Crown Agents have—the annual report of the Crown Agents is now, as distinct from past practice, to be submitted to me so that I may make it available to Parliament and the accounts will similarly be made available to Parliament. The audited accounts for the last possible year—1972—are already in the Library. I think my hon. Friend will find that they give the kind of information that is needed, but I am certain that if this proves not to be the case the Crown Agents or myself would be very responsive to any discussion about what further information they might include.

Mr. Hormer: May I echo the confidence in Mr. Cuckney and the efforts that he has so far made? With respect to the inquiry which is about to take place, may we take it that the findings in the Coopers and Lybrand report are temporary findings and are liable to the fullest possible justification by the full judicial inquiry which is to take place later?

On that point, will the right hon. Lady not only allow that inquiry to make the fullest inquiries into all the matters which have occurred in the past but allow Sir Claude Hayes, in giving his evidence, to see the findings which that judicial inquiry may make, unlike the practice in the past in Department of Trade investigations, and allow him to comment on any findings that the inquiry makes before those findings are published?

Mrs. Hart: Obviously, the detailed conduct of the inquiry must be a matter for Judge Fay, who will be leading it, and for the other members of the inquiry. It never has been the practice in the past for a Government, having set up an inquiry, to regulate the precise way in which the inquiry is to be conducted, but I am certain that the inquiry will wish to give every opportunity to all concerned fully to be acquainted with the whole situation and to say whatever they want that is the fairest way of conducting it.

Mr. Skinner: Will my right hon. Friend agree that one of the important reasons why it has been her duty to tell the House, not only on this occasion but on others, too, of the scandalous investments and so on within the area of the Crown Agents is that the Crown Agents wanted the highest rate of return and that usually in this system of ours the highest rate of return can involve investments within the murky and seamy side of life; and the net result was that, like a good many other people who got their fingers burned, they poured their money into property speculation and, indeed, into slum speculation?

Will my right hon. Friend in future insist that investments are of a kind which will not leave her as a Minister to have to come to the House, as the previous Minister did, in order to try to explain away how these investments have been made?

Will my right hon. Friend also see to it that the committee of inquiry will establish quite clearly how much money has been lost as a result of all these investments in these areas of secondary banking, with a particular reference to the amount of money that was lost as a result of the investment in the ill-fated Stonehouse venture? All these matters should be investigated by the committee of inquiry.

Mrs. Winifred Ewing: On a point of order, Mr. Speaker. Is it not the case that today at Question Time, when Scottish Questions were answered, questions which were much shorter in duration than the one which we have just heard were interrupted by your good self as being too long? Can you explain why it is that the hon. Member who has just asked a supplementary question seems to be allowed to ask as long a question as he likes?

Mr. Speaker: I will try to make the position clear. At Question Time the object is to get as many Questions answered as possible. Long supplementary questions cut out other Members' supplementary questions and Questions. After statements, the considerations are not quite the same. It is a matter for
[Mr. Speaker,]
my discretion, although I admit I do not often have to complain of excessive brevity on the part of the hon. Member for Bolsover (Mr. Skinner).
Perhaps the right hon. Lady will now answer the hon. Gentleman's question.

Mrs. Hart: My hon. Friend is right in pointing to the fact, which I outlined in my earlier statement in December, that it was the over-investment in property companies and secondary banking, in which there had been a considerable decline in the value of assets, which led to the immediate crisis of liquidity in the Crown Agents. I have given a positive directive that this is now to diminish. and the Crown Agents are now very sensibly withdrawing in a phased way—because it is correct to phase it—from both secondary banking and properties. Since October over £59 million has been withdrawn from property and secondary banking by the Crown Agents.

On the second point about London Capital, I think I made it clear a month or two ago that this is a matter for the commercial judgment of the Crown Agents and that they are acting entirely in accordance with their best and most prudent judgment in this matter. It is not strictly a matter in which I would regard it as proper for me to intervene.

Mr. Stambrook: Does not the experience of the Crown Agents confirm the folly of any Government or quasi-Government Institution using its assets to operate in fields in which it has neither qualifications nor suitability?

Mrs. Hart: What emerges clearly—and I hope we have now corrected the situation—is that if we have a valuable Government institution, which the Crown Agents is—it has the most tremendous ramifications and involvement and an excellent reputation for its procurement policies and all its other activities on behalf of many overseas investments and overseas public corporations—it is of the greatest importance that we have people who are best able to make the right kind of judgments in the operations in which they are involved. I think my own appointments since July have created a board with the expertise and judgment to enable these matters to be correctly administered from now on.
On 16 October 1975 the Minister for Overseas Development (Mr Reg Prentice) announced the Government's intention to publish a White Paper setting out their proposals for introducing legislation to incorporate the Crown Agents.

CROWN AGENTS

The Minister for Overseas Development (Mr Reg Prentice): With permission, I wish to make a further statement about the financial position of the Crown Agents and other matters relating to that organisation.

My predecessor announced in December 1974 that the Government had agreed to provide a recoverable grant of £85 million to the Crown Agents to cover the writing down of asset values in their 1974 accounts as then foreseen and to provide financial backing appropriate to their operations, and that standby facilities had also been arranged with the Bank of England.

I have now received the audited accounts for 1973 and 1974 and have placed copies in the Libraries of both Houses. The balance sheet as at 31st December 1974 shows that the Government grant of £85 million was not enough in the event to avoid a technical state of insolvency, with liabilities exceeding assets at that date by some £15 million. This was because a greater degree of writing down of asset values and provisions for losses were found necessary for the period covered by the accounts.

I should emphasise that the Crown Agents have no immediate liquidity problems. They have still not needed to draw on the £85 million grant or on the standby facility. I am also reassured by the thorough and energetic action which has already been taken by the new Board of the Crown Agents, under its Chairman, Mr. Cunliffe, to clear up the problems of the past and lay the groundwork of a more soundly based future for the organisation. I should like to pay my own tribute to their efforts.

Nevertheless, without Government backing the Crown Agents would at present be in a difficult position, which could affect the confidence of depositors and others. I have therefore thought it desirable formally to reaffirm the assurance given by my predecessor in December 1974, that Her Majesty's Government stand behind the Crown Agents. Hon. Members will find the terms of my assurance to the Chairman in his covering report on the 1974 accounts, and I emphasise now to the House that the Government wish to see the Crown Agents continue in being for the sake of the valuable services which they are able to render both to their many overseas principals in the developing world and to Her Majesty's Government in their relations with overseas countries.

Like my predecessor I am, however, concerned that the future activities of the Crown Agents, and their relations with Ministers, should be on a more closely defined basis. The Government have been giving much thought to the future status, structure and functions of the Crown Agents. We have decided that the right solution will be to introduce legislation which would confer independent legal personality on the Crown Agents by incorporating them, define their functions for the future and provide that specified powers of direction should rest with Ministers.

This would create a well understood relationship of a kind which exists between a number of bodies in the public sector and the Ministers responsible for them. It would clarify the responsibilities of the Government in exercising the broad oversight over the activities of the Crown Agents that has been shown to be desirable by all that has happened; while leaving it to the Board to run their own day-to-day affairs. It would not disturb the traditional relationship between them and their principals.

My predecessor told the House in April that she hoped to publish a White Paper during the present session giving the Government's thinking on these matters. I shall not quite be able to meet that target, but I hope to publish a White Paper shortly to set out our present view of the provisions which will or may be required in the legislation to incorporate the Crown Agents.

Meanwhile, I should inform the House of a further complication arising from the past activities of the Crown Agents which will have to be dealt with separately and in advance of this legislation. I was informed in August by the Chairman that certain loans made by the Crown Agents either directly or through a nominee, company might be challenged as unenforceable, on the grounds that the Crown Agents were neither licensed money lenders under the terms of the Moneylenders Acts nor a bank for the purposes of those Acts. The Crown Agents are advised that if the matter were brought before the courts, they would have a good defence particularly on the basis that they and their staff are exempt from the operation of these Acts as Crown servants. However, if there were a challenge in the courts the matter might take a long time to resolve. Meanwhile the Crown Agents' financial position might be seriously worsened by the withholding of loan repayments and interest due, and in other ways.

CONFIDENTIAL
This would increase the potential call on the Exchequer for financial support for the Crown Agents to a degree which we should find quite unacceptable in the circumstances. It would mean that a heavy additional liability would fall on the public purse, and that other creditors of those property and other companies to which the Crown Agents had made loans would be in a position to benefit by taking advantage of an uncertainty in the application of legislation. I think it is essential to put this anomalous situation right. The Government will therefore introduce a Bill, for consideration as early as possible in the next Session, to put the matter beyond doubt.

Mr. Maude: These are serious and disturbing figures, and no doubt at the appropriate time we shall wish to discuss how the Crown Agents, with their great traditions, got into this situation, but I imagine that we shall have to await the report of the Fay Committee, which will have all the facts before it.

The Crown Agents are a considerable asset to the country and provide very valuable services to their principals overseas. The Minister can therefore take it from me that we support him in his desire to give all the help he can to the new chairman and the new Board.

With regard to the legislation, will he take note that we shall look carefully at the actual proposals, bearing in mind that the main need of legislation at this stage is to ensure the confidence of the overseas principals in the Crown Agents?

Mr. Prentice: The House will be glad to know that the Opposition agree with us that the Crown Agents perform a very valuable service which should continue and that we should give them the appropriate support.

Mr. David Steel: I, too, welcome the steps that the Minister has mentioned this afternoon. Will he confirm that, if this were a private company, it would be insolvent, and will he give an undertaking to the House that the inquiry being made into its operations and finances will be made public and published to the House?

Mr. Prentice: The answer to the latter point is, "Yes". I think the answer to the former point would also be, "Yes". It will not have escaped the attention of the House that a great many private enterprise companies—if "enterprise" is the appropriate word—got their fingers pretty severely burned in the property market, and in secondary banking and activities of that kind.

Mrs. Harri: May I welcome very much my right hon. Friend's statement, and particularly the policy that is to be pursued in terms of the future incorporation of the Crown Agents. I am quite certain that that is the right course to pursue.

May I also say that I very much hope that the Fay Committee of inquiry will go very deeply into the causes of the misadventures of the past, which were, as he said, largely concerned with adventures in the property and secondary banking sector.

May I also say to him that I totally share his own confidence in the future of the Crown Agents and in all the tremendous and very difficult work that the new Board and the new chairman have carried out since they were appointed a year ago.

Mr. Prentice: I am grateful to my right hon. Friend for the way in which she has put those points. I think that, in relation to this whole rather tangled story, a tribute should be paid to her, first, for the work she did from the Opposition Front Bench in probing into these matters and persistently questioning the Government of the day, and secondly, for the prompt action she took on assuming office, and particularly the directions she gave to the Crown Agents, which have provided a framework within which they are now working, and which they are fully implementing.

Mr. Tapsell: Arising out of the last part of the right hon. Gentleman's statement, will he give an assurance that the legislation, the introduction of which he is contemplating, will not be retrospective to the extent that it weakens the present legal position of one of the parties to the possible legal controversy to which he referred?

Mr. Prentice: The House will be glad to know that we have in mind a very short Bill which will clarify the position about which there is some doubt. It will not alter the law as most people understand the law but will simply clarify it, so as to avoid the situation which I described in my original statement. If that were not done, there might be a period of uncertainty, which could be most damaging to the Crown Agents and consequential to public funds.

Mr. Tapsell: On a point of order, Mr. Prentice.
Mr. George Cunningham: Will the Minister accept that some of us have almost exhausted our capacity for surprise at the successive manifestations of incompetence which have been shown in running the Crown Agents, and that this shows how wrong it was for the House of Commons Select Committee on Overseas Development just over a year ago to terminate its investigation of the Crown Agents, which might have revealed this latest example of incompetence a bit sooner than it has been revealed?

Are we to understand that there will be two Bills, one the declaratory Bill on the point he has just mentioned and the other on the relationship of the Crown Agents to Government and Parliament? If there are to be two Bills, will the second Bill be produced in the immediately forthcoming session as well as the first?

Secondly, may we be told what is the state of play on the papers which were referred to the Director of Public Prosecutions in respect of some of the staff, and how many of the staff of the Crown Agents have either been dismissed or are currently suspended pending investigations?

Mr. Prentice: My hon. Friend also played an active part in helping to draw attention to all the things that had gone wrong in the past, and I pay tribute to him for that. But I think he was wrong in saying that I had revealed some further example of incompetence. I have drawn attention to a legal doubt which has arisen and which might be damaging, unless it were corrected, to the finances of the Crown Agents.

I think that the story of recent months has been a success story. The Crown Agents are disengaging as fast as they possibly can from the wrong type of investment in which they were engaged in the past. Their current activities are succeeding, and their overseas principals, including 120 different governments and a number of other organisations, show continuing confidence in them.

As to my hon. Friend's question whether there will be two Bills, I envisage a very short Bill on the narrow legal point that I mentioned. I also envisage a White Paper, very shortly, which will itself lead to further legislation, though not quite as quickly—probably not in the next session.

With regard to his point about the Director of Public Prosecutions, I have nothing to add to the reply that my hon. Friend the Parliamentary Secretary gave in January. This matter is still with the Director of Public Prosecutions. It is taking a long time. It is not a matter over which I have any control.

I do not have a figure for the number of staff dismissed, but I will look into it and give my hon. Friend any information that I can.
Mr. Costain: Is the Minister aware that the Public Accounts Committee endeavoured to look into these matters in past years but was prevented from doing so because the accounts were not audited by the Comptroller and Auditor-General? Will the new arrangements put the accounts under the authority of the Comptroller and Auditor-General so that the Public Accounts Committee may deal with these matters, or will they be matters for the nationalised industries' accounts?

Mr. Prentice: The accounts which have been placed in the Library today have a commentary by the Comptroller and Auditor-General. Therefore they could be studied by the Public Accounts Committee if it saw fit.

Mr. Lee: My right hon. Friend has made a low-key statement, but is not this a profoundly unsatisfactory state of affairs? Will he reconsider the points made by my hon. Friend the Member for Islington, South and Finsbury (Mr. Cunningham)? Does not this call for a public inquiry under the Public Tribunals Act? Will my right hon. Friend say how much additional money will be required in the interim, since the subvention provided by his predecessor, as he said, clearly proved inadequate? Finally, may I congratulate my right hon. Friend on the fact that his stringent version to nationalisation is not wholly infeasible?

Mr. Prentice: It is an unsatisfactory state of affairs, of course. My hon. Friend described my statement as "low key". The simple reason is that it is a sequel to two statements to the House by my predecessor which dealt with the matter in a more fundamentally. As to whether there should be a study by a tribunal, there is a study being carried out by Judge Fay helped by Sir Edmund Compton and an accountant, Mr. Peter Godfrey—.

Mr. Lee: But it is not a public inquiry.

Mr. Prentice: This is taking place in private. That was thought right, and it was not challenged in the House when it was first announced. But there will be a public statement about it in due course.

As for the amount of additional money that will be needed, the significant point is that the £85 million of standby facilities at the bank has not been used. What we are saying is that there will be continued Government backing. Whether the money will be used and to what extent it will be needed, we cannot foresee. That depends on many imponderable factors in the future. Certainly I shall keep the House informed of any significant developments.

Mr. Marshall: Although we welcome in general the proposal about the future state of the Crown Agents in their incorporated form, subject to any study of the White Paper, may I ask the right hon. Gentleman to be more clear-cut about allowing freedom in day-to-day management and perhaps, in that context, stress what he omitted to say in his statement that, in addition to serving their overseas principals and the Government themselves, the Crown Agents are serving as a form of direct and invisible exports which are of value to the country? I hope that that side of their activities will be strengthened and encouraged in the future.

Mr. Prentice: The operations of the Crown Agents are of great value to the country in many ways that we cannot measure, because their activities create opportunities which lead indirectly to further investment, exports and so on. The work which they do in training people overseas is of help and of indirect benefit to this country, too.

As for the details of the division of powers between the Minister and the Crown Agents when they are incorporated, I ask the hon. Gentleman to await the White Paper. We are considering this. But we envisage something broadly comparable with the relationship which exists already between many Ministers and the nationalised industries. I am sure that the House would not want a Minister in this House to answer for day-to-day decisions. One difficulty at the moment is that the situation is so unclear in the constitutional sense and needs clarification by new arrangements of this kind.

Mrs. Hart: I am grateful, Mr. Speaker, for being allowed to intervene a second time. Will my right hon. Friend confirm to a number of my hon. Friends, first, that the problem about holding a public inquiry, which was considered very carefully at the time, is that a great deal of the evidence which has to be given to the Fay Committee has to come from companies and banks, is highly confidential and would not have been forthcoming at a public inquiry? Will my right hon. Friend assure them also that those against whom it is possible that charges might be made are under study by the Director of Public Prosecutions? Will he assure them, further, that although a great deal of Government money has been required to sustain confidence in the Crown Agents and to provide standby credits, it has not been spent or needed to be spent?

Mr. Prentice: I think that I can press an affirmative answer to all three of my right hon. Friend's questions. I made reference in my original statement certainly to her latter point about the money not having been drawn upon, and I am glad that my right hon. Friend underlined that.
On 29 November 1976 the Minister for Overseas Development (Mr Reg Prentice), in reply to a question from Mr Frank Hooley, announced that token provision had been made in the Winter Supplementary Estimates to cover the liability on Her Majesty's Government arising from the technical insolvency of the Crown Agents.

Mr. Hooley asked the Minister for Overseas Development what provision he has made for the contingent liability of public funds arising out of his assurances of support for the Crown Agents; and if he will make a statement.

Mr. Prentice: Token provision has been made in the Winter Supplementary Estimates to cover the liability on Her Majesty's Government arising from the technical insolvency of the Crown Agents. My predecessor made a statement in the House on 18th December 1974 announcing the Government's support for the Crown Agents, and I reaffirmed this assurance of support on 16th October 1975. The Crown Agents have not so far needed to seek additional financial support from Her Majesty's Government, and the Supplementary Estimates provision is necessary now only as a formal indication of the continuing contingent liability. This overall liability takes account of certain contingent liabilities on the Crown Agents arising from contracts for the supply of British goods and services, including defence equipment, undertaken by one of their wholly-owned subsidiaries, Millbank Technical Services Limited, to which I have given my specific agreement.
On 3 May 1977 the Minister for Overseas Development (Mrs Judith Hart), in reply to a question from Mr Denis Skinner, made the following announcement about the management of the Crown Agents' property investments in Australia.

OVERSEAS DEVELOPMENT

Crown Agents

Mr. Skinner asked the Minister of Overseas Development if she will make a statement on the present position with regard to the Crown Agents' investment in Australian property.

Mrs. Hart: My predecessors and I have discussed with the Crown Agents how my directive in 1975 that they should carry out an orderly phased withdrawal from the secondary banking and property fields should be applied to their investments in the Abbey Capital Property Group in Australia. It was clear that the Crown Agents could not be certain of implementing any strategy to this end as minority shareholders in the group, even though they had put up almost all the development finance. They were, therefore, authorised to negotiate with the other interests involved with a view to securing full control of the group. They have now succeeded in obtaining this at a reasonable cost. They have also been able to strengthen their management arrangements for the group, both in Australia and in London.

I have made it clear to the Crown Agents that I shall wish for continuing consultations about the strategy to be followed in conducting the affairs of the group, which must take account of trends in the Australian market. I intend to review with the Crown Agents their policy for the group at regular intervals in the light of market trends, and have asked the Crown Agents for six-monthly reports.

Meanwhile, the Crown Agents have to meet or refinance certain existing obligations in Australia. For this purpose I have agreed that they should borrow up to US $220 million from a consortium of United Kingdom banks, of which US $210 million is to be used in Australia and US $10 million for commitments elsewhere. An agreement to this end has been concluded with my approval. I would stress that this does not mean an expansion of the Crown Agents' interests in Australia, but is required solely to meet existing commitments.
CROWN AGENTS: INVESTMENT AND LENDING POLICY

References to the Crown Agents in this paper include their subsidiary companies.

2. The Crown Agents will make any investment of resources belonging to or under the control of their overseas Principals in respect of which they have explicit instructions from those Principals, to whom they will be answerable for those investments.

3. Where they are investing resources belonging to or under the control of their overseas Principals but are exercising their own discretion as to the investments made, or where they are offering advice as to investments to be made under 2. above, the Crown Agents, with a view to protecting their own good name and the position of Ministers from whom they hold their appointment, will take care to avoid transactions which might be likely to embarrass HMG.

4. In all their investment and lending operations in connection with their own account funds the Crown Agents will be guided by the best standards of banking prudence and the normal requirements of the Bank of England and by a similar regard for their own good name and for the position of Ministers. They will equally conduct their operations so as to avoid conflict with, or damage to, the interests of their overseas Principals.

5. In general the financial and banking operations of the Crown Agents are to be directed towards maintaining their reserves at a level suitably related to the overall requirements of their business and to the adequate capitalisation of their subsidiaries.
6. When lending money to other institutions or persons the Crown Agents will do their best, insofar as possible, to acquaint themselves with the full activities of the borrowers and the use to which such money is to be put and will seek to ensure that any loans which they make are employed in accordance with the general considerations in paragraph 4. of this paper.

7. The Crown Agents will not on their own account take a controlling interest in companies, other than those established as wholly-owned subsidiaries to deal with existing business already being undertaken, without prior discussion with the Minister. Any proposed investment of 10% or more in the equity of a quoted company will be subject to prior approval by the Minister.

8. The Crown Agents shall not engage directly in the property market, other than in respect of property for their own occupation or on the explicit instructions of an overseas Principal. Any extension of their own account activities into this field will be subject to prior approval by the Minister.

9. The Crown Agents will carry out an orderly phased withdrawal from the sphere of secondary banking activities.

10. In all transactions, whether on their own account or for Principals, the Crown Agents will, of course, be subject where relevant to the Exchange Control regulations of the Bank of England.
Our ref: ICA 206/203/07

J O Cuckney Esq
Crown Agents for Oversea Governments
and Administrations
4 Millbank
London SW1

8 July 1977

On the instructions of the Minister, I am sending you the enclosed guidelines relating to consultation between the Crown Agents and this Ministry over the realisation of the Crown Agents' own-account investments. These should be read as supplementing the earlier Ministerial directive of 3 February 1975.

2. The guidelines have been discussed and agreed with your officials. While they reflect for the most part arrangements which have evolved during the process of consultation over the last two and a half years, they also provide a statement of the principles underlying current practice, and constitute a formal record of the arrangements which the Minister wishes you to follow in future.

3. The arrangements proposed in Sir Richard King's letter of 13 August 1975, and agreed in your reply of 15 August, would appropriately apply to communications made under these guidelines.

(D J Kirkness)
GUIDELINES ON CONSULTATION BETWEEN CROWN AGENTS AND ODM OVER REALISATION OF INVESTMENTS

1. Following the Minister's directive to the Crown Agents in February 1975 that they should not engage directly in the property market and should conduct an orderly phased withdrawal from the sphere of secondary banking activities, the assets covered by this directive have been transferred to a separate Realisation Account. It will be the object of the Crown Agents, in consultation with their professional advisers, to dispose of all these assets as rapidly as they can. However, in each case attention will have to be paid to the desirability of securing the maximum financial advantage from such disposals, and also to the need to minimise the risk of further funds being lost, either through fresh commitments or through unreasonable delay in recovering existing investments.

2. It is recognised that the desiderata of early disengagement and maximum return may conflict and that a balance will need to be struck in individual cases between them. In accordance with his general obligation to keep the Minister informed of the development of the Crown Agents' business, the Chairman will make regular reports to the Minister about overall progress in realising the assets in the Realisation Account; and he will consult the Minister before taking a decision on the realisation of any major asset in the Realisation Account (for the purposes of this directive, major assets may be defined as those of which the original cost was more than £5 million) or in any case where special considerations of the kind outlined below apply, irrespective of the value of the investment. In this connection the Minister will need to be informed of, and examine with special care, cases where

i. the Crown Agents consider that the balance of advantage lies in rejecting a course of action which would appear to involve the least financial loss to them on the particular investment in question;

ii. the Crown Agents are for any reason proposing to increase their exposure on a particular investment;

iii. the Crown Agents are proposing to refuse an offer for any investment which is broadly in line with recent valuations or an offer which has the support of their professional advisers, or proposing, for reasons other than strictly commercial ones, to accept an offer which is considerably lower than recent valuations;
iv. the Crown Agents are proposing for any reason to make no active efforts for the time being to dispose of an asset;

v. there are wider political considerations to be taken into account;

3. The management of assets in Australia owned by the Abbey Capital Group will be in accordance with the overall policy of the Australian property assets agreed with the Ministry from time to time.

4. The requirement to consult the Minister in the cases defined above is not intended to rule out consultation in other cases where there is substantial uncertainty about the financial or other consequences of a proposed course of action.
PROGRESS MADE IN REALISING MAJOR ASSETS IN THE REALISATION ACCOUNT

Note: The order used in listing these assets follows that of the table at paragraph 373 of the Pay Committee Report.

English and Continental Group

The Crown Agents have bought out the interests of most of the shareholders, and now hold a majority interest, giving them control of the Group. They have been pursuing a policy of disposing, to the best possible advantage, of the major remaining assets, policy directed towards producing the maximum possible recovery of Crown Agents' loans, and thereafter complete disengagement from the Group. The Crown Agents have already recovered a total of £5.8m (most of which comes from the successful sale of the English and Continental Homes site at Warmley, Avon). Despite these recoveries, however, losses on this investment, when they are finally known, are bound to be high - probably in the region of £35m.

Stern Group

On 13 August 1975 the Crown Agents entered into a Scheme of Arrangement with the other creditors of the Stern Group to enable them to recover as much as possible of their loans. Only two properties remain specifically charged to the Crown Agents, and these are expected to realise about £2m. In addition, claims have been submitted under the guarantees given by Mr and Mrs Stern as the formal step necessary prior to the institution of legal proceedings for the recovery of their personal debts. The Crown Agents expect to recover about £4m, out of total loans and investments of some £14m.

Australian Property Investments (Abbey Capital Property Group)

To enable them to choose for themselves the most advantageous possible strategy for their Australian property investments, the Crown Agents have secured control of the companies of the Group. They have strengthened the management, restructured the Board, undertaken a major reconstruction of the Group, and arranged a loan of up to £9210m from a consortium of United Kingdom banks to enable them to meet existing /commitments.
As a result of these measures the Crown Agents are in a position to control the strategy of disengagement from their investments in Australian property in whichever manner is most advantageous to them, although as explained in para 23 of the White Paper such disengagement will take some considerable time.

**Sterling Industrial Securities**

This Company and its assets have now been sold for £2.36m. Total loans and investments by the Crown Agents in this Company amounted to £2.5m.

**Big City Finance**

Progress is being made in bringing court action by the liquidator and the Crown Agents (through the Attorney General) against the individuals involved. Total loans by the Crown Agents amounted to £1.75m.

**Ed Bank and Trust International**

This Bank, wholly owned by the Crown Agents, has made substantial losses as a result of property loans. After making full provision of £0.62m against their equity investment, the Crown Agents have now sold this bank to a subsidiary of Charterhouse Limited. The basis of the transaction is that the Crown Agents restore the solvency of the Bank by taking over its bad loans and investments. An associate of the purchaser will attempt to realise these bad loans and investments, but the extent of the Crown Agents' recovery from these is highly uncertain. The provision already mentioned, and a further provision against restoring the solvency of the Bank amounting to £3.96m has been made and these provisions, at present rates of exchange, are expected to be fully adequate to meet the total exposure.

**Old Capital Corporation**

The Company has been in voluntary liquidation since 24 December 1975. Liquidation has been substantially completed, although a number of legal questions remain outstanding.
It is expected that the remaining claims by the liquidator will shortly be finalised, thus allowing the winding up of the Company. Full provision has been made against the whole cost of this investment, and associated loans, amounting to £6.3m.

Wallace Brothers and Co (Holdings) Limited

Although a £2m loan outstanding on 31 December 1976 was received in full with interest on the due date, full provision has had to be made against the Crown Agents' equity holding in this Company, at £3.3m. This holding was sold to the Standard and Chartered Bank for a nominal amount, but a deferred consideration may be payable in certain circumstances.

Caribbean Bank

The Crown Agents continue to own half the shares of the Group and are working with their fellow shareholders in difficult trading conditions to safeguard their own interest and those of the Bank's depositors.

Barclays Hotels

The inadequate nature of the charge originally taken on the security prevented the Crown Agents from realising the full ongoing value of the properties. Consequently, on the advice of their professional advisers the Crown Agents sold their debts for £6m, with the net result of a realised loss of £6.5m.

/Triumph Investment Trust and G T Whyte & Co Limited
CONFIDENTIAL

Triumph Investment Trust and G T Whyte & Co Limited

These Companies are in liquidation and a receiver is acting for the debenture holder. It is estimated that a total of £3.8m may be recovered, out of total loans of £10m.

Hounslow Group Limited

The Crown Agents had lent £9m to this Group. Amounts continue to be received from the National Westminster Bank in respect of the Crown Agents' share of the proceeds of the receivership. £1.3m had been received by July 1977.

Richard Square Development Corporation

The Crown Agents had disposed of all their interests in this Corporation by May 1976, making a total loss of £3.5m on an investment of £3.6m.

Insecurities Limited

The inadequate nature of the charge originally taken on the security prevented the Crown Agents from realising the full ongoing value of the properties. Consequently, on the advice of their professional advisers the Crown Agents sold their debts for £2m, with the net result of a realised loss of £3m.

Inverclyde Hotels

The Crown Agents' security for their loan of £3m to this Company is a first charge on five properties and a second charge on one other. Two of the five properties have now been sold. It would appear from a valuation carried out in February 1977 that the balance of the debt, after provision of £2m to 31 December 1976, is exceeded by the value of the three remaining properties. Judgement has now been obtained against the保证ors of the loan, and the Chancery Registrar's department perfected judgment on 17 October 1977.

G S Gill Hotels Limited
C Gill Hotels Limited

The Crown Agents lent £2m to this Company, and have already made provisions of some £1m. As a result of the sale of the underlying security for this debt, the Crown Agents have become involved in litigation with one would-be purchaser of that security, and this litigation has not yet been concluded.
RETURN to an Order of the Honourable the House of Commons dated 00 November 1977 for

Report by the Advisory Committee on the Crown Agents (the Stevenson Committee), 24 March 1974

being Annex V to the Statement by Her Majesty's Government on the Report by the Pay Committee of Inquiry on the Crown Agents (House of Commons Return number 000 of 00 November 1977)

Ordered by The House of Commons to be printed 00 November 1977

LONDON
HER MAJESTY'S STATIONERY OFFICE 00p net
NOTE

A number of passages in this Report are deleted in the published version.

These deletions have been made to protect the confidentiality of the relationship between the Crown Agents and their principals; to safeguard commercial confidentiality; and in one case to avoid the publication of a reference to individuals which might be considered damaging.

The places where deletions have been made are marked with three asterisks, thus: * * *
The Minister for Overseas Development

I submit herewith the Report of the Committee.

The Report has been prepared on the basis that it is not for publication. If publication, or circulation outside UK Government circles were proposed, the Report might need a little editing.

The Chairman of the Crown Agents has expressed concern to me about the security of the document and the danger and damage of a leak. The Committee maintained strict security especially in the later stages and all papers have been returned by the members. In regard to the report there are only the original submitted to you and one copy which the Secretary of the Committee holds together with the other papers of the Committee.

A report from Messrs Price Waterhouse on English and Continental Property Co Ltd is awaited but the Committee decided not to delay its Report on that account. Arrangements have been made for the receipt of the Report (Chapter 6.37) and the Committee can be reconvened, if necessary, to consider it. I have agreed with the Chairman of the Crown Agents that he should have a copy of the Price Waterhouse Report.

If the Committee can be of any assistance on matters arising out of its Report the members will, of course, be at your service.

Matthew Stevenson
24 March 1972
11 November 1977

CABINET

DRAFT WHITE PAPER ON "THE CONDUCT OF COMPANY DIRECTORS"

Memorandum by the Secretary of State for Trade

1. I attach a draft White Paper on the Conduct of Company Directors. The White Paper contains proposals to make insider dealing a criminal offence, and deals with a number of weaknesses in the law which have been demonstrated in recent company investigations, particularly in connection with loans to directors and other cases where the private interests of directors may conflict with the interests of the company. Also included are a number of recommendations from the Bullock report relating to the responsibilities of directors, notably the requirement that they should have regard to the interests of employees.

2. The Ministerial Committee on Economic and Industrial Policy (EI) have agreed the content of the White Paper, and the Legislation Committee (LE) have authorised the drafting of the clauses necessary to implement the proposals in the White Paper, although it has not been decided whether the Companies Bill to be introduced early next year will contain any provisions other than those necessary to implement the European Economic Community Second Directive on company law and to increase the fees of the Registry of Business Names.

3. It is widely known, from informal consultations and from an announcement I made in the House of 28 July, that I have been preparing proposals on the subjects covered in the White Paper. If these matters are to be included in the 1978 Companies Bill, then it is necessary to allow reasonable time for public discussion of the detailed proposals before the Bill is published. But if in the event it is decided that pressure of the Parliamentary timetable prevents the implementation of these proposals this Session, it will be better to have published firm and detailed proposals rather than to appear to have abandoned work in these important areas for company law reform.
4. It was agreed at El that early publication of the White Paper would create a very strong expectation of early legislation. I am prepared to make it clear when the White Paper is published that there may be no time for legislation on its proposals this Session.

5. If my colleagues agree, I propose to publish the White Paper at the end of November.

Department of Trade

ll November 1977
The Government announced in a statement by the Secretary of State for Trade to the House of Commons on 28 July 1977 that it was preparing legislative proposals to make insider dealing in securities a criminal offence and to remedy weaknesses in the law which had been demonstrated by recent company investigations, notably in connection with loans to directors and the private interests of directors. This White Paper describes the action which the Government intends to take to improve and strengthen the law on these subjects.

Duties of directors

2 Consideration of all the topics in this paper must begin with the legal responsibilities and duties of company directors. Directors are appointed to act in the interests of the company and an important area of their legal responsibilities derives from trust law - the fiduciary duty to act in the interests of the company. They are also under a duty to exercise care and skill in the discharge of their functions. These duties are part of common law and are not defined in statute. The Government believes that it is desirable to include a general statement of the duties of directors in statute law.

3 For the statutory definition of fiduciary duty the Government will introduce a provision requiring a director to observe the utmost good faith towards his company in all of his actions and to act honestly in the exercise of the powers and in the discharge of the duties of his office. It will also be provided that a director shall not make use of any money or property belonging to his company to benefit himself;
nor of any information acquired by him or opportunity afforded to him by virtue of his position as a director of a company, if by doing so he gains an advantage for himself which may conflict with the interests of the company.

4. The standard of skill and care which the law expects of a company director in the performance of his duties derives from case law. He is required to perform his duties with reasonable care, exercising that degree of skill which may reasonably be expected of a person of his knowledge and experience. The law appears to draw a distinction between the standard of skill and the standard of care. For the standard of care, an objective test is set, namely that to be expected of a reasonable man; the standard of skill, on the other hand, is a subjective test under which the level required depends upon the knowledge and experience possessed by each director. The Government has decided that the present requirements of the law should be codified in legislation which will require a director to exercise that degree of care and diligence that a reasonably prudent person would exercise in comparable circumstances and the degree of skill which may reasonably be expected of a person of his knowledge and experience.

5. The Government also believes that employees should be given legal recognition by company law. The statutory definition of the duty of directors will require directors to take into account the interests of employees as well as of shareholders. They will also be required to send the annual report and accounts to all employees as well as to shareholders. This will be an additional financial and administrative burden to companies, but the Government believes that employees as well as

(1) Re City Equitable Fire Insurance Co Ltd 1925 Ch 407
shareholders are entitled to the information in company reports and accounts and that these should be made available to both on an equal footing.

6 The Bullock Committee also recommended that there should be "one place where a director, and particularly the new employee representative, can see a statement of the basic duties he owes to the company as a result of his membership of the board". The Government agrees that it would be useful to bring together in one place a comprehensive statement of the various legal responsibilities of directors, but this would seem more appropriate to a handbook than to the statute itself. The Government intends to consult with the CBI and the TUC about the preparation of such a handbook.

7 The Bullock report also drew attention to the case of Parke v The Daily News Limited in 1962, where the family controlling the company which purchased The Daily News wished to distribute the whole of the purchase price among the employees who would become redundant. A shareholder of The Daily News contested this proposed action and the Court found that there was no lawful basis for it. It is not certain that the requirement which we propose to introduce that directors should take into account the interests of employees as well as of shareholders would be held to extend to the actions of directors in the course of winding up a company, or to former employees. The Government therefore, intends to make it lawful for directors to make provision for employees or former employees when closing down the whole or any part of the business.

(1) Report of the Committee of Inquiry on Industrial Democracy (Cmnd 6706) Chapter 8 paragraph 36
(2) Supra cit Chapter 7 paragraphs 11 and 12
Loans to directors

8 The definition of the fiduciary duty of directors, proposed in paragraph 3, will broadly give statutory form to the existing common law that a director may not make use of his company's money to further his private interests, and loans by companies to their directors are prohibited, with certain important exceptions, by Section 190 of the Companies Act 1948. Nevertheless there have been a number of serious cases where directors have sought to circumvent the law in order to obtain large sums of money from their companies, and inspectors in recent company investigations have recommended that Section 190 should be strengthened.

9 The Government propose to reform the law relating to loans to directors in the following ways:

- For public companies and private companies which belong to a group of which a public company is also a member
  a) to widen the scope of Section 190 to prohibit, subject to certain exceptions, loans to directors' families and to companies in which a director has an interest as well as loans to directors themselves; and to make breach of these provisions a criminal offence
  b) to introduce limitations on the scale and terms on which loans to directors to be made when they are permitted under the specific exemptions:

- For all companies:
  a) to ensure that there is greater disclosure of loans to directors by amending Section 197 of the 1948 Act.

The following paragraphs discuss these proposals in greater detail.

10 Section 190 provides that it shall not be lawful for a company to make a loan, or to enter into a guarantee or provide any security for a loan, to a person who is its director or a
director of its holding company. In the case of public companies and
private companies that belong to a group of which a public company is
also a member it is proposed to extend this prohibition to include a
director's spouse, son or daughter, and to prohibit the making of a loan
to any company which a director or his family controls or in which he or
his family has a major financial interest, defined as 20 per cent or more
of any of the classes of capital or of the company's long or medium term
loan debts. Loans to trusts of which the director or any member of his
family is a trustee, other than a bare trustee, or a beneficiary, will
similarly be prohibited.

There are at present three exceptions to the general prohibition on
loans to directors: a subsidiary company may make a loan to its holding
company where the latter is its director; a company may provide, subject
to certain safeguards, funds to a director to meet expenses incurred
for the purposes of the company; and finally there is the "banking
exemption" which provides that, in the case of a company whose ordinary
business includes the lending of money, a loan may be made to a director
where such loan is in the ordinary course of the company's business.
Alleged abuses of the second and particularly the third exemption have
given rise to considerable concern.

It has been suggested that the meaning of "in the ordinary course of
business" should be defined more closely. It is however difficult to
formulate a definition which would be satisfactory in all circumstances.
We therefore propose instead to require that such loans must be on normal
commercial terms as to interest rate, repayment terms, security and other-
wise; they are to be subject to an overall limit of £50,000 and are to be
disclosed in the accounts; and to make a breach of the new provision subject
to criminal penalties. It will however be permissible for a director to
obtain a low interest loan for house purchase from his company provided that
this is done under a scheme which is available to employees of the company and
on the same terms; the limit of £50,000 will nevertheless still apply and the
loans must be disclosed.

In order not to obstruct legitimate inter-company lending,
there will be an exemption to the provisions in paragraphs 10 to 12 above for loans by one company to another within the same group defined as a holding company and its subsidiaries. However where such loans would otherwise have been caught by the rules on prohibition, limitation or disclosure details of the loans must be disclosed separately in the accounts of the Lending Company.

14 The new disclosure provisions to replace those in Section 137 will cover all loans made to directors, including those to their families and associated companies, and will require for each loan:

- a statement of the identity of the borrower, and the name of the director concerned if he is not the borrower
- a statement of the terms of the loan, including interest rate and security
- a statement of the amount outstanding at the beginning and the end of the period, and the highest amount outstanding during the period if this is a higher amount
- a statement as to whether any interest due has not been paid, and whether any provision had been made in the accounts for non-recovery of the loan.

This information will be part of the accounts and will be subject to audit.

15 There are other ways, besides the receipt of a loan, by
which a director may become indebted to his company, such as trade credit. It is considered that where such indebtedness is significant it is a matter of legitimate concern to the shareholders, and it is intended that in future companies should be required to show, separately from any loans, the amount of other indebtedness of each director to the company, or his family or associated company, where such indebtedness exceeds £5,000. It is also proposed to limit to £10,000 the advances which can be made by a company to its director to cover expenses.

**Directors’ conflicts of interest**

16 The general fiduciary duty of a director to his company also needs to be strengthened by specific statutory provisions covering transactions, other than loans, in which the director’s duty to his company conflicts or may conflict with his private interests or those of his family. In general, it is not possible to lay down in law what directors may or may not do in particular circumstances: the variety of situations is too great. There are, however, two specific types of contract where the possibility of conflict is so clear that the approval of the shareholders should be sought before the contract is valid: one concerns long-term contracts of service, the other significant Purchases by the company of assets from or sales to, a director or a company in which the director has an interest. The Stock Exchange listing agreement already provides that, for listed companies, certain of these contracts must be authorised by the shareholders. The Government propose that for all companies directors’ service contracts for periods longer than 5 years shall not be valid unless approved by the company in general meeting, and intend to introduce a requirement that significant contracts involving the transfer of assets between a company and a director, his family, or another company in which a director has an interest, shall require the prior approval of the
company in general meeting.

17 For other transactions involving possible conflicts of interest it is proposed to provide for fuller disclosure of transactions in the annual accounts of companies, and to strengthen the rights of shareholders to take legal action where they consider that their interests have been harmed by the actions of the directors. The new disclosure provisions will be along similar lines to those already in operation for listed companies, which provide that details of contracts of significance, defined as contracts involving in aggregate more than 1 per cent of the company's purchases or receipts, shall be disclosed. It is considered that this information should be provided in the form of a note to the accounts, rather than in the directors' report, and will therefore be subject to audit.

18 Hitherto, directors who have pursued their private interests at the expense of the company have had little to fear from the shareholders, even when the latter have the necessary information. In private companies in particular, this may be considered as one aspect of the need to improve the position of minority shareholders, and it is intended to introduce legislation to amend Section 210 of the 1948 Act to enable minority shareholders to take action more readily to protect their interests by providing that they may petition the court on the grounds that the affairs of the company are being conducted in a manner unfairly prejudicial to their interests. Such amendment will of course help to deal with a wider range of abuses than those involving contracts in which the directors have a personal interest.

Non-executive directors

19 Non-executive directors can perform a useful function in helping to resolve problems of conflicts of interest as well as in other ways. In recent years there has been growing interest
in the role of non-executive directors on company boards. The report of the Company Affairs Committee of the CBI "The Responsibilities of the British Public Company" published in 1973 (the Watkinson Report) concluded that "the inclusion on the board of public companies of non-executive directors is highly desirable .... by virtue of the fact that unlike executive directors they are not closely involved in the day-to-day affairs of the company and they are in a better position to see the company as a whole and to take a critical view of it". Despite this, only 35% of companies in The Times 1000 1975/76 had more than two non-executive directors. Twenty five per cent had none.

20 Non-executive directors can bring to the board a breadth of knowledge and experience which the company's own management may not possess. Even more important, they can increase the element of independence and objectivity in board decision-making. Not being involved in day-to-day management they are able to take a detached look at the way in which the company is being run and at its medium and long term policies. They should provide independent supervision of the company's management. In order to do this effectively, however, the non-executive directors need free access to management information and there need to be enough of them. One or two non-executive directors on a board which is 20 strong are unlikely to exercise real influence.

21 In the United States and Canada a practice has developed in recent years whereby the boards of public companies appoint an audit committee composed wholly or mainly of non-executive directors. The duties of the audit committee are flexible depending on the needs of the company, but the core functions are to review the financial statements and to review the audit arrangements and the company's internal financial controls. The audit committee works closely with the auditors who are normally invited to attend its meetings. It has been found in the United States and Canada that audit committees play a useful role in strengthening the influence of non-executive directors and the position of the auditors. Public companies registered under the
Canadian Business Corporations Act 1973 are required to have an audit committee and this will also be a requirement from 1 July 1978 for companies listed on the New York Stock Exchange. The time may come when it will be appropriate to legislate in this field, but the Government believes initially at least it will be better for companies, investors and their representative bodies to work out schemes which can benefit from a degree of flexibility which the law could not provide. It has been found in North America that one of the conditions for the successful operation of audit committees is that the board should contain a sufficient number of strong and independent non-executive directors to serve on them. This means that companies must be willing to allow members of their senior management or directors to serve as non-executive directors on the boards of other companies, to the general advantage of industry. The Consultative Committee of Accountancy Bodies, in a memorandum to the Secretary of State for Trade, has supported experiments with audit committees by UK companies. The Government welcomes this and also the consideration which is currently being given to them by the Confederation of British Industries and the Stock Exchange.
Insider dealing

22 Insider dealing is understood broadly to cover situations where a person buys or sells securities when he, but not the other party to the transaction, is in possession of confidential information which affects the value to be placed on those securities. Furthermore, the confidential information in question will generally be in his possession because of some connection which he has with the company whose securities are to be dealt in (e.g., he may be a director, employee or professional adviser of that company) or because someone in such a position has provided him, directly or indirectly, with the information. By seeking to make a profit from such information, or to avoid a loss, the individual in question can be held to be taking an unfair advantage of the person with whom he is dealing.

23 There are at present in this country no legal sanctions aimed specifically at discouraging insider dealing although, for example, both the 1967 and the 1976 Companies Acts contain provisions requiring disclosure of dealings by directors and substantial shareholders. In addition, the Stock Exchange regulations and the City Code on Take-overs and Mergers contain provisions against insider dealing and the Stock Exchange has recently announced details of a "model code" which it intends to introduce as part of its Listing Agreement; this lays down principles to be observed by directors and employees wishing to deal in their company's securities. The Government has looked carefully at the issues involved and has paid attention both to what is done in other countries and to the views expressed by various organisations in this country. The question of what should be done about insider dealing has attracted considerable debate here and overseas and this has served to clarify the issues and to identify the conflicting considerations which have to be balanced. That insider dealing is wrong is widely accepted and the Government has concluded that this should be underlined by statutory provisions which would make insider dealing in certain circumstances a criminal offence. It will not be possible to produce a perfect answer to the problem which will enable the
immediate identification and conviction of every wrong doer but the Government intends to establish as soon as possible that insider dealing is an offence and to create penalties which will be sufficient in most cases to deter those who are tempted to use inside information for their own personal gain. If the provisions proposed prove insufficient in the light of experience, the Government will not hesitate to modify and refine them.

24 The Government believes that market transactions in quoted securities should be treated differently from other transactions. In the former, with the jobbing system and market structure, it will not generally be practicable to identify a victim who has suffered as a result of insider dealing. It is this that rules out any adequate civil law remedy that would compensate the victim and it is for this reason that the only realistic deterrent is the creation of a criminal offence. In other cases there will be a direct contractual relationship between the parties and it is, therefore, possible to build on existing civil law remedies with some strengthening of the law on fraud and misrepresentation (see para 30). The Government is considering into which category the ARIEL system and the over-the-counter market should fall.

25 The Government's principal proposal is that it shall be a criminal offence for an insider to deal on the market in quoted securities in certain circumstances where he has inside information. We intend, however, that this offence should not be one of absolute liability. The prosecution will need to show that the insider knew or had reasonable grounds to believe that the information was not generally known and was price sensitive and that he dealt nevertheless. Also, it will be possible for a person to offer as a defence that his purpose in dealing was not to make a profit or avoid a loss by the use of his inside information.
In making these proposals the Government has recognised that the creation of insider dealing as an offence must not be such as to inhibit dealings which are not under criticism. It has particularly in mind that the directors and employees of a company will not infrequently hold shares in the company for which they work. By the very nature of their employment they will usually be in possession of confidential information and they could be inhibited from dealing perfectly innocently unless their special position was recognised. The difficulty is a real one, but the Government believes that the defence set out in the preceding paragraph will afford a suitable measure of protection in relation to innocent dealings by directors and employees. While the Government welcomes the initiative taken by the Stock Exchange in producing the "model code" referred to in paragraph 23 above, the Government does not consider that it would be practicable or desirable to provide in legislation that compliance with the "model code" should of itself be a defence to the proposed criminal offence. Furthermore, in the Government's view, the wide variety of possible factors to be considered make it impossible to lay down, whether in legislation or in some statutory code, more specific guidance about the circumstances in which, under the provisions set out above, it would be lawful to deal.

In defining an insider it would be possible either to list in the legislation specific classes of persons who together with defined associates would be treated as insiders (principally directors, employees, substantial shareholders and persons with a professional or business relationship with the company) or to adopt a wider approach, as in the United States, that an insider is anyone who has inside information. The principal advantage of the wider approach is that it might avoid some of the anomalies as to who is and who is not within the defined category of insider. However, it would be difficult to enforce in practice and could bring within the prohibition on dealing a much wider range of individuals who would be in some doubt as to whether they were committing a criminal offence by dealing or not. Since this would be unsatisfactory, we think it best to adopt the approach of listing specific classes of persons. However, we intend to adopt a wide definition of associate or "tippee".
28 As to tippee, the Government proposes that anyone who receives information which he knows to be price sensitive and not generally available and which he realises has come directly or indirectly from an insider should fall within this category. It is not proposed to restrict the definition of tippee to those who are in some defined relationship with the insider. The Government recognises that this broad definition may inhibit some transactions but believes that its proposals for a defence against the criminal charge will provide an adequate protection for the innocent. If in a few cases a person is not clear whether he falls within the definition of an insider's tippee, the prudent course will be for him to refrain from dealing. The alternative of setting out in the legislation those who are in defined family or business relationships with the insider would necessarily introduce arbitrary distinctions and could on occasion exclude from the crime persons who were knowingly behaving in an improper manner.

29 It is not proposed that companies themselves should be capable of prosecution for insider dealing. The provisions required to bring companies within the scope of the offence would be very complex and we do not think that by focussing solely on individuals we should be likely to miss any culpable person who should be brought within the net. Also the main aim of the legislation will be to set out in the statute standards by which people can measure their behaviour. However, we would propose to make it an offence for an insider or a tippee to procure dealings by any other person and in this case companies would be included in the definition of person. This provision is necessary to prevent evasion of the legislation by, for example, a person dealing through a company of which he is the major shareholder.

30 Where a market transaction is not involved and there are face to face dealings between vendor and buyer the insider would be put under an obligation, to be enforced by criminal sanctions, to reveal
his status to the other party involved in the transaction. Although
the latter probably has already sufficient grounds for a civil
action where this is not done, we intend to provide specifically
that default would give grounds for action to rescind the contract
in question and recover any loss caused by the failure to disclose.

31 Where insider dealing takes place in market transactions in
quoted securities there are substantial problems in linking buyers
and sellers which seem to rule out civil actions by those who claim
to have made losses through buying or selling shares at a critical
time. Indeed one of the main arguments for creating the criminal
offence of insider dealing is precisely that there is usually no
effective civil remedy. With the establishment of criminal
sanctions criminal penalties will be the natural way of making
insiders pay for illicit gains. In addition there would be nothing
in the statute which would prevent civil remedies being sought in
any suitable case under the present law. The Courts have general
power now under the Powers of the Criminal Courts Act 1973 to order
a convicted person to pay compensation, and this would apply to
convictions for insider dealing. However such an order has to be
made in favour of an identified person, and in market transactions
it will not normally be possible to identify such a person.
There may be some scope for the use of these powers in the more
straightforward cases, where the victim is identified and the
extent of his loss is clear. It is often argued, however, that
it would be wrong to allow the insider to retain the financial
benefit of his actions and that the company itself should be
allowed to sue for "disgorgement". There will be cases in which
the company will already have a right to recover profits obtained
from the misuse of information acquired by directors or employees
by virtue of their position or which has been entrusted to persons
in confidence. To extend the law so as to enable the company to
sue for disgorgement where it has no right to do so at present
would bring with it a windfall profit resulting from the criminal
behaviour of one of its employees but would mean that the insider
did not keep any illicit gains. The arguments for and against some
provision to ensure that an insider is deprived of such gains are finely balanced and the Government has not yet reached a firm conclusion: further discussion of this subject would be welcome.

32 The preceding paragraphs set out the main principles on which the forthcoming legislation on insider dealing will be based. This legislation will also deal with a number of questions of a more detailed nature, such as the position of trustees and the arrangements within financial institutions for restricting access to the confidential information held by certain departments. These raise important and sometimes difficult issues, and will be the subject of further consideration and consultation.
14 November 1977

CABINET

1978-79 NATIONAL INSURANCE CONTRIBUTION RATES
IN RESPECT OF EMPLOYED EARNERS

Memorandum by the Secretary of State for Social Services
and the Minister for Social Security

1. We have been unable to reach agreement with the Chief Secretary,
Treasury on the Class 1 National Insurance contribution rate to be fixed for
April 1978, when the New Pensions Scheme starts. Subject to agreement
on this, the other changes in rates (including a reduction in the self-
employed rate as endorsed in principle by the Home and Social Affairs
Committee) have been agreed with the Treasury and are given in the
attached Annex.

2. The present Class 1 rate is 14\% per cent (employer 8\% per cent,
employee 5\% per cent). This is bound to go up next April with the start
of the new Scheme, and the statutory maximum is 16\% per cent (employer
10 per cent, employee 6\% per cent). We think the increase should be
limited to 16 per cent, so that the employee's contribution can be held at
6 per cent.

3. There are strong national insurance reasons for a rate lower than
the 16\% per cent maximum. The Government Actuary advises that on
given assumptions (an annual earnings increase of 10 per cent, 1,470,000
wholly unemployed (1,650,000 in total) and 9 million contracted out) a
16\% per cent rate would produce overall an income to the National Insurance
Fund of £10,941 million. Inevitably the nature of the assumptions makes
this a very speculative figure, which could be in error in either way. Taking
them as the basis of calculation, however, a 16\% per cent rate would
produce a deficit of about £33* million; and 16 per cent would produce a
deficit of £402* million. It would be a departure from the practice of recent
years to aim for anything other than a large surplus. But the National
Insurance Fund will have a credit balance of about £3,700 million by April
next year, and it can well support a deficit of this order.

*If, for the purposes of the Government Actuary's report on the Contributions
Order, the assumed unemployment level is stated to be less than 1.65 million,
the size of the deficit would be reduced. Conversely, a higher figure would
increase it.
4. For five years the national insurance annual income has been more than was required to pay benefit and administer the scheme: we had surpluses of £600 million and £928 million in the last two years, and expect another £600 million surplus this year. These surpluses have not gone unchallenged, and there have been demands that they be spent in improved benefits. Last year there was in fact pressure to reduce the rate because of the surplus: we resisted this on the ground that we wanted to avoid too big an increase when the new scheme started. With an even higher surplus now we shall at least be expected to moderate the increase.

5. The Government Actuary estimates that after 1978-79 if unemployment fell to, and remained at, 4 per cent, a 16 per cent rate would suffice for over 10 years. For many years we have worked on the principle that we should not look at the finances of the Fund in each year in isolation, but should take one year with another. The confidence of the general public that what they pay in contributions is to provide for benefits will be undermined if we are seen to work only in one way - towards growing surplus. We ought to make use of a very small proportion (£400 million) of the £3,700 million balance in the Fund to tide us over a temporary problem while unemployment remains high.

6. This is of particular importance for April 1978 because of the effect on take home pay at a time when the next stage of Child Benefit will also have an impact. The position is illustrated by the following figures for a man on average earnings with two children:

<table>
<thead>
<tr>
<th>Weekly Earnings</th>
<th>Additional to Employee's Contribution</th>
<th>Total Reduction in Take Home Pay (taking account of lost Child Tax Allowances)</th>
<th>Overall Gain in Family Income (taking account of increased Child Benefit)</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
<td>£</td>
<td>£</td>
<td>£</td>
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<tr>
<td>80</td>
<td>0.60</td>
<td>0.20</td>
<td>1.69</td>
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</table>

To hold the employee's contribution at 16 per cent reduces the impact on his pay by 40p, and increases the total family income, with child benefit, by the same amount. This will particularly help the low paid, who benefit more from a lower National Insurance contribution than from tax cuts costing the same amount; and it could be announced before Christmas. The political advantage of the lower figure will help in our public relations task of selling the new scheme in the coming months.

7. This assumes that the whole benefit of holding the contribution to 16 per cent should be given to the employee. This would leave the employer paying 10 per cent. We should no doubt be criticised for departing from the present relativity between the employer's and employee's contribution and
loading it more heavily on the employer (who is already carrying the
2 per cent surcharge) which could be regarded as contrary to an assurance
given by the Government spokesman during last Session's proceedings on
the Miscellaneous Provisions Bill (Standing Committee A, second sitting,
16 December 1976, Columns 78/9). The Confederation of British Industry
and other critics would understand the importance for income restraint of
keeping the employee contribution as low as possible.

8. We strongly recommend setting the Class 1 contribution rate at
16 per cent from April 1978, with the employee paying 6 per cent and the
employer 10 per cent. We seek the agreement of our colleagues.

DE
SO

Department of Health and Social Security

14 November 1977
OTHER CONTRIBUTION CHANGES

1. The lower and upper earnings limits for Class 1 contributions to be £17.50 and £120 a week respectively.

2. The Class 2 rate to be £1.90 a week.

3. The Class 4 rate to be 5 per cent of annual profits or gains which fall between £2,000 and £6,250.

4. The Class 3 rate to be £1.80 a week.

5. The small earnings exception to be £950 a year.

6. The share fisherman's special Class 2 rate to be £3.00 a week.
1. In their paper (CP(77) 104) the Secretary of State for Social Services and the Minister for Social Security propose that the Class 1 joint contribution rate to be paid from next April by employers and employees contracted into the New Pensions scheme should be 16 per cent (6 per cent employees and 10 per cent employers) rather than the 16⅔ per cent (6⅔ per cent employees and 10 per cent employers) which is provided for in the legislation and generally expected to apply. The Government Actuary's calculations show that a 16⅔ per cent rate would produce a deficit in the National Insurance Fund in 1978-79 of some £33 million; whereas a 16 per cent rate would produce a larger deficit of some £402 million. There would be a similar cost to the Public Sector Borrowing Requirement.

2. The Chancellor of the Exchequer and I think it would be imprudent to go for the lower contribution rate for the following main reasons:

i. People are hoping to see further tax reductions in the 1978 Budget. In particular, the Trades Union Congress will be looking for either further increases in tax thresholds, or a reduced rate band of tax. However, the scope for this will depend on how the economy develops between now and next spring, and in particular on the outcome on pay. The position could well be tight. A sum of over £400 million could be important to a politically viable Budget.

ii. The choice is between helping to make room for tax reductions in the next Budget, and announcing now a smaller increase in national insurance contributions next April than would otherwise have taken place. I have no doubt that the former would have a greater perceived effect on take home pay.

iii. We shall be able to help more low income households through tax reductions than through lower increases in national insurance contributions for those contracted into the new scheme.
We should clearly not undermine the basis of the National Insurance Fund. But a 1.61 per cent rate will involve a substantial turn round from surpluses in previous years, including the large surplus expected this year, to a deficit in 1978-79. And there can be no certainty that it will be possible to reduce this rate in the near future. It is wholly defensible, therefore, not to plan for a large deficit this year particularly since the accumulated balance of the Fund will still fall in real value next year measured in terms of the number of weeks of expenditure for which it provides cover, since benefits will be further increased next autumn. The assumptions on which the Government Actuary’s calculations are based could, of course, prove wrong. But this could go either way – giving a lower or higher deficit on the Fund. If, for example, earnings increased by more than is assumed, so would unemployment, which would add to the deficit.

CONCLUSION

3. As explained in paragraph 2 ii. above, there is a clear choice between a smaller increase, but still an increase, (a married man on average earnings would pay 40p rather than 60p assuming an equal split between employees and employers) and having nearly £400 million available in the Spring Budget. I believe the difference between these rates is too small to forgo the advantages of having so large a sum available for either income tax reliefs or the other options such a sum would provide. The Chancellor of the Exchequer and I therefore recommend that the joint contribution rate to apply from next April should be set at 1.61 per cent, divided as to 10 per cent for employers and 6.5 per cent for employees, as provided for in the present statute.

JB

Treasury Chambers
14 November 1977
CABINET

PAY POLICY AND LOW PAY

Memorandum by the Chancellor of the Exchequer

1. Following discussion of the Secretary of State for Employment's paper (CP(77) 98) I was invited CM(77) 33rd Conclusions, Minute 2) to submit a further paper setting out my own views. This supplements my minute of 7th October to the Prime Minister, which was circulated to Cabinet colleagues.

2. In its discussion, Cabinet concluded that the crucial question would be whether a concession for the lowest paid would help in securing an overall increase not exceeding 10 per cent. For this purpose we took the "lowest paid" as meaning those not earning more than £40 a week. There seem to be two circumstances in which a concession would help:

   i. If the Trades Union Congress (TUC) could be persuaded to underwrite the 10 per cent guideline in return, or

   ii. if the chief pressure on the policy is from this group of workers.

3. There is no evidence that the TUC will be prepared to underwrite the 10 per cent guideline in any circumstances. The one faint possibility is that if we can maintain it until a majority of workers have settled within it, the TUC can be persuaded to acquiesce grudgingly to it for the remainder of the round in the interests of equity. This stage will probably not be reached until, say, March next year. Moreover, whatever time we choose for renewed talks with the TUC, whether about the remainder of this round or about the arrangements for pay after next July, I suspect that low pay will not play much part given that the TUC has shown little interest in the subject for some time.

4. As regards the chief pressures on the policy, the average earnings of the groups of workers involved in the major challenges to the 10 per cent guideline so far are as follows:
Lorry drivers £73.90
British Oxygen £83.20
Air Traffic Control Assistants £76.92
Police Constables £76.33 (outside London)
Firemen £74.90
Miners £80.90

As will be seen, none of these groups falls into the "lowest paid" category. A special concession for those earning less than £40 would therefore be of no general assistance in relieving pressure on the policy.

5. The one area in which some conflict has arisen is the limited one of Wages Councils. Wages Councils exist for those sectors of industry in which there are no effective bargaining arrangements. They are often esoteric, like Button Manufacturing or Ostrich Feather, Fancy Feather and Artificial Flower making; but some cover important groups like agricultural workers and Licensed Residential workers. The Councils establish minimum rates for their industries. A number of Wages Councils have recently made proposed awards which breach the 10 per cent guideline, and in each case we have made representations against their proposals.

6. Not all workers in Wages Council industries are actually paid at minimum rates: for example, the Minister of Agriculture, Fisheries and Food recently estimated that over 90 per cent of workers covered by the Agricultural Wages Board are paid above the minimum. The danger in excessive settlements lies in the fact that the awarded percentage increase in minimum rates is normally carried through into the higher rates that are actually paid. The only way to tackle this is to warn employers that they run the risk of discretionary powers being used against them if they do so. The danger remains even if some low pay exception is made to regularise the excessive awards by Wages Councils, and arguably would be made worse in such circumstances because it would be harder to justify the use of discretionary powers when the awards were reflected in increases for workers in the same industry earning more than £40 a week.

7. The tendency to reflect increases at the bottom of the pay structure in higher rates is in my view a strong argument against any exception for the low paid generally. The main effect of such an exception is to jack up the whole earnings structure, which we cannot afford. It also establishes the low paid as a "special case", when we are doing all we can to avoid establishing any.

8. My conclusion is therefore that an exception to the 10 per cent guideline in favour of the low paid would not help us to secure an overall increase in earnings not exceeding 10 per cent, and indeed would probably
prevent us from achieving that aim. The only other argument in favour of such an exception would be that it would offer significant relief to family poverty. That argument fails because of the very small proportion of the low paid who are in fact family breadwinners, as shown in the Annex to CP(77) 98, and because fiscal action is in any case a far better way of helping them. I therefore recommend strongly against any exception for the low paid.

D W H

Treasury Chambers

24 November 1977
CABINET

NATIONALISED INDUSTRIAL BOARD MEMBERS' SALARIES

Note by the Lord Privy Seal

1. I attach a memorandum by my officials on this subject.

2. As Minister responsible for these salaries I am in no doubt that the continued postponement of the increases recommended by the Top Salaries Review Body (TSRB) in their sixth report (TSRB 6) is causing great difficulties for the efficient manning of our nationalised industries at board level. The constant pressure on me from sponsor Ministers to bend or break the pay rules in seeking to recruit individuals of the requisite ability shows how far behind the market the current rates have fallen. I hope that my colleagues who are responsible for the nationalised industries will themselves expound the difficulties they are experiencing when this paper is considered.

3. At the same time, I fully accept that at the present crucial stage of the Round 3 pay policy there are very strong arguments against any form of special treatment for such comparatively highly-paid people whatever the justification. And it is unlikely that the situation will be any more favourable later in the round.

4. But we must take our decisions on this problem in full awareness of what we are doing. If we decide that we can do nothing within option a. of the memorandum, then effectively we shall be burying the TSRB 6 which will be overtaken by a new report next April. This is therefore our last opportunity of closing the large gap between the current rates and the market rates by taking advantage of the fact that the TSRB 6 recommendations can be regarded as a pre-policy commitment which would not therefore run foul of the guidelines. If we do nothing the gap between current rates and those likely to emerge from the next TSRB report will be that much larger and there will be no prospect of bridging it in the foreseeable future.
5. We also need to realise that the alternative options b. and c. in the memorandum are simply ways of giving the Nationalised Industrial Board Members' Salaries the guidelines increase which they are no doubt already counting upon. These options do not therefore really help with the problem of TSRB 6 and they will do little either to restore competitiveness or improve morale.

P

Civil Service Department

28 November 1977
PAY OF NATIONALISED INDUSTRY BOARD MEMBERS (NIBMs)

MEMORANDUM BY OFFICIALS

This paper considers possible courses of action to deal with the pay of nationalised industry chairmen and board members (NIBMs), and the other public sector posts which are linked to it. Annex A describes the present position and how it came about. This annex also includes a table showing the salary rates in payment (with the exception of those of Group C Board Members with which no meaningful general comparison can be made) with details of the increase recommended by the Review Body.

INCOMES POLICY CONSIDERATIONS

2. The increases for NIBMs recommended by the Top Salary Review Board (TSRB) with effect from 1.1.75 (TSRB 6) are large and even if they were staged on the basis adopted for the other groups covered by the Report, would involve additions to current salaries for the generality of under £1000 to about £12000; with an exceptionally high increase of £17,000 for the Chairman of the Post Office and actual reductions in some rates. However, the TSRB 6 recommendations pre-date the three rounds of incomes policy which began in 1975 and could therefore be treated as a pre-policy commitment, i.e. be implemented outside the current guidelines; and the NIBMs have been told this officially. Obviously however any such payments, however they were justified, would be presentationally harmful to the success of pay policy either now or later in the round.
PROBLEMS OF NON-IMPLEMENTATION

3. The out-of-date salaries hinder recruitment of the able people necessary for the efficient running of these industries. Vacancies are hard to fill and standards cannot be sustained. It is increasingly necessary to resort to 'ad hoc' terms - for example to pay starting rates in the upper part of the pay range. This feeds the resentment of existing members and makes expensive problems for the future.

4. None of the other groups covered by the TSRB have been totally denied their recommended 1.1.75 rates. Members resent their treatment by comparison with that given to these other groups which they regard as discrimination. Some NIBMs and many people in the "consequential" groups earn less than the £13,000 which was allowed in full for other groups. In some cases board member salaries have been overtaken by the first, and even the second tier of officials below them.

5. If no action is taken Board members pensioned in or by analogy with staff schemes who retire during non-implementation will suffer the adverse effects on their pension levels until they die. It is possible to give pensions protection by promulgating increases based on TSRB 6 back to 1.1.75 while deferring actual payment to a current date. The promulgated rate then becomes the pensionable salary.

6. Special problems arise over the NHS consultants and British Nuclear Fuels Limited (BNFL) on which a separate paper is being circulated. Although developments here are relevant they do not in practice materially affect the choice between the options on the general issue.
THE OPTIONS

7. The three main possibilities are:

a. The TSRB 6 recommendations could be treated as a commitment predating the 3 rounds of incomes policy since 1975. On this basis part at least of these increases would be implemented at once without formal offence to pay policy. The remaining parts of the report, if any, would then be disregarded; the report would be superseded by the recommendations from the next review (TSRB 10) from 1.4.78. These new recommendations, would, if Ministers so decided, be implemented during the later part of the current round, up to a limit consistent with the current pay policy guidelines.

There are several variants of this option, and these are described in Annex B. This option offers the opportunity of going further in easing problems of recruitment etc., than any of the others, depending on how close it gets to full implementation of the 1974 recommendations. It enables the pension position of retired board members to be improved. Provided the increases are not more generous than those given to the other TSRB groups as Stage 1 of the TSRB 6 recommendations, this option would not raise the question of Stage 2 for these others.

b. Alternatively TSRB 6 could be partially implemented from any convenient date, probably 1 January 1978, within the current pay policy, ie only as far as the guidelines allow. Again several variants exist and some are listed in Annex C. Variant C is designed to pay increases exactly proportional to the salary structure designed by the TSRB, thus preserving the "shape" of their scheme. Although in cash terms the increases would fall substantially short in many cases of even the Stage I increase granted to other...
groups, option C of Annex C would enable 85% of the TSRB recommended salaries to be paid. Because implementation would depend on the current guidelines, it is very unlikely that any action on TSRB 10 could be taken before January 1979 at the earliest. As with option a. above, the rest of TSRB 6 would be superseded by TSRB 10.

This option, like a., allows a degree of pensions protection for the retired; but since the increase falls well short of even Stage 1 of TSRB 6 and any action on TSRB 10 would be postponed indefinitely, the pensions of those retiring would be reduced in line with the level of salaries. Since this option confines any increase in Round 3 to the maximum allowed by the guidelines it is unlikely to create difficulties for pay policy.

c. The third main possibility is to defer any action until TSRB 10 is available. Implementation of some part of that report, in the light of the guidelines, would lead to results very similar to those under b. above. But the time-scale would be different. The first payment would be made from 1.4.78, and there would be a presumption that further stages of TSRB 10 should wait for another 12 months, i.e. to April 1979.

PENSIONS PROTECTION UNDER THE THREE OPTIONS

8. There are two ways of providing pensions protection (for those already retired) on the basis described in paragraph 5. The actual pay increases agreed could be promulgated as from 1.1.75 (but their payment deferred until a current date); or the TSRB 6 recommendations in full could be promulgated with the payment of anything more than the agreed increase (from a current date) deferred indefinitely. The first course would perhaps be more logical; the second more generous and comparable to the treatment accorded to the other TSRB groups.
9. Both options b. and c. might well be regarded by the NIBMs as nothing more than they could reasonably expect anyway under current pay policy and therefore as in effect a final repudiation of TSRB 6 with no better prospect of any improvement under TSRB 10.

TIMING

10. A decision cannot be long delayed. Apart from the intrinsic urgency of the problem, 1.1.78 is the date on which the NIBMs would be due for a Round 3 increase under the 12 months rule. Moreover, something will have to be said about the Government's intentions in the White Paper replying to the NEDO Report on the Nationalised Industries which specifically raised the pay question.
In December 1974 the Review Body on Top Salaries (TSRB) made its first substantive report (Report No 6) on the four groups within its remit (Higher Civil Service, Senior Officers of the Armed Forces, the Higher Judiciary and Nationalised Industry Chairmen and Board Members (NIBMs)). The recommended increases for NIBMs were intended to bring them into an appropriate relationship with their counterparts in private industry as from 1 January 1975.

2. The average increase recommended by TSRB for NIBMs was 30%. However, because a fundamental reassessment of the work was carried out individual increases varied widely. For the first and second tier boards, for example, they range from 15% to 50%, and in the special case of the Post Office between 60-73%. For some third tier boards there was a nil or very small increase and for an appreciable proportion of NIBMs neither the salary increase nor the new salary was particularly high.

3. For the other groups covered by the TSRB recommendations increases ranged from 10-50%.

4. In his statement on 20 December 1974 the then Prime Minister recognised that the salary rates recommended by the Review Body were appropriate on the basis they had followed. He announced the acceptance of the recommendations for all groups other than NIBMs, subject to the staging of increases for levels above £13,000 (the second stage to be payable in 1976, though in fact it has not yet been paid).

5. Decisions on the recommendations for NIBMs were postponed pending the report of the Royal Commission on the Distribution of Income and Wealth (RCDIW). Decisions on the consequentials of all the TSRB groups many of whom earn less than £13,000 per annum were also deferred.
6. No action was taken when the report of RCDIW was received and so far Ministers have felt that the general pay climate precludes even partial implementation of the recommendations for NIBMs.

7. The issue has been considered on a number of occasions (including CC(74)50th Meeting, EC(75)10th Meeting, EY(76)14th and 16th Meetings). In March 1977 (EY(77)7th Meeting of 21 March) it was the general view that NIBMs should have a Stage I payment similar to that granted to other groups covered by TSRB 6 recommendations, except that no single increase should exceed £5,000.

8. A target date for payment of 1 August 1977 was adopted, subject to its acceptability in relation to developments in determination of the general policy meanwhile and to TUC views. In the event a firm decision to make payments on that date was not taken.

9. Representations about the situation have come from many informed quarters including sponsor Ministers, the Chairman of the Review Body and past members of public boards. The issue has also been raised in Parliament. In response, concern has been expressed about the present situation and it has been said that the Government hopes to do something as soon as possible.

10. Sir Peter Menzies, when Chairman of the Nationalised Industries Chairmen's Group, submitted a lengthy memorandum to the Prime Minister at his invitation, in January 1977 to which no effective substantive response has been possible. His successor, Sir Denis Rooke is equally pressing in his views.

11. The Chancellor has since told Board Chairmen that it would not be possible to start the current round with a big increase, though he hoped that something could be done before the end of the pay year. He also drew their attention to the phased correction of anomalies which the general policy envisages.

12. The TSRB 6 recommendations have not yet been accepted publicly. Their prior acceptance in whole or in part is a pre-requisite of any
improvement on the present position. The NIBMs would no doubt expect at least the same staged treatment as was applied to the other groups.
## Salary Increases Recommended for NIBMs in TSRB Report Number 6

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<th>POST</th>
<th>Midpoint of Current Salary Range</th>
<th>Average Recommended Increase</th>
</tr>
</thead>
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<td>£</td>
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*Note: 'Current salary range' means the range in payment at 1/1/75 or the corresponding range for Boards established since that time. It does not include the increase of £208.80 paid to NIBMs from 1/1/77 under the second phase of incomes policy since this increase will not be subsumed when TSRB report number 6 is implemented.*
The main ways of partially implementing the recommendations in TSRB 6 are as follows:

1. to accept the recommendations in full, and to treat NIBMs exactly like the other groups. That would mean promulgating the full recommended increases from 1 January 1975 but making the actual payments in stages, the first stage to be deferred to a date to be selected, with the second stage payable from the same date as other TSRB groups. This would relieve the pension problem and it would minimise the problems arising from the next TSRB review;

2. to accept the recommendations and to implement them in full from a current future date on a staged basis, the first stage to be payable from that date and the second stage when it is granted to other TSRB groups. This would probably be acceptable to most serving NIBMs and it would alleviate the problems over recruitment and retention. It would not relieve the pension problem, and it could leave some problems for the next review;

3. to accept the recommendations and to stage the increases as in 2. above, but with the first stage effective from a current future date and no commitment as to when the second stage is paid. From the time that it was implemented this would represent a move to alleviate current problems and would still result in sizeable current increases, but it would leave NIBMs with a feeling of discrimination against them as compared with other groups. It would not relieve the pensions issue, and it would leave more difficult problems for the next review. This is the course most Ministers favoured in March, though a majority preferred also;

4. to impose a limit of £5,000 on any individual increase. This would have the effect of limiting some of the more spectacular
increases (eg in the Post Office) but generally would have the same effect as in 3. above.

5. A further possible refinement on any of the above options would be to limit the initial payment to within an increase of 10%. This could be achieved by any of the methods described in Annex B. The essential difference would be that it would have to be presented as an interim measure which would not preclude a further increase in Round 3 from TSRM 10. It would not lessen the incomes policy difficulties in the options, nor would it make them more acceptable to NIBMs. But it would give the appearance of doing something positive at an early date which did not of itself go further than the current guidelines.
NATIONALISED INDUSTRIES BOARD MEMBERS: POSSIBLE TREATMENT UNDER THE 10% POLICY

The following options illustrate three possible methods of applying the 10% policy to Board members. These are:

Option A: a 10% increase all round. This would actually give some NIBMs a better deal than they would have got with TSRB 6.

Option B: giving each NIBM an increase, from the 10% kitty for the whole group proportional to the original TSRB 6 increases. As these would represent an increase of about 30% on existing salary levels (a very approximate calculation), this means that each would receive \( \frac{10}{30} \) or about 33% of the TSRB 6 increases.

Option C: bringing the absolute levels of salary as close as possible to TSRB 6 within the constraint of a 10% kitty. This would enable 85% of the original TSRB 6 salaries to be paid; a few would actually receive less than they do at present through this arrangement, notably the Chairman and Deputy Chairman of the British Waterways Board (who are due for a salary decrease under TSRB 6).

1. Special consideration would need to be given to the members of those Boards who were recommended for a net salary cut in the Boyle Report.
THE 1974 RECOMMENDATIONS OF THE THREE REVIEW BODIES: SECOND STAGE PAYMENTS

Note by the Lord Privy Seal

1. I attach a memorandum by officials on this problem.

2. I agree with the conclusion that the Government cannot voluntarily pay Stage 2 of any of the increases recommended by the various Review Bodies (option ii. in paragraph 8) without creating considerable presentational difficulties for pay policy.

3. If this is accepted the aim must be to concede Stage 2 only in those cases where we are legally obliged to do so. The most difficult case is that of the consultants. Whether we should let them test their case in the courts (option iii.) or concede it at the outset (option i.) depends very much on our judgment of the legal position. In general however I would favour the strongest possible resistance to these claims. But if the consultants manage to get Stage 2 and any others follow it will be increasingly difficult to hold the line, even where the legal entitlement is comparatively weak.

Civil Service Department

28 November 1977
1. Ministers decided (before the introduction of the pay policy) to stage the implementation of increases in salary due to certain groups of higher paid staff who were the subject of recommendations by the various Review Bodies (TSRB, DDRB). In all cases, the payment of the second stage was deferred under the terms of the pay policy. This paper considers the implications for these staged payments of the Law Officers' opinion about the contractual right of NHS Consultants to the payment of their second stage, at least from 1 April 1977. It also considers the implications for Nationalised Industries Board Members (NIBMs) for whom no payments have yet been authorised, and for the salaries of Members of Parliament.

Coverage

2. The groups involved are the Higher Civil Service, the Higher Judiciary, Senior Members of the Armed Forces, the Nationalised Industries Board Members all covered by Report No 6 of the Review Body on Top Salaries, NHS Consultants covered by Report No 5 of the Review Body on Doctors' and Dentists' Remuneration; those who have their salaries adjusted consequential upon salary adjustments for these main groups, and Members of Parliament covered by Report No 7 of the Review Body on Top Salaries. The present position of each of these groups is set out at Annex A.

3. Two of the groups whose salary adjustments are consequential upon revisions of the pay of NIBMs are the directors of British Nuclear Fuels Ltd (BNFL) and of the Radio Chemical Centre (TRC). These present separate but related problems. The IPCS, who represent them, claim that the BNFL directors have a contractual right from their terms of appointment to continue a link with Civil Service salaries which they enjoyed as officials before BNFL was formed in 1971. The Attorney General has advised that there is a strong probability that the IPCS would be successful in the legal action which they are threatening. The circumstances of the directors of TRC are identical. If conceded, or determined
by the Courts in favour of the IPCS, this claim would give immediate entitlement to what the Higher Civil Service has received from 1 January 1975, and would place these directors in the same position as civil servants in respect of second stage payments, except that their contracts are clearly known to be legally enforceable.

**Incomes Policy Considerations**

4. This policy requires that the cost of any start made to correct serious anomalies which have arisen during the period of strict pay guidelines should be offset against the 10% earnings limit for settlements. Increases in excess of the guidelines arising from statutory obligations can be paid, and it is also recognised that powers to restrict awards which have contractual force is now limited to breaches in the 12 months' rule.

5. In this case we are dealing with the recommendations for settlement dates before the onset of the pay policy, and with pre-policy commitments announced by the Prime Minister on 20 December 1974 (TSRB) and by the Secretary of State for Social Services on 18 April 1975 (Consultants) which were postponed under the provisions of the Remuneration, Charges and Grants Act 1975. If they cannot be postponed further under the powers vested in the Secretary of State for Employment under this Act, incomes policy considerations do not strictly speaking apply to them.

6. Nevertheless, whatever the technical and legal positions, it is obvious that large cash payments to well paid people in the public sector and outside Round 3 could create a substantial presentational problem. The complex merits of such payments could not be readily explained. This difficulty would be much reduced if it were possible to present these increases as the correction of an anomaly within the current guidelines. But this would mean treating the cases as anomalies arising during the period of strict pay guidelines (which they are not) and preempting money which should be available for pay increases due in the present round. It would not be likely to be acceptable to
the groups concerned, especially to those who believe they have a legal right to the money so far withheld. It would effectively postpone any solution of the overall problems, and it would not provide an effective answer if the issue came to court.

**The Options**

7. As will be seen from Annex A, consideration of the options for dealing with the NHS Consultants in the light of the Law Officers' opinion brings into play a series of complex inter-relationships. Action over the opinion as to the contractual right of the Consultants cannot be long delayed as the Health Departments need to respond to the specific enquiries they have received, to advise the health authorities on their position, and to be ready to answer questions likely to be posed shortly by the Doctors' and Dentists' Review Body. In determining the options, the relationship with present pay policy has to be considered, and it also has to be borne in mind that as far as contractual rights are concerned, these relate to the rights of the individual which are not extinguished by arrangements which may have been accepted by their representatives.

8. The available options therefore seem to be:

1. to concede that the Consultants must be paid their second stage in full from 1 April 1977. This would be in conformity with the Law Officers' view that contractual rights established before 11 July 1975 cannot, under the Secretary of State for Employment's powers under Section 1(5) of the Remuneration, Charges and Grants Act 1975, be held up beyond the normal settlement date in the year beginning 1 August 1976. It would inevitably mean that any other groups who could show that their contractual position was as good as the Consultants would also have to be paid; for example, Judges should they decide to remove their waiver, and perhaps also any consequentials of the Civil Service in fringe bodies who have legally enforceable contracts who were told initially that the second stage payment was due from 1 January 1976 and subsequently that it was postponed under pay policy. There would also be strong pressure for the Government to act similarly for other
groups, eg the Civil Service and the Armed Forces whose contractual position is less clear. This in turn could affect the Government's position on NIBMs who have no contractual right to payment but a better case on merits, and it could result in increased pressure on MPs' pay.

ii. to accept that the outstanding commitment to payment of the second stage increases need not be further postponed in Round 3 of the pay policy, and to select a date for payment accordingly. This could be any date after 1 August 1977 but probably most conveniently the first settlement date thereafter, ie 1 April 1978 for the Consultants. This would mean ignoring the Law Officers' advice that a contractual obligation exists from 1 April 1977 to the Consultants. It would not therefore eliminate the risk of legal action by individuals, and it would leave the problem of how to explain the position. Moreover, since this decision would not rest on the need to act to meet the contractual obligation there would be no way of distinguishing between the various groups. This in turn would increase the pressure from NIBMs and possibly from MPs.

iii. to leave the Consultants no option but to test their case at law by suing the health authority. The authority might win, in which case the position would remain unchanged. The probability according to the best legal advice obtainable is, however, that they would lose. If they did the position would be no better than at i. above, except to the extent that the time taken to settle the case might move the effect to a less sensitive time in terms of pay policy. It would be rather worse than ii. because it would publicly expose the weakness of the Round 2 position. The internal repercussions of the legal decision would remain. Moreover, the Secretary of State for Social Services' endeavours to improve relations with the medical world might well be irreparably damaged. There is also a distinct possibility that before the matter reached the courts the BMA and the DDRB would themselves expose the weakness of the Government's stance.
Conclusion

9. Considerations of pay policy seem to rule out the "voluntary" implementation of State 2 payments outside the Round 3 guidelines whatever its technical status as a pre-policy commitment. Quite apart from the adverse effect which such large cash increases would have, there would then be no justification for withholding full implementation of the TSRB recommendations for all the other groups as well, including NIBMs and their consequentials who would have to get Stage 1 as well. Even in the context of legal vulnerability this is not really a viable option as it would be likely to create the maximum embarrassment to pay policy.

10. But if Stage 2 has to be conceded to the Consultants on legal grounds, the Government will have to decide whether to concede Stage 2 to the other groups for reasons of equity; or whether pay policy considerations must restrict the concession to those groups who can also establish a legal right to it. But before that situation is reached it will be necessary to decide whether in view of the Law Officers' opinion the Government has no alternative but to give the Consultants' Stage 2 from 1 April 1977 as a legal entitlement without testing the practice in the Courts; or whether there is sufficient element of doubt to justify leaving it to the Consultants to sue the health authorities. The Government will also wish to bear in mind in this context that the position over civil servants legal rights is by no means clear, and that if it is decided to proceed only after action in the courts, the Civil Service unions might pursue their case in this way too (as the IPCS are already known to be contemplating).

11. The position on the two special cases of BNPL and TRG is similar in its legal aspects to that of the Consultants, though it relates to an entitlement, via the Civil Service position, to Stage I payment from 1 January 1975. The decision on this again depends on whether the Law Officers' opinion leaves no alternative but to grant payment of Stage I, or whether there is sufficient doubt to leave the IPCS to sue in the courts. The strength of the legal view appears to be similar to that for the Consultants so the two should move in step.

CONFIDENTIAL
NHS CONSULTANTS

NHS Consultants are in contract with statutory Health Authorities (which are the agents of the Secretaries of State for Social Services for the administration of the National Health Service); which were directed, early in 1976, that in pursuance of the pay policy, the staged payments which were due to be paid from 1 April 1976 were not to be payable from that date. They are entitled to further advice as to what to do, and in particular to know if they are to face a continuing risk of being sued.

2. The Law Officers' opinion is that the NHS Consultants have a contractual right to the payment of their second stage, and that while this right would probably be held to have been lawfully postponed under the first round of pay policy if a determination to that effect were made by the Secretary of State for Employment under section 1(5) of the Remuneration, Charges and Grants Act 1975, there is a substantial risk that legal action to secure payment from 1 April 1977 under the second round of the policy would be successful even in the face of a purported determination that it may be further postponed.

3. The opinion indicates that in the view of the Law Officers the Health Authorities would be in breach of contract if they did not make these payments from 1 April 1977, and that Consultants, if they were to sue, would stand a very good chance of success. This raises the issue whether, in the face of a threat to sue, the Government should allow the legal action to take its course, or should in the light of the legal advice they have obtained accept that payment must be made. It also raises the question of how to deal with direct questions about the statutory basis for non-payment which have now been put by the BMA and an individual Scottish Consultant. The Health Departments have so far avoided a direct answer, saying that the matter of staged payments is under consideration, but they cannot put off an answer for very much longer and would be in an insupportable position if they were to expose the extent of their present
knowledge and nevertheless were to force the issue to the courts. The Departments had previously heard that the BMA were considering litigation, and the present enquiries suggest that this consideration continues. At the least health authorities would have to be advised that they might be sued, and this advice could not be given confidentially.

4. Further, the DDRB have, on a number of occasions, expressed the view that the staged payments should be made, but have accepted that this was not possible because of incomes policy. They have asked the Department to provide them with evidence on the effect of incomes policy on the wish that the doctors and dentists have expressed to them that they should immediately reconsider medical and dental salaries. It is highly likely that they will seek an explanation from the Departments of the legal basis for continuing to withhold payment, and will publish the answer. The Departments take the view that they would have if challenged directly on this point to answer the DDRB on the basis of the advice that the Law Officers have given.

THE HIGHER JUDICIARY

5. The Higher Judiciary has a statutory right to payment of the second stage from 26 July 1976. The position is at present protected by voluntary waivers the terms of which (in England) are:

"Notwithstanding that the salary legally payable to me with effect from 26 July 1976 in respect of the judicial office I now hold is [£X] a year, I wish to be paid the salary payable with effect from 26 July 1975 in respect of that office and in respect of any judicial office I may hereafter hold until such time as there is an increase in any of the salaries mentioned in the statement by the Prime Minister on 20 December 1974; and I abandon any claim for payment of money withheld from me in accordance with this wish."

(The terms of the waiver, though not the essential substance, differs in Scotland).
Formally the Judges' waivers are already spent through the payment of the supplement of £208.80 earlier this year to all the TSRB groups, including those specifically mentioned in the statement. The Judges have not sought, on the strength of this, to assert their statutory right to Stage 2 increases; but clearly they might consider doing so if the Consultants were to receive such increases while they and the other TSRB groups continued to be denied them. In any event they would certainly no longer regard themselves as bound by the waivers.

THE HIGHER CIVIL SERVICE

6. Although it is generally believed that civil servants do not have enforceable contracts of service, the position is in fact more complex. It is safe to say that this question has never been tested in the courts, but beyond this there is a body of academic opinion which favours the view that there is a contract of employment between the Crown and a civil servant but that it contains an implied term that the Crown may dismiss at will. The Privy Council case of Kodeeswaran v Attorney General of Ceylon is also relevant as indicating that a civil servant might successfully sue for pay accrued. There can therefore be no certainty about the outcome if a legal test case were to be mounted in respect of a civil servant's right to the second stage Payments of the TSRB6 recommendations. These were promulgated in the Civil Service Pay and Conditions of Service Code which carries the force of an instruction under Article 5 of the Civil Service Order in Council 1969 and is mandatory on Departments. As with the Consultants, the subsequent postponements of the Payments have to be viewed in this light.

7. Since senior civil servants are in precisely the same position as Consultants in relation to the second stage payment, it would be invidious to treat them differently. If they were, and Consultants were settled out of court, this would be bound to be seen as the Government giving way to the most vocal and powerful group, and any suggestion that the settlement arose from a different contractual position might simply lead to a test case by civil servants which could have wider undesirable implications.

CONFIDENTIAL
THE ARMED FORCES

8. It is unlikely that a contractual right exists for senior officers of the Armed Forces, but in other respects their position is similar to that of the Civil Service. But there is an added complication in this area that the senior officers feel very strongly about the position of the pay for lower ranks and would find themselves in a difficult position if they were asked to accept second stage payments while the pay problems which exist below (subject to current consideration by AFPRE) are outstanding. Any discrimination against senior officers of the Armed Forces would nevertheless be greatly resented by the Forces generally.

NATIONALISED INDUSTRY BOARD MEMBERS (NIBMs)

9. Although any decisions to implement the Review Body's recommendations would almost certainly lead to a contractual right to payment, the present situation is that the Government has not yet accepted those recommendations and has therefore taken no steps to implement them. No contractual right to payment therefore exists.

10. This does not mean, however, that NIBMs can be ignored. Even though some board members are on much higher salaries, it is hardly feasible that second stage payments could be made to other groups before anything is done for NIBMs. Moreover, to the extent that the position on second stages is being considered for other groups, this is itself a relevant consideration for what might then be done for the NIBMs' group and the two issues cannot easily be separately considered.

MEMBERS OF PARLIAMENT

11. Following the recommendation in Report No 7 of the Top Salaries Review Body, Members of Parliament, by Resolutions of the House, have a "rate for the job" of £8,000 plus the Round 2 increase of £208, though the amount actually in payment is restricted at most to £6,270. (This rate includes the Rounds 1 and 2 increases). No undertakings have been given as to how and when the full rate will be brought into payment. If,
however, Stage 2 payments are made elsewhere, whether to meet contractual rights or otherwise, this could have implications for the position on MPs' pay.

CONSEQUENTIALS
12. Any groups whose salaries are indirectly related to the recommendations of the Review Bodies will have to follow what is decided for the main groups. Judicial and Board Member consequentials are at present held up pending a decision on board members' pay. No contractual right to payment can therefore exist for them. "Non-Boyle" consequentials of the Higher Civil Service will have received the first stage payment and will have the expectation of the second stage when it is received by the main group. But a number of these consequentials lie in the fringe body area where there is a strong probability that contractual rights will exist. Such people will be in the same position in law as the Consultants, and any action they might be disposed to take would repercuss on the Civil Service. There is also a strong probability that action would be contemplated, certainly if the Consultants were to take action. The IPCS is already minded that way in the case of the directors of British Nuclear Fuels Limited where they claim there is a contractual entitlement to Higher Civil Service increases and are challenging a decision to apply the same treatment as for NIBMs.

9 November 1977
5 December 1977

CABINET

MILK PRICES

Memorandum by the Secretary of State for Foreign and Commonwealth Affairs

INTRODUCTION

1. As Chairman of the Ministerial Committee on European Questions I seek decisions by the Cabinet on the level of our domestic producer price for milk and certain related issues, on which the Committee has been unable to reach agreement.

PRODUCER PRICE

2. The Minister of Agriculture, Fisheries and Food has proposed a producer price from 1 January to 31 March of 49.2p per gallon compared with an average of 46.5p for the period April-December 1977 and an actual price of 47.75p from September to December 1977. He considers that such an increase is needed for the January-March quarter when costs are at their seasonal peak and production is low, and that this is the minimum price needed to stabilise the size of the national herd which is declining contrary to the Government's declared policy of expansion. Other Ministers saw no justification for a producer price of more than 47.4p which they thought would allow for adequate returns to producers while minimising the increase that would be needed in the retail price (paragraph 4 below). The Committee were however prepared to agree to a compromise price of 48p if the Minister of Agriculture, Fisheries and Food could accept it.

3. Given the Committee's decision on the retail price (paragraph 4 below) an increase in the producer price from 1 January involves an increase in the subsidy payable to meet the Government's outstanding liability of £23 million to distributors. A producer price of 48p involves a subsidy increase of £13.75 million. A producer price of 49.2p involves a subsidy increase of £23 million. The Committee saw no objection in principle to making whatever increase in the subsidy within those limits was needed to finance whatever producer price might be agreed.
RETAIL PRICE

4. The Committee agreed to increase the retail price from £1 1½p to £1 2½p per pint from 1 January in order to meet rising production and distribution costs provided that it could be announced as applicable (barring exceptional and unforeseen developments) until the end of 1978. It could thus be presented as an increase of less than 10 per cent and as being in accordance with counter-inflation policy. The Committee recognised that a price of £1 2½p might be overtaken by rising costs in the autumn, but considered that any shortfall should be recouped from a further retail price increase in 1979. Another way of delaying the need for a retail price increase in 1977 would be to increase the subsidy by the full amount of £23 million referred to in paragraph 3 while keeping the producer price below 49.2p. Depending on the level of the producer price between 48p and 49.2p per gallon there would then be an additional sum of up to about £9 million available to meet rising costs (equivalent to the deferment of a lp increase in the retail price for one month).

5. It now appears that a categorical undertaking to hold the retail price for a year would be inconsistent with the Government's obligation to review it objectively and openly with the distributors in the spring and again in the autumn. But it should be possible to announce our firm aim and intention to hold the price for a year barring exceptional and unforeseen developments; and to achieve this aim in practice.

CONCLUSIONS

6. Cabinet is invited

a. to decide the level of the producer price for milk for January-March 1978 having regard to the proposal of 49.2p put forward by the Minister of Agriculture, Fisheries and Food, the figure of 47.4p favoured by some other Ministers, and the compromise of 48p.

b. To decide whether the subsidy should be increased to an extent corresponding to the level of the producer price, or to a greater extent, but subject to a limit of £23 million, for the sake of greater flexibility in the handling of the next retail price increase.

c. To agree that the announcement of the retail price of £1 2½p should be made along the lines suggested in paragraph 5.

DALO

Foreign and Commonwealth Office

5 December 1977
1. It seems to us, after consultation with the Prime Minister, that it may be helpful to Cabinet to have a note of the main features of the new pensions scheme which is to come into force next year. The planning of the scheme was undertaken immediately after we took office in March 1974, and it was first put forward in the White Paper "Better Pensions" in September of that year. Legislation followed in the Social Security Pensions Act 1975. That Act received all-Party support in its passage through Parliament and brought to an end a 20-year wrangle over the future of pensions.

2. Contributors to the new scheme will qualify for a basic pension on the lines of the present flat rate and also for earnings-related "additional pension". This additional pension will build up to its full level in return for 20 years' contributions after 1978: a married man on average earnings will then have a total pension entitlement - basic and additional together - of considerably more than half pay. The scheme will cover invalidity and widowhood as well as retirement; it will entitle a woman to the same personal pension as a man with the same earnings, and it will make special provision for those, men and women alike, who have to give up work because of responsibility at home. It will be fully protected against inflation. And it will eventually give especial help to people with fluctuating earnings (that is, in practice, to manual workers in particular) by basing their pensions on their best 20 years of earnings after 1978.

3. The development of a state pension related to earnings will, rather belatedly, bring Britain into line with the European Economic Community (EEC) generally and with other advanced industrialised countries: by the end of the century our pensions will bear comparison with those payable anywhere in the world. However the scheme we are adopting is unique in that it makes provision for contracting out, and therefore does not divert resources into making duplicate provision for people who are already covered by good occupational schemes. The partnership which has been forged between state and private pensions is perhaps the main reason why informed opinion generally welcomes and supports the new scheme.
4. The Annex to this paper

i. explains the new pension arrangements in greater detail;

ii. draws attention to certain issues on which there may be some public debate in the coming months - in particular the position of existing pensioners; and

iii. sets out the steps which are being taken to publicise the new scheme before it takes effect in April. In addition to Departmental publicity, 17 Labour Party regional conferences have been arranged between February and April to discuss the new scheme. We shall undertake the bulk of these Party engagements between us; Barbara Castle and Eric Deakins will also be involved. The Trades Union Congress (TUC) who will have a large delegation at the launching conference in January, will actively encourage constituent unions to send members to the Labour Party Conferences. We regard this educational programme, both in the Party and the country, as being of extreme importance and of offering scope for real political gain. The publicity will emphasise that the scheme represents the first major pension reform undertaken in this country since Beveridge, and is accordingly something of which the Government can be proud. Any willingness on colleagues' part to devote time in public speeches to giving the widest possible publicity to the new pensions scheme will be greatly welcome.

D E
S O

Department of Health and Social Security

6 December 1977
ANNEX: THE NEW SCHEME IN DETAIL

1. In April 1978 people in employment will begin to contribute towards the Government's new earnings-related scheme, and will start to build up title to a pension in two parts, known as the basic and the additional pension.

BASIC PENSION

2. The basic pension will be virtually the same as the present flat-rate national insurance pension. The April 1978 level (£17.50 a week for a single person and £28 for a married couple) will be that of the present standard rate of pension and, as a minimum, it will be up-rated each year in line with the movement of earnings or of prices, whichever has risen the faster. It will be open to Government, as it is now, to raise the pension faster than the indices warrant or more frequently than annually, if this can be afforded.

3. There will however be two important changes in the rules of entitlement, both of particular interest to women. First, the "half-test", which is a special condition which a married woman has to satisfy before she can qualify for a pension on her own contributions, will be abolished. Secondly a person whose absence from the employment field has been due to "home responsibility" (broadly, responsibility for a child under the age of 16 or the need to care for a recipient of attendance allowance) will in future be able to qualify for a full pension from contributions in fewer years than are required at present, although a minimum of 20 years' contributions will still be needed.

ADDITIONAL PENSION

4. The new scheme's major innovation is its introduction of the earnings-related additional pension. This has the following features:

   (i) It will be earned by the payment of contributions as an employed person on earnings between the level of the basic pension and an upper limit (about 7 times the basic pension) beyond which no further contributions are payable. In 1978/79 this will mean earnings between £17.50 and £120 per week.
The pension will represent \( \frac{1}{80} \) of such earnings for each year of contributions under the new scheme. Thus a person who contributes for just one year before his retirement and who earns £75 a week will earn an additional pension of 72p per week (i.e. \( \frac{1}{80} \) of £75 minus £17.50) by his year's contributions and this will be payable in addition to his basic pension. The amount which will be earned by someone who contributes at the maximum level of earnings (£120 a week or more) during 1978/79 will be £1.28. Women will earn the same pensions as men with the same earnings.

After 20 years of contributions additional pension will amount to \( \frac{1}{2} \) (20/80ths) of earnings above the basic level in those years. Thus, in today's money, the employee who has contributed steadily on earnings of £75 a week will qualify for additional pension of £14.38 a week, giving him a total pension entitlement of £31.88 if single or £42.38 if married. (These amounts represent about 42\% - single - or 56\% - married - of his earnings.) The person who contributed on maximum earnings for 20 years would qualify for additional pension of £25.60 a week on top of his basic pension.

After the new scheme has operated for 20 years the formula for pension will remain at \( \frac{1}{2} \) of earnings but the earnings taken into account will be those in the contributor's best 20 years. This aspect of the new scheme will particularly favour manual workers whose peak earnings do not come immediately before retirement but early in life.

Before pension is calculated, earnings will be revalued. Earnings in each year of working life will be raised in line with the increase which has taken place in earnings generally since that time. Thus additional pensions will be based on earnings but will also reflect the rise which has occurred in the general standard of living.
(vi) Once it is in payment additional pension will be increased each year at least in line with prices. From next year onwards price-protection will also be extended to the graduated pensions which many contributors earned between 1961 and 1975.

(vii) The two-tier formula of basic plus additional pension will apply not only in retirement but also to the benefits payable in the event of invalidity and widowhood. In the case of a widow of working age it will be her late husband’s earnings, not her own, which are taken into account.

(viii) A widow who has retired may be entitled to additional pension on the basis of her own contributions as well as her husband’s. If so, she may draw both pensions, subject to the proviso that she would not receive more than would be payable to a single person who had contributed to the scheme on maximum earnings since its inception. A man whose wife dies when both he and she are over pension age will also be entitled to draw the additional pension for which they have both contributed, subject to the same maximum.

CONTRACTING OUT

5. There will be provision for contracting out of a part of the state arrangements, but to do so an occupational scheme will have to provide its members with pensions at least at the level of the new additional pension. In such a case the scheme members will pay a reduced contribution and will qualify only for the state basic pension. After they have retired, however, the state will undertake the inflation-proofing of that part of their occupational pension which is being paid as a substitute for the state additional pension.

THE SELF-EMPLOYED

6. There is no provision, as yet, for the inclusion of the self-employed in the new scheme. However, from 1978/79 onwards
the amount they pay will be determined in the same way as the contributions of employees who are contracted out of the additional pension, and their contribution liability will therefore be reduced, broadly from 8% to 5% of their earnings, as from April.

POTENTIAL PROBLEMS

(i) The demand for "crediting-in" existing pensioners

7. The 1974 White Paper "Better Pensions" acknowledged that a new earnings-related scheme would not normally operate retrospectively to cover those who had not contributed to it, but said that "With the introduction of the new scheme, the position of existing pensioners will be further reviewed in the light of the development of the economy." Since then the possibility has been explored of a system whereby existing pensioners would be credited-in to the new scheme by becoming entitled to an additional pension at a minimum level; the same minimum would be available to people retiring after 1978 whose contributions had earned them only a small additional pension or none. However, even a very modest scheme on these lines offering a supplement of £1 a week to the basic pension would incur very substantial extra expenditure - more than £300 million in the first year - for which no provision has been made.

8. In view of the cost, we cannot at this stage recommend crediting-in as an option to be pursued. But there could well be a strong campaign - from the "poverty lobby", representatives of pensioners and from our own supporters - in favour of crediting-in or, at least, urging us that some special measures should be undertaken to help existing pensioners in order to compensate them for their exclusion from the new scheme. The strength of such a campaign, and whether it will make some concession essential if damage is to be avoided to the whole concept of the new scheme, are matters which we cannot gauge before the publicity build-up for the scheme begins early in the new year. However, decisions about possible extra expenditure on existing pensioners, whether associated with the November 1978 up-rating or operating from April 1979 (when the first additional pensions become payable to new-scheme
contributors) need not be taken before the spring. For the time being, therefore, we suggest that questions about existing pensioners should be answered in part by reference to the Government's excellent record on pensions since 1974, and our success in protecting social security beneficiaries from the effects of economic crisis and public expenditure cuts, and partly by a reiteration of our 1974 pledge that, when the new scheme is introduced, their position will be further reviewed.

(ii) Contribution Changes

9. From April 1978 employees who are contracted-out, the self-employed and the few voluntary contributors will all pay less than they do now for the same pension. For employees fully within the state scheme, however, there will be a contribution increase; for men with families this will come at a time when a reduction in child tax allowances, linked to the phasing in of the child benefit scheme, may also mean a reduction in take-home pay. The national insurance increases can however be justified as a very reasonable premium for the benefits they will earn. The new contribution level will be 6½% of earnings and this will involve employees in paying 2½% more than at present. But the additional pension accruing each year in return - 1½% of earnings above the lower limit of (in current terms) £17.50 a week - will be much larger than the contribution increase.

10. There may be some additional criticism on behalf of those people who will reach pension age before April 1979, since they will earn no additional pension from their months of contributions to the new scheme. It is however inherent in the task of keeping the new arrangements reasonably comprehensible that benefits under them must accrue in whole tax years, so that the contributions paid in the part-year before retirement earn no specific addition to pension rights. This is already the position under the flat-rate national insurance scheme.
(iii) Arrangements for contracting-out

11. In spite of widespread publicity aimed at employers, it seems likely that delays on their part in applying to the Occupational Pensions Board for contracting-out certificates may well lead to a rush of such applications immediately before 6 April, and therefore to some administrative inconvenience and delays. The Occupational Pensions Board are fully aware of this possibility, and Regulations have been made to enable them to streamline their procedures in issuing contracting-out certificates on an interim basis. Further Regulations will be made before Christmas allowing employers and employees to pay the lower (contracted-out) rate contributions for a few weeks from 6 April pending receipt of their contracting-out certificates.

(iv) Complexity of the New Scheme

12. The benefit formula of the new scheme is simpler than that of the Crossman scheme and no more complex than those of earnings-related schemes abroad. Nevertheless it is not easy to explain in the way that a flat-rate pension increase would be. Any scheme which aims to reconcile the differing social aims of relating pensions to earnings, enabling past earnings to retain their value, benefiting low earners proportionately more than the higher-paid, and protecting pensions in payment against inflation is bound to be complicated, quite apart from the constraints imposed by a system of contracting-out and the need for the rules for the new additional pension to be consistent with those which already govern flat-rate entitlement.

13. Once the new scheme has begun, therefore, it may often be difficult for the individual pensioner to see how his particular benefit is calculated in terms of basic pension, additional pension and graduated pension, especially if he has been contracted-out and if such features as an increase in his pension because of deferred retirement come into the reckoning. Moreover, since the pension will reflect his individual record of earnings, a local office will not normally be able to answer his detailed questions about it without obtaining information which is held centrally on computer.
To date there has been some criticism of the quality of the general advice being given about the new scheme by our local offices: but the training of local staff has been under way for some time and is being intensified. They should therefore be able to deal adequately with public enquiries by the time that these arise in any numbers.

PUBLICITY FOR THE NEW SCHEME

14. The Government's immediate task is to give sufficient publicity to the new scheme to make it clear to those who will pay higher contributions from next April that these are the passport to a very significant increase in benefit rights. Previous pension schemes, from the graduated arrangements onwards, have not excited any marked degree of public interest but we are determined that the latest reform should be recognised for the advance that it is. As a first step, the Department of Health and Social Security is organising a one-day conference to launch the scheme on 25 January 1978; a large audience of interested parties including MPs, TUC, CBI and many other pensions interests will be invited.

15. The January conference will be the occasion at which we shall bring out a series of leaflets on new pensions, including a popular one-page summary of the scheme as well as detailed material about it. The conference will be followed in February and March by an extensive Governmental advertising campaign aimed at bringing the salient features of the new scheme to the attention of the general public. Speaking briefs and other material on the scheme will also be made available to Government spokesmen and to MPs of all parties.

16. As already explained in the paper, we will also be undertaking 17 Labour Party regional conferences.
CABINET

TOP SALARIES - NATIONAL HEALTH SERVICE CONSULTANTS AND OTHERS

Memorandum by the Attorney General

1. This item was not reached in Cabinet on 1 December 1977, and it raises some complex legal points. I think that it would be helpful to my colleagues to record my views in writing.

A. BRITISH NUCLEAR FUELS LIMITED DIRECTORS

2. In CP(77) 107 and 108 the Lord Privy Seal suggests that the cases of the National Health Service Consultants and the British Nuclear Fuels Limited (BNFL) directors must be treated alike as the strength of the legal advice seems to be similar. That is not my view. In my opinion there is a clear pre-pay policy contractual link between the BNFL directors' salaries and the corresponding Civil Service grades. This is not the position (see below) in respect of the Consultants' claim. My advice is that a claim by the BNFL directors would succeed in the courts.

3. Leaving aside the legal position, my colleagues may also think that the political impact of upholding the claim of a very small number of nationalised industry board members to equality of treatment with the Civil Service is likely to be very different from the political impact of allowing a large number of National Health Service (NHS) Consultants to obtain large retrospective payments in respect of the second stage of the Doctors and Dentists Review Body (DDRB) recommendation, when, as I understand it, no other "top salary" group has received the benefit of that stage.

B. NATIONAL HEALTH SERVICE CONSULTANTS

4. In July 1975 the Consultants were awarded an increase to be staged as to Stage 1 (retrospectively) from 1 April 1975, and as to Stage 2 from 1 April 1976. This was agreed by the Joint Negotiating Committee (JNC) and received the necessary statutory approval of the Secretary of State by circular.
5. In February 1976 a circular ("the second circular") provided as follows and received the necessary statutory approval of the Secretary of State:

"Staged Increases

7. Increases in remuneration which were due to be paid from 1 April 1976 in accordance with the staging arrangements set out in paragraphs 3 and 15-17 of the Appendix to HSC(IS) 159 and paragraphs 8-10 of HSC(IS) 167 will not now be payable from that date.

Payments Withheld

8. Payments withheld in accordance with paragraphs 6 and 7 of this notice will not subsequently be paid retrospectively, but will be credited in full for superannuation purposes."

6. Circulars in similar terms were issued for Wales and Scotland.

7. In August, 1977, the Solicitor-General, in my absence abroad, advised that there were two important areas of doubt -

a. As to whether in law the Consultants retained any right to the Stage 2 increase (having regard to the real possibility that the second circular might be held by the courts to have deferred the Consultants' rights other than for superannuation purposes indefinitely) or whether their rights were merely deferred in law until Pay Policy permitted them to be paid; and

b. as to whether, if the second circular gave the Consultants a claim in law to their increase under Stage 2 as soon as Pay Policy permitted, the Second White Paper permitted the whole of Stage 2 increase to be paid from 1 April 1977, or only the £4 provided for in the Second White Paper.

8. My advice, with which the Solicitor General agrees, is that the doubts on both these points are now so great that the Government is fully entitled to resist the Consultants' claim. In the light of the information available since August I believe that there is a very substantially lower chance of the Consultants succeeding than the Solicitor General and the Lord Advocate envisaged at that time. We have still had no legal claim from the Consultants founded upon a right to the Stage 2 increase accruing since 1 April 1977, notwithstanding that the Department of Health and Social Security have approved payment of the Second White Paper £4 increase. We may be confident that, if they had had even moderately strong legal advice in their favour, we should have heard something of it by now.
9. If we rely on these very serious doubts as to their legal entitlement the issue becomes purely one of policy as to how much to allow the Consultants and when. I think that we should be quite safe in adopting this line. I do not think that we could be fairly criticised even if (which I regard as unlikely) any claim they thereafter make in the courts were to succeed.

10. Having regard to the views expressed above on the effect of the second circular, it remains to apply the Pay Policy to the Consultants' case. They clearly have no claim until April 1978, 12 months after they received the £4 increase under the Second White Paper. But it is open to question whether they should be regarded as being then entitled to the full amount of the Stage 2 increases or whether any increase at that time should still be subject to the guidelines, i.e. confined to not more than 10 per cent. My colleagues may think that there are arguments in equity for giving them the full amount and that there is a clear distinction between the Consultants and other "top salaries" groups in that the Consultants did at one stage have a legal right to payment as from 1 April 1976, of which they have been deprived by executive act in the form of the second circular. Payment on 1 April 1978 would thus involve a 2-year deferment of a payment which all concerned thought in February 1976 would be subject only to a 1-year deferment, i.e. until 1 April 1977. This, however, is a matter of policy and equity rather than of law.

S S

Royal Courts of Justice
5 December 1977
CABINET

PAY OF NATIONALISED INDUSTRY BOARD MEMBERS

Memorandum by the Lord Privy Seal

1. At last Thursday's meeting (CM(77) 38th Conclusions) I was asked to report on a scheme to pay a 5 per cent increase to board members and consequentials, either on the kitty principle, or as a flat rate, with a few exceptions of up to 10 per cent to deal with cases of particular hardship. I have not been able in the time available to make a thorough examination of hard cases with colleagues, though the bids we have received are listed at Annex B.

2. Annex A analyses the various arrangements which could be adopted to give effect to a general 5 per cent increase on the lines we discussed. There are no obvious special factors other than pay levels which would provide a consistent and generally acceptable means for distributing the increase. Of the various options I would myself favour that described in paragraphs 4 and 5 of the Annex, preferably using the £13,000 level to determine who should have the higher increases.

3. But before we finally decide upon the increases to be given, I think we should pause to consider other aspects of the matter. Since the increases would not be in respect of a pre-policy commitment under the 1.1.75 recommendations (Top Salaries Review Body, sixth report (TSRB 6)), or constitute an interim payment with the balance to be made later, it must clearly be regarded as the Round 3 settlement for board members and consequentials which establishes their pay levels for the following 12 months.

4. It would be possible to relate payment to TSRB 6 and to make it on 1 January 1978. The 1.4.78 recommendations for board members (TSRB 10) would then remain to be considered for a settlement date at least 9 months later. This would leave board members with an increased feeling of injustice if the Government's decision was confined to them alone and was not presented as part of a coherent policy for the Review Body groups as a whole.
5. Moreover a decision to implement 5 per cent in January as a Round 3 settlement would be seen by the TSRB as in effect the rejection of their 1974 recommendations without any prospect that their April 1978 recommendations will be treated differently. They might well resign in consequence. This in turn would threaten the existence of the other two Review Bodies (covering the Armed Forces and Doctors and Dentists).

6. More generally, our decision would be seen as an act of explicit discrimination against the public sector - directed moreover against the group which has the best claim for preferential treatment. It would be assumed that the other TSRB groups would be similarly treated, and the Civil Service unions and the Doctors would be likely to see this as the writing on the well for them.

7. Many of these difficulties could be avoided by awaiting TSRB 10. This would mean that nothing could be done before April for board members. But once TSRB 10 comes out we shall be able to consider board members at the same time as other TSRB groups; and the TSRB report along with the other Review Body reports. Individual Round 3 settlements could then be developed consistently with one another. I think this course should be seriously considered. If on reflection we adopt it, an early announcement will be necessary.

8. Any decision not to allow TSRB 6 to be treated as a pre-policy commitment makes it difficult to do anything on pensions. If we maintain that increases should be restricted to 5 per cent in Round 3, whether we relate these to TSRB 6 or TSRB 10, we cannot credibly maintain that there is any intention of implementing TSRB 6. Retrospective promulgation of the full recommended rates would then be difficult to square with Inland Revenue's rules. It is therefore difficult not to conclude that any device to protect pensions is basically inconsistent with our decision on salaries and that there is no acceptable way of providing protection.

Civil Service Department

6 December 1977
WAYS OF DISTRIBUTING AN OVERALL 5 PER CENT PAY INCREASE

EQUAL CASH INCREASE

1. This would achieve a bias in percentage terms towards the lower paid members of the Group. But it would also cause severe compression of both relativities between boards and internal differentials within boards. The percentage increases at the lowest salaries would be close to 10 per cent, but those at the higher salaries would be very low.

The approximate cash increase would be £550. The percentage increases would range from about 9 per cent at the bottom to 2 per cent at the top, with an average of 5 per cent.

PROPORTIONAL INCREASES ON EXISTING OR RECOMMENDED RATES

3. Proportional increases within the overall 5 per cent pay bill figure would in cash terms favour the higher paid:

i. A 5 per cent flat rate increase would produce cash increases ranging from £300 at the bottom to £1,500 at the top. It would preserve existing relativities and differentials.

ii. Increases based on a proportion of the TSRB recommended increases (ie; approximately \( \frac{1}{5} \)th of these) would reflect relativities within the existing structure. The percentage increases range from 1\( \frac{1}{2} \) per cent to 16 per cent. The cash increases would range from about £150 at the bottom to £2,750 at the top.

iii. Increases within a 5 per cent kitty distributed to achieve the highest common proportion of the TSRB recommended rates (approximately 81 per cent of these) would reflect the relativities of the recommended structure, but the actual
percentage increases would range as high as about 39 per cent at the top, and there would be some cases where current salaries are already more than 81 per cent of those recommended.

**FLAT RATE OF 5 PER CENT WITH EXCEPTIONAL ADDITIONS UP TO 10 PER CENT FOR HARD CASES**

4. This solution would go beyond an overall 5 per cent increase. The problem would be to define the hard cases. When TSRB6 increases were postponed an exercise was conducted to establish whether some lower paid individuals might be allowed through. This exercise showed that it was not possible to discern any special features which would justify special treatment but which would not involve repercussions on others within the group. The list at Annex B shows the current departmental bids. There is no clear criteria other than salary level. This solution would require the fixing of arbitrary limits below which higher percentage increases would be allowed. For example, if a 10 per cent increase were allowed to those at or below £6,000, this would raise the average percentage increase to 5.02 per cent; at £8,000 the figure would be 5.4 per cent; at £10,000 it would be 5.8 per cent and at £13,000 (the limit to which TSRB6 was paid in full to other groups) it would be 7 per cent.

5. There are considerable advantages in this system. It would be relatively easy to administer and it follows current practice of dealing with pay in percentage rather than cash terms. It would be especially advantageous if the salary point for the 10 per cent increase were to be fixed at £13,000 as this was the level to which the TSRB 6 recommendations were allowed in full for other groups. The disadvantages are that increases might have
to be tapered at the change over point to avoid anomalies, and that the arbitrary nature of the dividing line could lead to substantial distortion in relativities within and between boards at this point.

MIXED CASH AND PERCENTAGE INCREASE

6. The basis here would be a fixed cash amount plus a percentage increase which would produce a 5 per cent increase at the mean salary for the group. This cash and percentage increase would then be applied at all salary levels. This would provide a balance in individual percentage increases in favour of the lower paid in the group. The percentage increases would then be less for the higher rates and more for the lower rates, but the actual cash increases would of course rise with salary.

7. The mean salary would be determined so as to ensure that the overall increase in the pay bill was at the accepted figure. This could be 5 per cent, or it could be higher if the position in paragraph 4 above was to be reflected, i.e. that the overall increase including hard cases should be more than 5 per cent. The balance of advantage to higher and lower paid groups would be determined by the proportion of cash to percentage increase. But as an illustrative example, if the mean salary was approximately £11,000 a cash sum of £275 plus 2 1/2 per cent of salary would give £550 - a 5 per cent increase. At £30,000 the increase would be £1,025 - a 3.4 per cent increase, whereas at £6,000 it would be £425 - a 7 per cent increase. A 10 per cent increase would occur well below the salary of any member of the group.

8. This system would have the advantage that once the cash and percentage increases are determined they will operate evenly over the salary range. There is no sharp change point. As with
the arbitrary level below which higher percentage increases would be allowed (paragraph 4) this system would provide higher percentage increases for the lower paid in the range, but it would do so within rather than in addition to the agreed overall percentage increase. In neither case would the higher increases be specifically related to "hard" cases. The most serious disadvantage is that it introduces the concept of cash payments into a policy designed to provide for percentage adjustments.
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<th>DEPARTMENT</th>
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<td>VICE-CHANCELLORS</td>
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<td>Maximum permissible</td>
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<td>LORD CHANCELLOR'S OFFICE</td>
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<td>President Pensions Appeal Tribunal</td>
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<td>Chairman of Council on Tribunal</td>
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<td>Judge Advocate of the Fleet</td>
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<td>HOME OFFICE</td>
<td>No special cases but consider all 15 consequentials' salaries are too low.</td>
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<td>Water Authority Chairmen</td>
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<td>Presidents and Vice-Presidents of Rent Assessment Panels</td>
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<td>WELSH OFFICE</td>
<td>Water Authority Chairmen</td>
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<td>DEPT OF TRANSPORT</td>
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<td>DEPT OF INDUSTRY</td>
<td>In general believe 1/6 recommended increases justified. But if a 5 per cent limit on general increase, then special cases would be the chairman and members of Post Office and Cable and Wireless Boards</td>
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<td>DEPT OF ENERGY</td>
<td>NCB two members</td>
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<td>EGC two members</td>
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<td>UKAEA one member (possibly also the Deputy Chairman)</td>
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<td>Possibly certain consequentials in BNFL and TRC</td>
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<td>Area Electricity Boards - 8 Chairmen</td>
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<td>All, 12 Deputy Chairmen</td>
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The salaries for these bids range from about £8,000 to £23,000.
CABINET

INQUIRY INTO THE CROWN AGENTS
Memorandum by the Lord Chancellor

1. The note by officials attached at Annex sets out in paragraph 8 the questions which Ministers must now consider in the light of the decision of the House of Commons on 5 December 1977. This was, in effect, to reject the Government's proposals to set up an inquiry which would sit in private but would publish its report, its terms of reference limited to assessing the culpability of individuals in the Crown Agents, the Ministry of Overseas Development, the Treasury, the Bank of England and the Exchequer and Audit Department. That rejection by the House of Commons followed a similar reaction by the whole of the Press to the announcement of the Government's decision.

2. The reasons put forward for the rejection are set out in paragraph 2 of the Annex. The major factor was the fear that a private inquiry would be a "cover-up" which would protect those who should not be protected.

3. In this situation, nothing less than a public inquiry would, I believe, now satisfy Parliamentary and public opinion. Paragraph 5 of the Annex identifies three possible forms of public inquiry - a non-statutory Inquiry, a 1921 Act Tribunal and a Select Committee of the House of Commons.

4. While a non-statutory Inquiry would get round any difficulty created by the language of the 1921 Act which requires the matter being enquired into to be "a definite matter of urgent public importance", and might (although I think this is doubtful) make it easier to build upon the Fay Report and its supporting evidence, I think the absence of compulsory powers would be a serious defect. Although in practice it may be true that even then the necessary evidence would be forthcoming, nevertheless a non-statutory Inquiry would, I believe, not inspire the same public confidence in the Tribunal's ability to get at the full truth. I think therefore that the only real choice now is between a Tribunal and a Select Committee.

5. As to the ground to be covered by the Inquiry, the possibilities are set out in paragraph 8(b) of the Annex. That set out in paragraph 8(b)(ii), i.e. "all individuals whose part in the Crown Agents affair may be thought to be blameworthy", would cover not only the individuals concerned in the Crown Agents, the Ministry of Overseas Development, the Treasury, the Bank of England and the Exchequer and Audit Department, but also the responsible Ministers and the businessmen and solicitors involved in the relevant Crown Agents "own account" transactions. It would therefore be appreciably wider than the original terms of reference proposed by the Government.
6. I do not think the scope should be narrower than this. The difficult question is whether the failure of organisations as well as of individuals should be expressly included. As organisations act through the individuals who run them, investigation of the failures of those individuals would enable the enquiring body, if so minded, to comment on failures attributable to organisational defects. In these circumstances I do not think it would be necessary to include a specific reference to the failure of organisations in the terms of reference, particularly when to do so could involve the risk of a very widespread inquiry covering again the whole ground of the Fay Report.

7. As to item 8(b)(iv) of the Annex, the investigation of the conduct of the individual businessmen and solicitors involved would enable the enquiring body to examine and report upon the relevant business and commercial practices in so far as they contributed to that conduct. A wide ranging investigation of commercial morality generally would not be appropriate for this kind of inquiry.

8. The merits and demerits of proceeding by way of a Tribunal under the 1921 Act or a Select Committee are conveniently set out in paragraphs 6 and 7 of the Annex. An additional difficulty attaching to a Select Committee is that it would cease to operate at the end of the Parliamentary session unless re-activated in the succeeding session. Dissolution of Parliament before the completion of the Select Committee's work could give rise to awkward consequences.

9. It is also to be borne in mind that any form of public inquiry into the conduct of individuals would almost inevitably preclude the institution of any criminal proceedings against them and could well involve the abandonment of any pending prosecution. Civil proceedings too might be prejudiced and could hardly be continued while the public inquiry was taking place.

10. Of the two options, I think a Tribunal of Inquiry would be a better means of satisfying public anxiety and public opinion, and of ensuring that those concerned are seen to be given fair treatment, even though this would inevitably take longer and be far more costly than a Select Committee.

11. At this stage it may be sufficient to announce the Government's intention that there should be a public inquiry and that its form and precise scope will be announced shortly. This would give the Government more time to consider both its terms of reference and, if it is to be a Tribunal, its composition, or, if it is to be a Select Committee, to enter into consultation with the other Parties in the House of Commons. Whichever procedure is decided upon, there would have to be a Parliamentary debate on a Resolution - in both Houses in the case of a Tribunal of Inquiry, or in the House of Commons in the case of a Select Committee.

E-J

Lord Chancellor's Office

7 December 1977
CROWN AGENTS - COMMITTEE OF INQUIRY

NOTE BY OFFICIALS

The Minister of State for Overseas Development announced on 1 December the Government's decision that following the Fay Report there should be a subsidiary inquiry under Sir Carl Aarvold with the following terms of reference:

"In the light of the report of the Fay Committee, to assess the nature and gravity of any neglect or breach of duty by individuals which may have occurred in the Crown Agents, the Ministry of Overseas Development, the Treasury, the Bank of England and the Exchequer and Audit Department."

This inquiry would have sat in private but its report would have been published. It would have had a clear and narrow objective - to help the management of the organisations concerned decide on any disciplinary action which was needed against individuals who were blameworthy for neglect or breach of duty.

In the House of Commons debate on 5 December (Hansard, Col. 1026-1096) and in press and public comment it has been strongly argued that the terms of reference are too narrow and that the inquiry should be in public. There are five strands in the criticisms:

1. The inquiry should be in public in order to demonstrate that people in public positions are held to account for their misdeeds in the same way as private citizens;

2. The inquiry should be in public to give Ministers and officials who were criticised in the Fay Report a public opportunity to justify themselves;

3. A statutory inquiry is needed to compel evidence because some people (in fact three, of whom two were subject to criminal proceedings) refused to give it to the Fay Committee;
(4) the inquiry needs to cover not just the behaviour of individuals but also the behaviour of the organisations concerned;

(5) the inquiry should deal with standards of commercial morality exposed by the Fay Report.

(A summary of the main points made in the Debate is at Appendix A.)

The Questions for Consideration

3. The Government does not formally need to take any action following its defeat on a motion to adjourn the House. There are indeed arguments for continuing with the private inquiry as originally conceived. It would be the quickest and cheapest way of establishing the culpability of individuals in the public service without pillorying in public individuals who were subsequently held to be relatively free of blame. It would keep to a minimum any duplication with the work of the Fay Committee and any diversion of effort from current work by the organisations concerned. Moreover if any public inquiry is set up it will in practice be necessary to abandon the criminal proceedings against Mr Sidney Finley (because the proceedings of the inquiry could prejudice his trial). This course would not however meet the strong views which have been expressed both in Parliament and more widely and Ministers may feel that some form of public inquiry is now inevitable. In that event the main questions for consideration are -

a. What should be the scope of such a public inquiry?

b. What form should it take?

The Scope of a Public Inquiry

4. There are four main possibilities –

a. A public inquiry with the same terms of reference as were proposed for the Aarvold inquiry

This would not meet the pressure from Government supporters for a wider inquiry although it would meet the desire of the Opposition that Mr Richard Wood should have an opportunity to defend his actions in public. In practice such an inquiry might well be driven wider than its terms of reference and a more effective inquiry might result if
this were accepted from the start. It might well be thought inequitable that the public servants involved in the Crown Agents affair should be subjected to a public inquiry while those outside the public service who contributed to that affair were not formally subject to it. On the other hand it can be argued that there are clear standards of duty owed by public servants and that no corresponding obligations bind the other individuals involved. If they acted illegally the remedy lies in criminal proceedings. If not there is no reason why they should be subject to a public inquiry the proceedings of which could in practice leave a stain on their reputations even if they were cleared by the eventual report.

b. A public inquiry covering the conduct of individuals both inside and outside the public services involved in the Crown Agents affair

This would go a long way to meet the criticisms both in Parliament and in the press. The inquiry would still be kept within bounds. On the other hand such an inquiry could leave unfinished business if it exposed weaknesses in organisations without including recommendations to deal with them.

c. A public inquiry dealing both with the conduct of individuals and the working of the organisations involved (Crown Agents, ODM, Treasury, Bank of England and Exchequer and Audit Department)

This course would meet the widely-held view that weaknesses in organisations were as important as the failings of individuals in contributing to the difficulties of the Crown Agents and could provide the basis for effective remedies. An inquiry of this sort would however be more appropriately undertaken by a Royal Commission than by a judicial or semi-judicial body. It would be prolonged and could seriously divert the organisations concerned from their ongoing business and obviously duplicate the work of the Fay Committee. It could affect public confidence in Government as a whole as well as in the other institutions concerned. In any case an inquiry worth its salt looking into the conduct of individuals would be likely in practice to expose any weaknesses in organisations which came to its attention.
d. A public inquiry ranging into the general issues of commercial morality raised in the House of Commons debate.

There was some demand for such an inquiry. It would however range so widely as to be of doubtful utility. It would overlay the work of the Wilson Committee on Financial Institutions.

**Form of a Public Inquiry**

5. It would be possible to have a non-statutory public inquiry. This would not be able to require the attendance of witnesses, a point to which much attention was directed in the House. This attention was somewhat misplaced. Fay managed well without powers but was of course sitting in private. Only three people refused to give evidence, two of them in any case subject to criminal proceedings. It would be most unlikely that the question of powers would arise with any still serving in the public sector as to disclosure of papers in that sector. If however a power to compel witnesses is felt to be essential in the case of an inquiry to be held in public the choice lies between:

   a. an inquiry under the Tribunals of Inquiry (Evidence) Act 1921;
      its establishment would require affirmative resolutions in both Houses of Parliament;

   b. an investigation by a Select Committee of the House of Commons.

6. An inquiry under the 1921 Act would be the normal procedure for dealing with this sort of case. It would ensure a judicial hearing for those who were subject to criticism. The tribunal would have statutory powers to compel witnesses to attend and give evidence. On the other hand such an inquiry would be slow-moving (probably taking at least a year) and expensive (the costs could amount to about £1 million). The proceedings of the tribunal could attract maximum publicity while it was sitting. There could be a problem of forming terms of reference which met the requirement of the 1921 Act that a tribunal is to inquire into "a definite matter ... of urgent public importance".
7. A Select Committee of the House of Commons could inquire into the way the House itself handled the Crown Agents affair. It can be held that a situation which has been provoked by an unprecedented surge of back bench opinion requires action by Parliament itself. A Select Committee would in practice be able to compel evidence. Failure to submit it would be a breach of privilege. The problem is essentially bipartisan: the events in question took place under administrations of both Parties. On the other hand since the Select Committee on the Marconi scandal in 1912 Select Committees have been generally thought to be an unsatisfactory way of investigating allegations of public misconduct. The Report of the Royal Commission on Tribunals of Inquiry under Lord Justice Salmon in 1966 commented -

"The Marconi scandal for this purpose sounded the death knell of this form of investigation, and because it was wholly discredited, the Act of 1921 was passed. To go back to it would, in our view, be a retrograde step. We of course recognise that there are many purposes for which Select Parliamentary Committees are most useful and indeed indispensable - but the investigation of allegations of public misconduct is not one of them. Such matters should be entirely removed from political influences." (Cmnd. 3121 para. 35)

In addition a Select Committee would also be costly as those involved would no doubt expect to be provided with legal representation. And there could be some awkwardness if a Select Committee had not completed its work during the life of the present Parliament.

Questions for Decision

8. The questions which Ministers will wish to consider are -

a. Should the inquiry be held in public or private (paragraph 3);

If the inquiry is to be held in public -

b. Should it cover -

1. the conduct of individuals in the Crown Agents, the ODM, the Treasury, the Bank of England and the Exchequer and Audit Department;
ii. all individuals whose part in the Crown Agents affair may be thought to be blameworthy;
iii. failure of organisations as well as of individuals;
iv. the wider question of commercial morality raised by the Crown Agents affair? (paragraph 4)

c. Should it be conducted in -
   i. a non-statutory public inquiry;
   ii. a tribunal under the 1921 Act;
   iii. a Select Committee of the House of Commons (paragraphs 5-7).
The main criticisms made on the debate on 5 December were as follows -

**The business practices of the City**

Criticism of such practices as letters of comfort or window-dressing (i.e. giving false information to shareholders). "This happens in the City all the time." - Mr John Mendelssohn.

**The Bank of England**

Criticism of the Bank for turning a blind eye to what was going on at the Crown Agents for so long, to which was coupled criticism of the auditors and solicitors involved.

- Mr John Mendelssohn
- Mr Cunningham
- Mr Skinner

The need to tighten the regulations and rules under which auditors prepare balance sheets -

- Mr Peter Brooke

**The Civil Service**

The Service was criticised especially for its mode of recruitment, its lack of business expertise and, in the case of the Treasury, for its pre-occupation with relatively minor matters concerned with the Crown Agents when it failed to notice massive losses resulting from speculative dealings.

- Mr Michael English
- Mr George Cunningham
- Mr Dennis Skinner
The Director of Public Prosecutions

Criticism of his slowness of action in this case.

- Mr Dennis Skinner

The Excessive Independence of the Controller and Auditor General

- Mr Michael English

Suppression and cover up

Criticism of attempts made to dissuade the present Minister of Overseas Development from pursuing her attempts to bring the affairs of the Crown Agents into the open. Reference to "a closing of ranks".

- Sir Harold Wilson

The House of Commons

Failure to organise itself so that Select Committees could pursue investigations of the kind that could have revealed at an earlier stage the situation of the Crown Agents.

- Mr George Cunningham

Failure of the House to exercise proper control

- Sir Harold Wilson

Failure of the House to react to warnings from the Press about the difficulties of the constitutional relationship, the speculative work of the Crown Agents and the possible financial dangers for the Government.

- Mr George Cunningham

The Select Committee on Overseas Development

Lack of urgency to start investigation of the affairs of the Crown Agents and lack of tenacity in terminating their inquiries prematurely.

- Mr Cunningham
II. Proposals for an open inquiry came from Mr Mendelssohn who opened the debate, and most of those who followed. The main points in favour of this course of action were -

- The need to avoid a whitewash and to counter "great distrust about Whitehall and about Parliament".
  - Mr Richard Luce

- The need for judicial procedures to give adequate protection to witnesses. The form of inquiry should be such as to compel witnesses to give evidence; reference to the Salmon Report on Tribunals of Inquiry in support of the 1921 Act procedure.
  - Sir Michael Havers

- Request for a special inquiry in respect of the Crown Agents Australian Investment.
  - Mr Frank Tomney

7 December 1977
12 December 1977

CABINET

PUBLIC EXPENDITURE WHITE PAPER

Memorandum by the Chief Secretary, Treasury

1. In accordance with the Cabinet Conclusions of 20 October (CM(77) 32nd Conclusions), I am circulating herewith a draft of Volume I of the Public Expenditure White Paper. If we can clear the draft at our meeting on 15 December, that will enable us to publish on Thursday 12 January, shortly after the House reassembles on 9 January. I am circulating Volume II separately with the suggestion that it should be cleared in correspondence.

2. The main purpose of the White Paper is to present publicly the public expenditure programmes as revised by the decisions we took in October. Account is taken of some later developments, including the new agreement now concluded with the banks on refinancing of export and shipbuilding credit and estimating changes on social security and agricultural support. The contingency reserve figures for 1979-80 and the two subsequent years have been raised to £1,500 million, £1,750 million and £2,000 million respectively (all figures at 1977 survey prices).

3. The section on the economic context (paragraphs 48-59) contains a table of illustrative economic projections on the lines of those given in the Chancellor of the Exchequer's paper discussed at Cabinet in July (CP(77) 70). The text emphasises that the projections are no more than illustrations of one possible evolution of resource use over the years ahead, on one particular assumption about the growth of total output.

4. The draft also includes a table of revenue projections (Table 9). The figures in the table are subject to final checking. The Expenditure Committee and others have been pressing for a fuller account of the general economic background to the expenditure plans, and in particular for revenue projections (which were provided in the 1969 White Paper (Cmnd 4234)). We have told the Committee that we will provide revenue projections.
Subject to any further minor revisions or drafting changes which may be necessary, I invite my colleagues to approve the attached draft of Volume I of the White Paper for publication.

J B

Treasury Chambers

12 December 1977
THE GOVERNMENT'S EXPENDITURE PLANS, 1978-79 TO 1981-82

PART I

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<td>Summary of changes since Cmnd 6721</td>
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<td>16</td>
<td>Changes to expenditure programmes since Cmnd 6721</td>
<td></td>
</tr>
<tr>
<td>17</td>
<td>Changes to expenditure programmes since Cmnd 6721 by economic category</td>
<td></td>
</tr>
</tbody>
</table>
THE GOVERNMENT’S EXPENDITURE PLANS,
1978-79 TO 1981-82

PART 1

This White Paper presents the Government’s latest plans for public expenditure. Volume I gives a general account of the plans and their economic and fiscal context, Volume II details of individual expenditure programmes and supporting material.

2. The improvement in the country’s financial situation, to which the cuts in public expenditure plans which preceded last year’s White Paper (Cmnd 6721) made an important contribution, enables the Government now to plan for resumed and continuing expansion of many programmes financed by public expenditure. Along with other measures to improve the outlook for employment and to bring the growth of output on to its intended path, the Chancellor of the Exchequer announced on 26 October 1977 the Government’s decision to add £1 billion(1) to the plans for 1978-79. That decision is reflected in the present White Paper.

3. Renewed expansion in expenditure plans must be governed by the Government’s broad economic objectives of containing inflation, reducing unemployment and promoting industrial efficiency. In addition, the Government now aim at a greater degree of stability than has been achieved in recent years, so that expenditure programmes can be managed with confidence that they will not be subjected to the disruption of sudden cuts.

4. Both for this reason, and in order to leave room for manoeuvre on taxation, it is necessary that the planned growth rate for total public expenditure should be within the prospective growth rate of national income. The present plans are constituted to this end. As always those for the later years are provisional. The Government want to improve and in many cases expand the provision of public services, and will do so as circumstances permit; but they do not intend to set up plans which go beyond what the economy can safely be assumed capable of sustaining.

5. The Government intend to maintain and develop the procedures of expenditure control, including the new features introduced in recent years, such as the system of cash limits and strict observance of the announced control figure for the contingency reserve, and the arrangements for monitoring expenditure in the course of the year as described in Cmnd 6721. The latter is an important management tool which, as experience grows in its use, should promote a closer match between plans and outturn.

(1) All figures in this White Paper are at 1977 survey prices unless otherwise stated. They have each been rounded to the nearest £1 million and do not therefore necessarily sum to the totals.
Summary of the plans

6. The planning figures for public expenditure until 1981–82 are shown in table 1, together with the Cmnd 6721 planning figures for the current year. The tables at the end of this volume give more details.

Public expenditure plans.

<table>
<thead>
<tr>
<th>TABLE 1</th>
<th>£ million at 1977 survey prices</th>
</tr>
</thead>
<tbody>
<tr>
<td>as in Cmnd 6721</td>
<td></td>
</tr>
</tbody>
</table>

**Expenditure on programmes:**
- Central government: £39,582, £41,660, £41,982, £42,419, £42,569 (as in Cmnd 6721)
- Local authorities: £15,399, £15,488, £15,718, £15,889, £15,990
- Total general government: £54,981, £57,148, £57,700, £58,308, £58,559
- Certain public corporations(1): £992, £952, £1,012, £1,002, £1,015
- Total expenditure on programmes: £55,973, £58,100, £58,712, £59,310, £59,575
- Contingency reserve: £750, £750, £1,500, £1,750, £2,000
- Total: £56,723, £58,850, £60,212, £61,060, £61,575
- Debt interest: £2,500, £2,000, £1,900, £1,800, £1,600
- Total public expenditure: £59,223, £60,850, £62,112, £62,860, £63,175
- Total programmes, contingency reserve, and overseas and market borrowing of nationalised industries: £57,263, £58,550, £59,612, £60,860, £61,325

1 Corporations whose capital expenditure is included in public expenditure: mainly the water authorities and housing corporations. These corporations do not include the nationalised industries. A list is given in part 6.

7. The figures for the year immediately ahead, 1978–79, are firm plans. These provide the basis of Estimates, cash limits and rate support grant. The figures for the succeeding years are increasingly provisional: they will be reviewed in successive annual surveys.

8. The planned total of public expenditure programmes and the contingency reserve for 1978–79, adjusted to include the total net borrowing requirement of the nationalised industries (see paragraph 9 below), is approximately £1 billion higher, at 1977 survey prices, than the provisional plans for that year published in Cmnd 6721.

9. Public expenditure, as defined in these White Papers, includes finance provided by the Government to the nationalised industries, whether by loans, public dividend capital or grants. The amount provided by the Government is greatly affected by the net amounts which the industries borrow from, or repay to, overseas lenders or the market. As the Select Committee on
Expenditure have pointed out, such borrowing, or repayments, can distort the year-to-year path of government lending to the industries, and hence of public expenditure as a whole: over the next few years the industries are due to repay substantial amounts borrowed from overseas lenders in the mid-1970s, and to replace this by borrowing from the National Loans Fund. One way of discounting this is to adjust the planned total of programmes and the contingency reserve to include the total net borrowing requirement of the nationalised industries (not just what the Government lends to them). Line 10 of table 1 gives figures for the total adjusted in this way.

10. This adjusted total rises by about 2\% per cent in 1978–79, compared with the Cmnd 6721 plans for the current year (1977–78)\(^1\). The rate of growth in the two succeeding years—1979–80 and 1980–81—is of the order of 2 per cent a year. The present figure for 1981–82 is under 1 per cent, but the plans in the later years are increasingly provisional and subject to revision in subsequent surveys; this applies especially to the final year. The precise figures are:

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978–79</td>
<td>+2.2%</td>
</tr>
<tr>
<td>1979–80</td>
<td>+1.8%</td>
</tr>
<tr>
<td>1980–81</td>
<td>+2.1%</td>
</tr>
<tr>
<td>1981–82</td>
<td>+0.8%</td>
</tr>
</tbody>
</table>

Expenditure in 1976–77

11. At output prices, total public expenditure in 1976–77 was £554\half billion. This was nearly 11 per cent more than the output price figure for 1975–76, but in volume terms (constant prices) the total of programmes excluding debt interest was less than in 1975–76, by nearly 3\half per cent. This fall owed much to a reduction in net government lending to nationalised industries, as the industries borrowed heavily in foreign currency. In total public expenditure including debt interest the fall was somewhat less than in programmes alone, because payments of debt interest increased. Table 2 gives the figures.

12. The outturn of programmes in 1976–77 was less in volume terms than the Cmnd 6721 plans for that year, by about 3\half per cent, or £22\half billion at 1977 survey prices.

13. One major difference between plans and outturn was in programme 5, government lending to nationalised industries. This is a particularly difficult programme to forecast. The 1976–77 outturn figure of £330 million was not only much lower than in the previous year (see paragraph 11 above) but also well below the 1976–77 provision of £917 million in Cmnd 6721: overseas borrowing by the industries was greater than assumed in Cmnd 6721, which provided only for such overseas borrowing as had already been undertaken when the figures were prepared. In addition, both the trading results and the capital expenditure of the nationalised industries turned out differently from the assumptions used in Cmnd 6721.

\(^1\) The increase compared with the latest estimates for 1977–78 is much greater, but this is not a valid comparison: the latest estimates for 1977–78 provide for some underspending but no such provision is made in the plans for 1978–79, although under-spending is likely to occur in that year also. See further paragraphs 21–22.
14. The aggregate outturn in 1976-77 in volume terms on all programmes other than the nationalised industries was about 3 per cent below the planning figure in Cmnd 6721. In some programmes, notably education, health and social security, the difference was slight, but outturn was below the plan in every programme. Details are in tables 14 and 16 and in Part 2.

15. Many factors contributed to this difference. The more extensive use of cash limits was itself probably one, as many programme managers were especially careful to run no risk of exceeding their limits. On the central government programmes covered by cash limits, expenditure (at outturn prices) was about 2 per cent or £600 million below those limits. In volume terms the difference was somewhat greater, since prices rose faster than had been allowed for when the cash limits were set. Another factor was that expenditure on new measures to promote employment turned out less than the original estimate. Other factors included over-provision for refinancing of export credit, unavoidable delays in obtaining some defence equipment, and delays in road building as a result of weather conditions in the second half of the year.

16. The volume of local authority current expenditure was marginally below that envisaged just before the year began for England and Wales, and marginally above for Scotland. The overrun expected last autumn, and built into the Cmnd 6721 figures, did not occur.

### Public Expenditure, 1974-75 to 1977-78

<table>
<thead>
<tr>
<th>TABLE 2</th>
<th>£ million at 1977 survey prices</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Expenditure on programmes:</strong></td>
<td>1974-75</td>
</tr>
<tr>
<td>Central government</td>
<td>39,661</td>
</tr>
<tr>
<td>Local authorities</td>
<td>16,904</td>
</tr>
<tr>
<td>Total general government</td>
<td>56,565</td>
</tr>
<tr>
<td>Certain public corporations(1)</td>
<td>1,138</td>
</tr>
<tr>
<td>Total expenditure on programmes</td>
<td>57,703</td>
</tr>
<tr>
<td>Debt interest</td>
<td>907</td>
</tr>
<tr>
<td>Total public expenditure</td>
<td>58,610</td>
</tr>
</tbody>
</table>

| Total programmes and overseas and market borrowing of nationalised industries | 58,743 | 59,077 | 57,635 | 54,739 |

1 See note (1) to table 1.

### Expenditure in 1977-78

17. Table 2 summarises the estimate of outturn in 1977-78 used in this White Paper, alongside the latest estimates for the past three years. For 1977-78 the volume of expenditure on programmes is now put at about 95 ½ per cent
of the Cmd 6721 provision for programmes and contingency reserve. In addition, the expected net outturn of debt interest is significantly below the figures in Cmd 6721.

18. A considerable part of the difference of 4½ per cent between the outturn for programmes now expected and the earlier plans is attributable to two major items: government lending to nationalised industries, which is again expected to be substantially lower than planned initially, and refinancing of export and shipbuilding credit, which, partly owing to the new arrangements with the banks, is expected to show net repayments to the government this year. Apart from these two items, the outturn is now estimated at over 97 per cent of the Cmd 6721 plans.

19. The changes from Cmd 6721 reflect many causes. For example, lower interest rates have reduced the scale of housing subsidies, some delay is still being experienced in defence works and procurement programmes and, in some cases, firmer estimates of expenditure in 1976–77 have led to revised estimates for the current year.

20. The value of central government expenditure covered by cash limits in the first half of the financial year was about 3½ per cent below what departments had expected at the beginning of the year. For the year as a whole the estimates given in this White Paper reflect the belief of departments that the volume of their expenditure over the full year will be somewhat nearer the initial plans. For local authority current expenditure the figures now given are consistent with those available at the time of the negotiation of the rate support grant for 1978–79.

21. Some continuing divergence between planning figures and outturn is to be expected in future years. Any system of control which applies limits to programmes will normally result in outturns being somewhat less than planned levels. The likelihood of such shortfall is taken into account in the forecasts for the economy and the public sector borrowing requirement which inform the Government’s consideration of public expenditure, and hence in the decisions on the planned level of expenditure.\(^1\)

22. How completely plans will be achieved in any one year is hard to predict, particularly in the light of recent experience. There is a general tendency to over-estimate the extent to which expenditure can be increased rapidly in the short run. But increasing familiarity with the new control and information systems should promote a closer match between estimates and outturn.

### Expenditure plans, 1978–79 and after

**Central government**

23. The main services provided by the central government (including transfer payments) account for over 70 per cent of total programmes. Figures for these services are summarised in table 3.

---

\(^1\) An allowance for shortfall is made below in the table 9 projections of expenditure and revenue.
24. About 40 per cent of public expenditure by the central government, excluding debt interest, is on goods and services, the largest elements being defence and the national health service. The remainder consists of transfer payments—including social security benefits, housing subsidies and industrial support—and net lending, which includes loans to nationalised industries.

Nationalised industries

25. The table 3 figures for public expenditure by the central government include provision for government lending to the nationalised industries. Estimates of this lending are shown in table 4, along with estimates of the total net borrowing requirement of the industries, which are included in the adjusted planning total in table 1. The differences between the two sets of figures reflect the industries' net borrowing from, or repayments to, the market and overseas, and in particular the major programme of foreign currency and market debt repayments which the industries are expected to make between 1978-79 and 1980-81. The precise timing of this programme is uncertain. If repayments were made sooner than assumed in table 4, that would affect the figures for net government lending, but total net borrowing by the industries would not be affected to any great extent.

Nationalised industries' borrowing

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Net government lending</td>
<td>330</td>
<td>420</td>
<td>1,350</td>
<td>1,550</td>
<td>1,350</td>
<td>1,100</td>
</tr>
<tr>
<td>Total net borrowing (other than short-term)</td>
<td>1,764</td>
<td>950</td>
<td>1,050</td>
<td>950</td>
<td>1,150</td>
<td>850</td>
</tr>
</tbody>
</table>

26. The estimates for total net borrowing show the industries' requirements for loans from all sources and for public dividend capital. They depend on assumptions about the level of investment by the industries, their markets, pricing policies and productivity. They may need to be revised further when the Government has completed the process of setting financial targets for each of the industries, and in the light of the current consideration of the problems of the British Steel Corporation.
27. Notwithstanding these uncertainties, the fall in the industries' overall net borrowing requirement after 1976-77 marks an improvement in the financial position of most of them. After the deficits caused by price restraint in the early 1970s most of the industries are now profitable again as a result of the progressive return to economic pricing. They are therefore able to make a substantial contribution to the financing of their own investment which is expected to amount to about £3½ billion in 1977-78 and in 1978-79. It is part of the Government's medium term expenditure strategy that this improvement in the industries' financial position should be maintained.

28. Volume II contains a commentary on each of the nationalised industry programmes and presents figures for the industries' capital investment programmes and their financing.

Local authorities

29. Local authorities are responsible for more than one-quarter of public expenditure. They are responsible for the greater part of expenditure on education (which accounts for more than half of their current expenditure), on housing (which accounts for a similar proportion of their capital spending), and on other environmental services. They employ more than one in ten of the working population.

30. The Government does not have the same direct control over expenditure by local authorities as over its own spending. Part I of Cmnd 6721 explained the means of influence open to the Government and the extent to which the Government's ability to regulate this expenditure within a reasonable margin is dependent on the co-operation of local government. Green Papers on Local Government Finance (Cmnd 6811 and 6813) were published in May 1977 following the report of the Layfield Committee. These emphasised the need to develop, on a partnership basis between central and local government, the duties and responsibilities involved in the provision of local public services. They proposed financial arrangements designed to give a substantial degree of local autonomy while safeguarding the central government's economic responsibilities and policy interests. This was intended to provide a satisfactory long-term basis for ensuring that total local authority expenditure was maintained at a level which the country can afford. Discussions are continuing with the local authority associations about these proposals.

31. Over the past three years, current expenditure by local authorities has had to be reined back. A year ago it was still feared that the adjustment was not being achieved as quickly as the Government had hoped, and that an absolute reduction in the volume of expenditure might be required in 1978-79. In the event, a rate of growth which had reached nearly 10 per cent in the one year 1974-75 has been succeeded by an increase of only about half that amount over the whole of the following three-year period.

32. General recognition of the requirements of the economic situation, and restrictions on the availability of government finance, have no doubt contributed to the speed with which this necessary adjustment has been achieved. But it also illustrates the increasingly close co-operation between central and
local government in the planning and control of public expenditure, through the Consultative Councils on Local Government Finance in England and Wales and in discussions with the Convention of Scottish Local Authorities.

**Public expenditure by local authorities (Great Britain)**

<table>
<thead>
<tr>
<th>TABLE 5</th>
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<tr>
<td>£ million at 1977 survey prices</td>
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</thead>
<tbody>
<tr>
<td>Current expenditure:</td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Environmental services(1)</td>
<td>1,382</td>
<td>1,431</td>
<td>1,466</td>
<td>1,445</td>
<td>1,483</td>
</tr>
<tr>
<td>Law, order and protective services</td>
<td>1,321</td>
<td>1,378</td>
<td>1,393</td>
<td>1,416</td>
<td>1,432</td>
</tr>
<tr>
<td>Education and libraries, science and arts</td>
<td>6,351</td>
<td>6,384</td>
<td>6,438</td>
<td>6,535</td>
<td>6,568</td>
</tr>
<tr>
<td>Health and personal social services</td>
<td>987</td>
<td>1,012</td>
<td>1,044</td>
<td>1,072</td>
<td>1,096</td>
</tr>
<tr>
<td>Other programmes</td>
<td>1,664</td>
<td>1,541</td>
<td>1,502</td>
<td>1,495</td>
<td>1,513</td>
</tr>
<tr>
<td>Total</td>
<td>11,705</td>
<td>11,746</td>
<td>11,843</td>
<td>11,962</td>
<td>12,090</td>
</tr>
<tr>
<td>Capital expenditure</td>
<td>4,815</td>
<td>3,945</td>
<td>3,083</td>
<td>3,282</td>
<td>3,376</td>
</tr>
<tr>
<td>Total</td>
<td>16,520</td>
<td>15,691</td>
<td>14,926</td>
<td>15,244</td>
<td>15,467</td>
</tr>
</tbody>
</table>

(1) Programme 8 “other environmental services”

33. It is no longer necessary for the total volume of current expenditure to be cut in 1978–79. After taking account of demographic factors and of the continuing revenue effects of capital projects, there will be little scope for improvements in the level of service provision, and continued restraint in local authority spending plans will be necessary. However, as the figures in table 5 show, the rate support grant settlements for 1978–79 provide for some resumption of growth in the total of current expenditure.

34. Similarly, the plans in Cmd 6721 for the capital expenditure of local authorities also provided for a reduction in 1978–79 compared with the current year. Now it is possible to look ahead to a small increase. The figures shown in table 5 reflect the special measures to assist the construction industry announced during 1977.

35. The Government will be discussing the implications of the plans in this White Paper for the years after 1978–79 with the local authority associations in the Consultative Councils and the Convention in the normal course of the next public expenditure survey.

36. The definition of local authority current expenditure for White Paper purposes differs in certain respects from “relevant expenditure” which is the aggregate on which the level of government grants to local authorities is based each year following the rate support grant discussions. For 1978–79 the percentage of aggregate Exchequer grant has been fixed at the same level as for 1977–78, that is 61 per cent for England and Wales and 68½ per cent for Scotland. Table 6 shows how relevant expenditure has been financed since 1975–76 as between central and local sources of revenue and how the Government expects it will be financed next year. A reconciliation between local authority current expenditure in public expenditure survey terms and “relevant expenditure” is given in Volume II of this White Paper.
Financing of local authority relevant expenditure (Great Britain)

TABLE 6

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total expenditure(1)</td>
<td>11,230</td>
<td>12,610</td>
<td>13,990</td>
<td>15,120</td>
</tr>
<tr>
<td>Government grants</td>
<td>7,420</td>
<td>8,260</td>
<td>8,610</td>
<td>9,280</td>
</tr>
<tr>
<td>Local rates, including rate rebate grants and changes in local balances</td>
<td>3,810</td>
<td>4,350</td>
<td>5,380</td>
<td>5,840</td>
</tr>
</tbody>
</table>

1 Includes a small element of expenditure met from rates which is not relevant for grant purposes.

Contingency reserve

37. The planning totals for the years ahead include substantial contingency reserves to cover unforeseen items and items which cannot be properly quantified at this stage. The scale of provision is shown in table 1, line 6. The size of the contingency reserve for the later years is reviewed along with the spending programmes in each successive annual survey.

38. As explained in Cmnd 6721, any addition to a programme decided upon during the year is charged against the contingency reserve if it cannot be offset by an appropriate saving in the programme concerned or other programmes. The arrangements for approving claims on the contingency reserve, and for monitoring these claims, form an important part of the Government’s procedures for control of public expenditure.

Debt interest

39. The figures for total public expenditure shown in table 1 include debt interest, but debt interest payments are not included in the planning totals discussed in paragraphs 7-10 above. In Cmnd 6721 a new concept of debt interest payments was introduced, including only those payments which have to be financed from taxation or further government borrowing. Payments met from interest receipts on money lent, or for which provision is made from trading surpluses or rents, are excluded.

40. On this basis the estimate for 1977-78 is £1,850 million compared with the 1976-77 figure of £1,700 million (both at 1977 survey prices). The estimates for this year and next are substantially below those in Cmnd 6721, which were £2,650 million and £ million respectively, on a comparable basis. The reductions are due mainly to lower borrowing and interest rates than were assumed when the Cmnd 6721 estimates were made. Volume II of this White Paper gives a fuller explanation.

Analysis by economic category

41. Tables 10 and 12 show that the economic analysis of public expenditure is not expected to change much over the planning period. Current expenditure on goods and services, which now accounts for nearly half the total, continues to rise slowly.
42. Public expenditure on fixed investment increases over the planning period but remains relatively low compared with the years up to 1975-76. Most of it is construction work, and the extra spending on construction announced during 1977 means that a steady level of direct public spending on construction in the next four years is now planned, at rather over £4½ billion a year. In addition, government grants and lending help to finance other construction work, for example by the nationalised industries and housing associations. If construction expenditure by those bodies is included, the total planned level of public spending on construction rises to some £6½ billion in 1978-79 and some £6½ billion in 1981-82. Fuller details are being published separately and will appear in the next issue of "Housing and Construction Statistics".

43. Transfer payments increase in total over the planning period, with some changes in composition. Payments to individuals, notably of pensions and other social security benefits, continue to rise, while subsidies tend to fall. There are marked changes in net lending, including the increased government lending to nationalised industries and the reduced government refinancing of fixed rate export and shipbuilding credit mentioned earlier.

**Public expenditure and gross domestic product (GDP)**

44. In the first half of this decade public expenditure continued to grow at much the same rate as in the previous decade, while national disposable income grew very little, partly because of the slow growth in output and partly because of the deterioration in the terms of trade. The ratio of total public expenditure to GDP(1) increased from 38 per cent in 1971-72 to 46½ per cent in 1975-76, and fell to 44½ per cent in 1976-77.

45. This ratio is not a wholly satisfactory indicator of the importance of the public sector in the economy as a whole. Total public expenditure includes transfers and loans to the private sector, which require government taxation or borrowing but finance private, not public, consumption and investment. Moreover, the total is affected by changes in the extent to which the nationalised industries rely on the Government to meet their external financing needs.

46. For some purposes a more useful ratio is that for general government's expenditure on goods and services. This ratio rose from 22½ per cent of GDP in 1971-72 to 27 per cent in 1975-76, and fell to 26 per cent in 1976-77. On either basis there was a sharp increase up to 1975-76 followed by some fall last year. Table 7 gives a run of figures.

---

1 To calculate these ratios total public expenditure is taken at current prices (or, for future years, in cost terms) and increased by an estimate of the value of government capital assets consumed during the year to make the figures comparable with the figures of GDP. The latter are measured at market prices (inclusive of indirect taxes and net subsidies) because this is the valuation basis of the public expenditure figures. The provision for capital consumption was included in the figures for government consumption and GDP this year for the first time in place of the former concept of notional or imputed rent on buildings owned and occupied by the Government.

2 Central government and local authorities.
47. On present expenditure plans and the illustrative assumptions on GDP growth made in paragraph 6, the ratios would tend downwards over the planning period—especially the general government goods and services ratio. The growth of transfer payments in the total is likely to keep the ratio of total public expenditure to GDP well above what it was in the early 1970s.

The economic context

48. In all industrialised countries the period since the oil price increases in late 1973 has been marked by high levels of unemployment and by rates of inflation which have remained high by previous standards. The persistence of inflation and, in many cases, the external financing problems created by the oil producers' surpluses have inhibited actions by governments to stimulate activity. Except in the United States, recovery from the recession has been hesitant and insufficient to stem the tide of rising unemployment. World trade has been depressed.

49. In spite of this, considerable progress was made in 1977 in carrying through the adaptation of the UK economy, and in particular in removing the financial imbalances that had proved so disruptive in 1976. The current account of the balance of payments moved into surplus, helped by the increasing flow of North Sea oil and an improvement in the terms of trade but also by a strong rise in the volume of exports. The rate of inflation decelerated. Confidence returned to the financial markets and was reflected both in lower interest rates and the strength of sterling.

50. In contrast to the financial indicators the real economy was sluggish. It became both feasible and desirable to give a stimulus to activity. In October the Chancellor of the Exchequer announced measures estimated to raise the rate of growth by about 1 per cent in 1978, to 3\(\frac{1}{2}\) per cent. He emphasised that attainment of this faster growth rate would depend on an average earnings rise in the current pay round consistent with the Government's guidelines, that is, not more than 10 per cent. Any faster rise in earnings would reduce growth by its adverse effects on confidence, interest rates and competitiveness.

51. The uncertainty over the future rate of inflation poses the major question mark over the medium-term prospects for the economy. A second uncertainty, partly linked with inflation, concerns the growth of productivity, and hence of
the economy's productive potential. Over the 25 years or so up to the beginning of the recent recession the trend rate of growth of gross domestic product was 2½ per cent a year. Over the past four years output has been virtually flat, and there has been almost no growth in recorded productivity. It is impossible to say how much of this absence of growth of productivity is cyclical—and so will be made good as output recovers—and how much it reflects a downward shift in the underlying growth of productivity. There are some grounds for thinking that the large changes in energy prices in 1973 and the low levels of investment in recent years may affect the future growth of productivity. This is an uncertain assumption, but, even allowing for the faster growth of labour supply and the contribution made by the rising output of North Sea oil, in the light of the available evidence it would be imprudent to count on a faster growth of productive potential than 3 per cent a year.

52. The economy, however, has excess capacity, which should permit for a period a rate of growth above that of productive potential. The extent of this slack, and the pace at which it can be taken up, are not easy to determine. The unemployed capacity—both labour and plant—is unevenly distributed, and there are physical constraints on the pace at which manufacturing output can grow without leading to over-heating in some sectors and a sharp worsening of the trade balance. It is essential to aim at a rate of growth that can be sustained over a number of years.

53. That rate of growth will be largely determined by developments in three areas—inflation, productivity and the growth of the world economy. On the last of these, concerted efforts are needed to raise demand and bring down unemployment in the industrialised countries; but the persisting problems of inflation and the OPEC surplus make it unlikely that action taken in the near future will be sufficient to return world trade to the growth rate seen on average in the decade before the oil price rise.

54. In this situation it is more than ever important for British industry to improve its competitiveness both by containing costs and by raising productivity. Only in this way can both high employment and an external current account surplus sufficient for our needs be achieved.

55. Provided inflation is contained and there is some recovery in world trade, the economy should be able to grow at above its past trend rate. But on present prospects a marked improvement in industrial performance would be necessary to sustain a growth rate above 3½ per cent over the next few years. The aim must be to achieve such an improvement; but it cannot be assumed in advance as a basis for planning public expenditure. A growth rate of 3½ per cent would be better than has been achieved on average since the war. But with the current degree of unemployment and the bonus of North Sea oil it would be disappointing if this were the limit. It should bring down unemployment, but the reduction would be gradual. Even growth of 3½ per cent, however, cannot be taken for granted unless inflation is controlled.

56. Table 8 provides an illustrative projection of a pattern of demand that might be associated with a growth of 3½ per cent in GDP and a growth of
about 2 per cent in the volume of public expenditure on goods and services. Table 8 sets this out in a rather longer perspective, covering the decade before the oil price rise and the years of recession and adjustment after it. The changes shown for 1977–82 are not forecasts: they are simply intended to illustrate one possible pattern of expenditure that would be consistent with the assumed growth of output.

### Gross domestic output and expenditure

**TABLE 8**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumers’ expenditure(1)</td>
<td>2 ½</td>
<td>- ½</td>
<td>3 ½</td>
<td>1 ½</td>
</tr>
<tr>
<td>Public authorities’ consumption</td>
<td>2 ¼</td>
<td>2 ½</td>
<td>2 ¼</td>
<td>2 ½</td>
</tr>
<tr>
<td>Gross fixed investment</td>
<td>3 ½</td>
<td>- ½</td>
<td>7 ½</td>
<td>5 ½</td>
</tr>
<tr>
<td>Increase in stock levels</td>
<td>3 ½</td>
<td>3 ½</td>
<td>3 ½</td>
<td>3 ½</td>
</tr>
<tr>
<td>Exports of goods and services</td>
<td>6 ½</td>
<td>4 ½</td>
<td>7 ½</td>
<td>5 ½</td>
</tr>
<tr>
<td>Total final expenditure</td>
<td>3 ½</td>
<td>4 ½</td>
<td>4 ½</td>
<td>4 ½</td>
</tr>
<tr>
<td>Imports of goods and services</td>
<td>2 ½</td>
<td>1 ½</td>
<td>8 ½</td>
<td>5 ½</td>
</tr>
<tr>
<td>Gross domestic product at market prices</td>
<td>3 ½</td>
<td>0</td>
<td>3 ½</td>
<td>2 ½</td>
</tr>
<tr>
<td>Gross domestic product at factor cost</td>
<td>2 ½</td>
<td>0</td>
<td>3 ½</td>
<td>2 ½</td>
</tr>
</tbody>
</table>

1 Including consumption financed by public expenditure on transfers.

57. Table 8 brings out the contrast between the trends in the years before 1973 and developments in the past four years. Between 1973 and 1977 there was no change in output and real national disposable income fell by 2.3 per cent, reflecting the adverse movement in the terms of trade. Whereas public and personal consumption had been growing more or less in line in the earlier period, they diverged after 1973: personal consumption actually fell between 1973 and 1977 while public authorities consumption rose at an average annual rate of 2 ½ per cent. The fall in real take-home pay was even sharper than the fall in consumption, which was moderated by substantial increases in social security benefits. Total public expenditure, in cost terms, rose at an average rate of 3 ½ per cent a year between 1973–74 and 1977–78. Investment, public and private, fell during the period. But there was a substantial improvement in the balance of payments—from a current account deficit of almost £1 billion in 1973 (and £3.5 billion in 1974) to a surplus in 1977.

58. Along with a satisfactory balance of payments, the first claim on higher output must be investment. A rise in the proportion of national income devoted to industrial investment is essential both for underpinning the faster growth rate assumed and more generally for increasing industrial efficiency and providing more employment.

59. After meeting these needs for industrial investment a 3 ½ per cent growth of output would provide more resources for public and private consumption and other investment than has been available in the past. On the illustrative projections above, a growth of 2 per cent a year in public expenditure on goods and services and the rise in transfer payments in the public expenditure plans would permit personal consumption to grow by around 3 ½ per cent a year. This would be considerably above the past trend, but would still leave
the average increase in personal consumption in the years 1973–82 at under 2 per cent, compared with an average increase in public authorities’ consumption of 2½ per cent over the same period.

Revenue projections and general government balance
60. Table 9 gives projections of the revenue and expenditure, and of the financial balance and borrowing requirement, of general government for the first three years of the survey period. The projections relate to the borrowing requirement of general government (ie central and local government) rather than the more familiar concept of the public sector borrowing requirement, which also includes borrowing by nationalised industries and other public corporations from sources outside government. The definition of public expenditure in these White Papers is now close to that of general government expenditure. The figures in the table are on the basis used by the Central Statistical Office for general government receipts and expenditure, as published in “Financial Statistics”.

<table>
<thead>
<tr>
<th>Table 9</th>
<th>General Government account</th>
<th>£ billion at 1976–77 prices</th>
</tr>
</thead>
<tbody>
<tr>
<td>Receipts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Taxes on income and expenditure</td>
<td>36·8</td>
<td>36·2</td>
</tr>
<tr>
<td>2. Capital taxes</td>
<td>0·9</td>
<td>0·8</td>
</tr>
<tr>
<td>3. National insurance contributions(1)</td>
<td>8·8</td>
<td>8·4</td>
</tr>
<tr>
<td>4. Other receipts</td>
<td>2·4</td>
<td>2·6</td>
</tr>
<tr>
<td>5. Interest receipts</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Total receipts</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Expenditure</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Expenditure on goods and services</td>
<td>32·5</td>
<td>30·2</td>
</tr>
<tr>
<td>2. Grants and subsidies(2)</td>
<td>19·3</td>
<td>19·5</td>
</tr>
<tr>
<td>3. Contingency reserve</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>4. Shortfall(3)</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>5. Interest payments</td>
<td>5·7</td>
<td>5·8</td>
</tr>
<tr>
<td>Total expenditure</td>
<td>57·5</td>
<td>55·5</td>
</tr>
<tr>
<td>Financial balance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5·5</td>
<td>3·4</td>
<td>4·4</td>
</tr>
<tr>
<td>Net lending and miscellaneous capital receipts, etc</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>-1·8</td>
<td>-0·9</td>
<td>-1·0</td>
</tr>
<tr>
<td>General government borrowing requirement(4)</td>
<td>-7·3</td>
<td>-5·5</td>
</tr>
</tbody>
</table>

1 Includes national health service and redundancy and maternity fund contributions.
2 Includes increase in book value of stocks.
3 See paragraph 63.
4 Minus sign indicates a borrowing requirement.

61. The projections for 1977–78 and 1978–79 are consistent with the forecasts for the public sector borrowing requirement published on 26 October. For 1979–80, they are based on the assumption that GDP will continue to
grow at $3\frac{1}{2}$ per cent and that private sector expenditure will be sufficient to produce a level of demand consistent with that growth rate. The figures for 1979–80 are thus not forecasts, but illustrations of what might be consistent with one assumption concerning the growth of GDP.

62. The figures of revenue for 1977–78 and 1978–79 are based on the existing tax rates and the levels of personal allowances announced by the Chancellor of the Exchequer on 26 October 1977. The projections for 1979–80 assume existing tax rates and an increase in personal allowances in line with the forecast rise in retail prices during 1978, following the provisions of the 1977 Finance Act.

63. The figures for public expenditure are based on current programmes, but a number of adjustments have been necessary to make the series consistent with the national accounts concepts used by the CSO. As the table shows the balance of receipts and expenditure, it is necessary also to make some allowance for the likelihood that, for the reasons explained in paragraphs 21–22 above, the outturn of expenditure programmes as a whole will fall somewhat below the planned level. Past experience shows that this kind of underspending varies considerably and cannot be closely predicted for any particular year. For 1977–78, the expenditure figures in this White Paper have already been revised downwards on this account. For 1978–79 and 1979–80, the allowance represents only a very broad judgment about the possible outcome, having regard to the experience of the previous two years, but assuming some improvement in the match between outturn and plans as a result of greater familiarity with the new control and monitoring systems.

64. As with the forecast published on 26 October the projections assume growth of average earnings at 10 per cent a year and an effective exchange rate index of 62\frac{1}{4}. Both expenditure and revenue are expressed at 1976–77 prices.

65. Forecasts of borrowing requirements are subject to a wide margin of error. The borrowing requirement is the difference between two large flows, and proportionately small changes in either can be large in relation to the borrowing requirement itself.

66. The projections show total tax revenue (at 1976–77 prices) declining in the current year, reflecting the changes in tax rates and allowances during 1977, but thereafter increasing faster than GDP. An important element in this rise is the growing volume of tax and royalty revenues arising from North Sea oil. These account for approximately £1·4 billion of the £4·1 billion projected rise in tax revenue between 1977–78 and 1979–80. The fall in the real value of social security contributions between 1976–77 and 1977–78 is largely accounted for by the movement of real earnings. For future years it has been assumed that the annual receipts and outgoings of the National Insurance Fund are roughly in balance.
67. Total general government receipts are projected to rise by about 8 per cent between 1977–78 and 1979–80, and total expenditure by 5 per cent. Thus, at unchanged tax rates, the general government borrowing requirement, at 1976–77 prices, is projected to fall through the period from about £5·5 billion in 1977–78 to about £4·5 billion in 1979–80.

Conclusion

68. An overall growth of public expenditure along the lines detailed in this White Paper should permit a sustained improvement in standards, while allowing at the same time a substantial growth in personal consumption after four years of no growth. The illustrative figure of 3½ per cent annual growth of gross domestic product used in the projections above is, it must be emphasised, not a prediction. If industrial performance improves it should be possible to sustain a faster growth than this. But, equally, a growth of 3½ per cent cannot be counted upon if inflation is not contained. There is now, thanks to North Sea oil and the adjustments carried out to the economy in the past year, an opportunity to move to a higher rate of growth than has been achieved for many years. But it is only an opportunity. To make it a reality is the major task now facing government, management and unions, and the nation as a whole.
<table>
<thead>
<tr>
<th>Programme and In Total</th>
<th>£ million at 1977 survey prices</th>
</tr>
</thead>
<tbody>
<tr>
<td>Defence</td>
<td>6,451</td>
</tr>
<tr>
<td>Overseas aid and other</td>
<td>1,185</td>
</tr>
<tr>
<td>services</td>
<td></td>
</tr>
<tr>
<td>Agriculture, fisheries</td>
<td>881</td>
</tr>
<tr>
<td>and forestry</td>
<td></td>
</tr>
<tr>
<td>Trade, industry and</td>
<td>747</td>
</tr>
<tr>
<td>employment:</td>
<td></td>
</tr>
<tr>
<td>Refinance of home</td>
<td>2,271</td>
</tr>
<tr>
<td>shipbuilding and fixed</td>
<td></td>
</tr>
<tr>
<td>rate export credit</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
</tr>
<tr>
<td>Government lending to</td>
<td>2,085</td>
</tr>
<tr>
<td>nationalised industries</td>
<td></td>
</tr>
<tr>
<td>Roads and transport</td>
<td>2,316</td>
</tr>
<tr>
<td>Housing</td>
<td>3,125</td>
</tr>
<tr>
<td>Other environmental</td>
<td>2,608</td>
</tr>
<tr>
<td>services</td>
<td></td>
</tr>
<tr>
<td>Law, order and</td>
<td>1,527</td>
</tr>
<tr>
<td>protective services</td>
<td></td>
</tr>
<tr>
<td>Education and libraries</td>
<td>7,600</td>
</tr>
<tr>
<td>and arts</td>
<td></td>
</tr>
<tr>
<td>Health and personal</td>
<td>6,514</td>
</tr>
<tr>
<td>social services</td>
<td></td>
</tr>
<tr>
<td>Social security</td>
<td>10,675</td>
</tr>
<tr>
<td>Other public services</td>
<td>982</td>
</tr>
<tr>
<td>Common services</td>
<td>802</td>
</tr>
<tr>
<td>Northern Ireland</td>
<td>1,397</td>
</tr>
<tr>
<td>Total programmes</td>
<td>51,366</td>
</tr>
<tr>
<td>Contingency reserve</td>
<td>51,366</td>
</tr>
<tr>
<td>Total</td>
<td>51,366</td>
</tr>
<tr>
<td>Debt interest</td>
<td>913</td>
</tr>
<tr>
<td>Total</td>
<td>52,279</td>
</tr>
<tr>
<td>Total programmes,</td>
<td>51,603</td>
</tr>
<tr>
<td>contingency reserve</td>
<td></td>
</tr>
<tr>
<td>and overseas and market</td>
<td></td>
</tr>
<tr>
<td>borrowing of nationalised industries</td>
<td>51,603</td>
</tr>
<tr>
<td>¹ Net of £559 million for proceeds of sale of shares in the British Petroleum Company.</td>
<td></td>
</tr>
<tr>
<td>-----------------------</td>
<td>---------</td>
</tr>
<tr>
<td><strong>Current expenditure</strong></td>
<td></td>
</tr>
<tr>
<td>Wages and salaries</td>
<td>15,325</td>
</tr>
<tr>
<td>Other current expenditure on goods and services</td>
<td>8,886</td>
</tr>
<tr>
<td>Subsidies</td>
<td>2,122</td>
</tr>
<tr>
<td>Current grants to persons</td>
<td>11,641</td>
</tr>
<tr>
<td>Current grants to private bodies</td>
<td>859</td>
</tr>
<tr>
<td>Current grants abroad</td>
<td>487</td>
</tr>
<tr>
<td><strong>Total excluding debt interest</strong></td>
<td>39,320</td>
</tr>
<tr>
<td><strong>Capital expenditure</strong></td>
<td></td>
</tr>
<tr>
<td>Gross domestic fixed capital formation</td>
<td>6,450</td>
</tr>
<tr>
<td>Increase in value of stocks</td>
<td>130</td>
</tr>
<tr>
<td>Capital grants</td>
<td>1,513</td>
</tr>
<tr>
<td>Net lending to the private sector</td>
<td>560</td>
</tr>
<tr>
<td>Net lending to overseas governments</td>
<td>2,129</td>
</tr>
<tr>
<td>Drawings from United Kingdom subscriptions to international lending bodies</td>
<td>301</td>
</tr>
<tr>
<td>Other net lending and investment abroad</td>
<td>66</td>
</tr>
<tr>
<td>Cash expenditure on company securities (net)</td>
<td>702</td>
</tr>
<tr>
<td>Capital transfers abroad</td>
<td>126</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>12,047</td>
</tr>
<tr>
<td>Contingency reserve</td>
<td>750</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>51,366</td>
</tr>
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1 The principal corporations other than nationalised industries are the National Enterprise Board and the Scottish and Welsh Development Agencies. A list is given in part 6.
### TABLE 12

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<th>Public Expenditure by Spending Authority and Programme and in Total</th>
<th>£ million at 1977 survey prices</th>
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</tr>
<tr>
<td>Health and personal social services</td>
<td>5,695</td>
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<tr>
<td>Education and libraries, science and arts</td>
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<td>Social security</td>
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<td>Other programmes including Northern Ireland</td>
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<td><strong>Total programmes</strong></td>
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<td>Other environmental services</td>
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<td>Law, order and protective services</td>
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1 Corporations whose capital expenditure is included in public expenditure; mainly the water authorities and housing corporations. A list is given in part 6.
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1 See note 1 to table 11. 2 See note 2 to table 12.
## COMPARISON OF PLANNED EXPENDITURE AND ESTIMATED OUT
## TURN IN 1976-77 AND 1977-78 BY SPENDING AUTHORITY AND ECONOMIC CATEGORY

### TABLE 14

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<th>1977-78</th>
<th>Percentage change</th>
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1. See note 1 to table 11.
2. See note 1 to table 12.
# SUMMARY OF CHANGES SINCE CMND 6721

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1 In addition to the programmes shown, many of these changes affect expenditure on programme 15—Northern Ireland.

2 Includes employment package announced on 3 March.

3 Excludes refinancing of home shipbuilding lending and fixed rate export credits and government lending to nationalised industries for which no estimates were published in Cmd 6721.
### CHANGES TO EXPENDITURE PROGRAMMES SINCE CMND 6721

#### Table 16

- **£ million at 1977 survey prices**

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<td>1. Defence</td>
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<td>Statement of 26 October: construction</td>
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<td>-117</td>
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<td>3. Agriculture, fisheries, food and forestry</td>
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<td>Other announced changes:</td>
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<td>Pig subsidy (20 January)</td>
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<td>4. Trade, industry and employment</td>
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<td>March 1977 Budget measures: employment schemes*</td>
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<td>Statement of 29 June: employment measures</td>
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<tr>
<td>Construction</td>
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<td>Coal for Scottish power stations (12 March)</td>
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<td>Rephasing of grants to Govan Shipbuilders (29 June)</td>
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<td>Instrumentation and automation industry (9 August)</td>
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<td>+2</td>
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<td>Energy conservation</td>
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<td>Other changes:</td>
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<td>Refinancing of home shipbuilding lending and fixed rate export credits</td>
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<td>+368*</td>
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*Note: Figures represent changes in expenditure compared to the previous year.
### CHANGES TO EXPENDITURE PROGRAMMES SINCE CMND 6721—continued

#### TABLE 16 (continued) £ million at 1977 survey prices

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<td>+4</td>
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<td>Statement of 26 October: construction</td>
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<td>+28</td>
<td>+12</td>
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<td>Other announced changes</td>
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<td>+66</td>
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<td>7. Housing</td>
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<td>Statement of 16 October: construction</td>
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<td>Other announced changes</td>
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<td>Housing improvements (2 May)</td>
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<td>Local authority mortgage lending etc, Wales (20 June)</td>
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<td>Local authority mortgage lending etc, Scotland (30 June)</td>
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<td>8. Other environmental services</td>
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<td>March 1977 Budget measures: inner cities construction</td>
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<td>+11</td>
<td>+11</td>
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<tr>
<td>Construction</td>
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<td></td>
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<td>Extension of eligibility for free school meals</td>
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<td>Statement of 26 October: Teachers in deprived areas</td>
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(i) = includes equalisation of costs to the years concerned.
**CHANGES TO EXPENDITURE PROGRAMMES SINCE CMND 6721—continued**

**TABLE 16 (continued)**

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<td>Health authorities</td>
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<td>Local authorities’ personal social services</td>
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<td>Other announced changes:</td>
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<td>Withdrawal of NHS road traffic accidents charges scheme (14 February)</td>
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| **12. Social security** |         |         |         |         |         |
| March 1977 Budget measures: |         |         |         |         |         |
| Effect of tax changes on child benefit tax offset |         |         |         |         |         |
| Statement of 25 May: 1977 uprating of benefits |         | +46     | +120    | +120    | +120    |
| Statement of 15 July: child benefit |         | +7      | +314    | +308    | +302    |
| Statement of 26 October: |         |         |         |         |         |
| Christmas bonus for pensioners |         | +97     | +14     | +18     | +19     |
| Uprating of mobility allowance |         |         |         |         |         |
| Effect of tax changes on child benefit tax offset |         | +3      | +14     | +14     | +14     |
| Other announced changes: Miscellaneous Provisions Bill (22 March) |         | -9      | -222    | +13     | +244    | +456    |
| Other changes             |         |         |         |         |         |
|                          |         | -9      | -54     | +494    | +723    | +930    |

| **13. Other public services** |         |         |         |         |         |
| Statement of 26 October: construction |         |         |         |         |         |
| Other changes              |         | -33     | -15     | +2      | +4      | +2      |
|                          |         | -33     | -15     | +2      | +4      | +2      |

| **14. Common services** |         |         |         |         |         |
| Statement of 26 October: construction |         |         |         |         |         |
| Other changes              |         | -43     | -11     | +3      | +4      | +4      |
|                          |         | -43     | -11     | +22     | +8      | +19     |

| **15. Northern Ireland** |         |         |         |         |         |
| Announced changes: consequentials of changes to GB programmes |         | +1      | +14     | +33     | +31     | +24     |
| Other changes              |         | -98     | -23     | +35     | +28     | +37     |
|                          |         | -97     | -9      | +68     | +59     | +61     |
| Total changes to programmes |         | -2,386  | -1,764  | +1,614  | +1,090  | +1,830  |

1 Cmnd 6721—1, paragraph 4, explained that the figures for 1979–80 and 1980–81 were even more provisional than usual, since they had not been further reviewed in the light of the developments which had led to the reductions in programmes for 1977–78 and 1978–79 announced on 15 December 1976. The changes for these years in this White Paper need to be read with this in mind.

8 Increased expenditure on market regulation under the common agricultural policy, partly offset by reductions in net EEC contributions.

5 Includes employment package announced on 3 March.

6 Excludes refinancing of home shipbuilding lending and fixed rate export credits for which comparable estimates were not published in Cmnd 6721.

6 No comparable estimates published in Cmnd 6721.

* These changes are mainly due to changed forecasts of the need for housing subsidy (see part 2, chapter 7, paragraph 5).

See footnote * to table 14.
### TABLE 17 £ million at 1977 survey prices

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<tr>
<td>Current: goods and services</td>
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<td>+10</td>
<td>+14</td>
<td>+14</td>
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<td>subsidies and grants</td>
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1 See footnote (*) to table 15.
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1 See footnote (1) to table 15.
BENEFITS OF NORTH SEA OIL

Memorandum by the Chancellor of the Exchequer and the Secretary of State for Energy

1. We attach a discussion paper on the benefits of North Sea Oil along the lines of that presented to the Trades Union Congress Labour Party Liaison Committee, on Monday 21 November.

2. Colleagues may wish to consider the following questions which are set out in the paper -

   i. How large and permanent are the benefits?

   ii. What are our objectives?

   iii. What is the overall strategy within which the oil revenues will be spent, short-term and long-term?

   iv. Should the revenues be hypothecated to an Oil Fund?

   v. How should the revenues be allocated?

   vi. What are the options?

      a. overseas investment?

      b. repayment of foreign debt?

      c. tax reductions?

      d. public services and social infrastructure?

      e. investment in manufacturing industry?

      f. investment in energy?

D W H

Treasury Chambers
12 December 1977
HOW SHOULD WE TAKE ADVANTAGE OF THE BENEFITS OF NORTH SEA OIL?

Paper by the Chancellor of the Exchequer and the Secretary of State for Energy.

North Sea oil will provide Britain with balance of payments gains and a new source of Government revenue. This paper sets out the probable size and duration of these direct benefits and considers how they should be used.

1. How large and permanent are the benefits?

2. The output of North Sea oil will amount to nearly half the nation's oil requirements during 1977 and should have eliminated our net oil import bill by 1980. If the real price of oil remains unchanged, the addition to GNP will be between £3 billion and £4 billion in 1980 (measured in 1976 prices) and around £5 billion in 1985 - figures equivalent to 3-5 per cent of our present GNP.

3. One major benefit of North Sea oil comes in the form of savings of foreign currency. Our underlying balance of payments position is likely to be improved as a result of the oil programme by about £5 billion in 1980, rising to £7-8 billion in 1985.

4. The other major benefit is that North Sea oil will provide a new source of revenue to the Government. Receipts will be small this year and next while investment costs are being recovered. But in 1979 the revenue is expected to reach over £11½ billion (at 1976 prices) and it will probably rise to at least £3½ billion a year in the mid-1980s.

5. On present evidence it seems likely that oil production will begin to fall off in the late 1980s, although it will continue at a diminishing rate through the 1990s. The size and timing of renewed dependence on oil imports will depend very much on future energy development. But benefits from North Sea oil as
such, in particular Government revenues from oil production, will necessarily decline.

6. It is important to realise that even at the peak of production in the mid-1980s the direct benefits from North Sea oil will be modest in comparison with the size and needs of the economy as a whole. For example, oil revenues of about £3½ billion a year must be put in the perspective of total public sector revenue which is already some £50 billion a year and a present depressed level of investment in manufacturing industry which amounts to some £5 billion a year.

7. The size of the benefits each year after the early 1980s will depend to some extent on how far the Government delays depletion of North Sea oil fields in order to secure a more gradual rundown of production later on and thereby reduce the eventual need for imports of oil which might be very costly. But whatever conclusions are reached on control of depletion, oil production will certainly be high enough to provide approximate self-sufficiency throughout most of the 1980s.

8. A brief outline of the Government's oil policy and factors influencing the size of the oil revenue is set out in the Appendix.

2. What are our objectives?

9. It is important to find ways of using the additional resources provided by North Sea oil which will enable us to achieve full employment, economic growth and rising living standards and maintain them not only while the oil is in flow but after it runs out.

10. This will only come about if the resources of North Sea oil are used as part of an overall economic strategy to ensure that expansion is sustainable over a long period. This strategy must involve public and private services as well as industry, provision of jobs as well as expansion of output and productivity, the needs of individual areas as well as those of national finance.
and the balance of payments and it should provide for greater equality as well as economic growth.

11. More specifically we are concerned:

   a. to raise living standards, reduce inflation and restore full employment in all parts of the United Kingdom - in particular in Scotland, Wales, Northern Ireland and English regions which have suffered most severely from industrial decline;

   b. to ensure that full employment and high living standards can be maintained when the oil runs out.

12. These objectives have some immediate implications. To restore full employment a very large number of extra jobs, possibly as many as 2 million, will be needed in the next decade and the majority of them must be in regions which have suffered from industrial decline. A proportion of these will be found in manufacturing industry; many will have to come from the expansion of public and private services of all kinds and in construction, transport and distribution. But such growth of services and other sectors will only be possible if there is at the same time a rapid and sustained increase in industrial production and productivity, involving reorganisation and re-equipment and retraining, in order to meet demand for manufactured goods without a large trade deficit.

13. North Sea oil will only provide modest assistance in making a start on the programme of economic and social reconstruction which is required. But if we are to adopt a coherent strategy the long-run objectives must be kept clearly in mind.

3. What is the overall strategy within which the oil revenues will be spent?

14. The economic strategy which accompanies the oil revenues will
be as important as the revenues themselves. To be effective this economic strategy must take account of both immediate and medium term problems of managing the economy.

15. Now that the worst financial problems arising from the rise in world oil prices and the world recession have been overcome, the Government has taken steps to start the economy moving ahead even before North Sea revenues begin to be available on a substantial scale.

16. The immediate purposes are a controlled expansion of production, to continue reducing inflation and to start improving living standards and public services. Co-operation between the trade union movement and the Government has been a major reason for success in correcting the financial situation and reducing inflation so far. With the return to more normal collective bargaining and following a period when living standards have been squeezed, there are great pressures to improve take-home pay by increasing money wages.

17. The Government has now been able to start reducing the burden of taxation and this, together with productivity increases as production expands, should make it possible for the real take-home pay for working people to increase without needing large money wage rises which would set off a renewed spiral of inflation. Reduction of taxation, the revival of investment and public spending and the growth of exports will all help to expand demand and bring about growth of production in the coming year.

18. The approach to a longer-term strategy has been discussed by the Government, the TUC and the Labour Party and some conclusions were set out in the "The Next Three Years", expressing a joint commitment to sustained expansion of the economy with adequate planning machinery, recognising that this cannot be left entirely to market forces.

19. The performance of our manufacturing industry since the war has not kept pace with that of our competitors. Our share of
world trade in manufactured goods has fallen from 25 per cent in 1950 and 16 per cent in 1960 to about 9 per cent now, although it has risen slightly in recent months. Because of our poor trading performance we have been unable to raise the overall growth rate of the economy and have had to cut out plans for public expenditure. The consequence has been a fall in industrial confidence, investment and employment and the postponement of cherished social programmes.

20. There are a number of problems affecting prospects for achieving high investment, full employment and a sustained growth in social spending, which include inflation, worldwide recession and the rapid increase in domestic labour supply.

21. Any strategy for using the benefits of North Sea oil to promote sustained economic recovery in Britain must therefore ensure that the oil revenues are used in expanding home production and employment. Creation of confidence in a steadily growing home market is a necessary but not a sufficient condition for this. We cannot rest our fate on the assumption that private industries, uncoordinated, will respond satisfactorily if left to themselves.

22. The programme of planned reconstruction will necessitate investment of public funds accountable to Parliament and the development of industrial democracy. Public agencies such as the NEB and the Development Agencies will have a large role to play in expanding investment, particularly in projects which aim to modernise and expand industry in declining areas and to improve the industrial infrastructure. The nationalised industries will have to carry out a great deal of productive investment. Company investment should be coordinated by Planning Agreements and the industrial strategy and supported by Industry Act assistance. Investment Reserve Funds built up from retained profits have been advocated as a mechanism for doing this.

23. Planning must also extend to the service sector and to assistance for small scale industry, with a significant role for the Co-operative Development Agency and local authorities.
4. Should the revenues be hypothecated to an Oil Fund?

24. An important preliminary question is whether North Sea oil revenues should be separately and specifically allocated through an Oil Fund, or whether they should be absorbed into public funds as a whole. The arguments in favour of such an Oil Fund are:

a. that use of the revenue would be visible and accountable, helping to ensure that they were not frittered away and enabling the public to assess the priorities which were proposed or being followed;

b. that continuing public discussion about what is inevitably seen as a precious national asset will be facilitated;

c. that it will demonstrate the Government's determination to use the revenues wisely and well and will be a protection against accusations that they have been wasted.

25. The arguments against hypothecating oil revenues in a special fund are:

a. that it might provoke disputes on special claims;

b. that the establishment of a fund could not in itself show how the revenues were being used on the grounds that there would be no way of demonstrating that the expenditure or tax reductions which the fund financed were additional to what would have been done in any case. For example it means little to say that the oil revenues are directed exclusively to financing one particular activity if that activity would otherwise have been financed out of general revenues and the hypothecation of oil revenue to it made it possible to spend the same amount of general revenues on other activities.
c. that a fund would increase pressures to use all the revenue on extra spending, as against using some for a reduction of taxes which might have a higher priority;

d. that it would reduce the flexibility a government needs in managing the economy and divert attention from the thrust of economic policy as a whole on which political opinion should concentrate.

5. How should the revenue be allocated?

26. Whether or not the revenues are allocated through an Oil Fund, they will constitute a substantial extra source of finance. Choices must be made about how they are to be spent and about how to take advantage of the related balance of payments savings. Public discussion is already focussing on this issue.

27. The broad options for allocation include:

a. overseas investment,
b. repayment of foreign debt,
c. tax reductions,
d. public services and social infrastructure,
e. investment in manufacturing industry,
f. investment in energy.

The revenues are by no means large enough to have a significant impact on all of these simultaneously, although the hypothecation of revenue to any one option would leave more money available from general revenues to finance other options.

28. But there are two broad views on how we should proceed. One is that the relative priority attached to each option may alter through time, will depend on the economic and policy environment and hence cannot be foreseen in detail now; it would therefore not be wise to narrow down the options at this stage. On this view some options are linked (eg manufacturing investment can be encouraged by increased consumption following tax reductions,
and by public expenditure on infrastructure). The other views is that the revenues, which at their maximum will probably amount to only £3½ billion per year, are not large enough to finance more than two of these options on a significant scale, that commitment to any two would necessarily preclude spending on others, and that the choice of options, once made, should be expected to endure.

29. Although the first two options have to be paid for out of balance of payments savings, these balance of payments savings from oil may, other things being equal, only be available for these purposes if oil revenues are not spent, but are used to reduce the PSBR. In other words, oil revenues may have to be allocated to these options. It may therefore be necessary to choose between these and other options as ways of spending the oil revenue. In the same way, to provide resources for extra private investment, whether at home or overseas, would require allocating oil revenue for that purpose and would mean that less was available for the public sector to spend.

6. What are the options?

a. Overseas investment

30. It would be possible to use the oil revenues to reduce Government borrowing and thereby secure a larger balance of payments surplus. Exchange controls could then be relaxed or abolished so that private individuals, companies and financial institutions could buy foreign bonds, shares, property or other overseas assets. Some would argue that investment abroad would provide Britain with a continuing income after the oil runs out, and might reduce upward pressure on the exchange rate which makes British industry less competitive.

31. Others argue that using the oil benefits for overseas investment would pre-empt using them to expand the economy more quickly, reducing unemployment and encouraging investment at home. It is debateable how far investment by UK forms overseas is a
substitute for investment in the UK, but with unemployment high the relevant test of which we should prefer is not simply relative profitability to the firm, but total value added in the UK versus post-tax profits overseas. If we were trying to run a high current account surplus, simply to finance overseas investment on capital account, this might also tend to make sterling overvalued, thus damaging the competitiveness of British industry.

b. Repayment of foreign debt

32. Britain has $22 billion of external debts of which $20 billion are due for repayment between now and 1984. The choice is not whether to repay the outstanding loans on the due dates - there is of course a legal obligation to do so - but how far to finance these arrangements by new overseas borrowing.

33. There are three potential sources from which the repayment of foreign debt might come: the foreign currency reserves, a surplus on the balance of payments or further loans from abroad. The question is whether part of this debt should be repaid from the oil revenues.

34. The arguments in favour of making a start with reducing the total of our outstanding debts are that at a time of economic weakness the UK was able to borrow money on the strength of expected revenues from North Sea oil. It would be unwise to rely on the reserves to repay debt as in the past inadequate reserves made us too vulnerable to events outside our control. Moreover some of the reserves are short-term funds which it would be imprudent to use to repay long-term debt.

35. If we are to spread the burden of debt repayment by raising new loans, this will require a satisfactory overall balance of payments. As Britain's economic performance strengthens there should be scope for raising new loans in this way. Potential creditors will be interested in the prospects for the yield of North Sea oil because it is this source of income in particular which provides assurances that loans will eventually be repaid.
We should ensure that we do not put international credit worthiness at risk: a Government forced to concentrate on remedying financial difficulties is unlikely to be able at the same time to give priority to domestic policies to restructure industry.

36. In order to decide how much of the debt repayment should be financed from new overseas borrowing, and how much from balance of payments surpluses, consideration would have to be given to the pattern of debt repayment over the whole period. This would have to be calculated to leave maximum scope for domestic growth and industrial competitiveness.

37. It is argued, on the other hand, that we should not use oil revenue to repay debt on the grounds that it would diminish the revenue available for expansion of our own economy, that net repayment may not be necessary since the funds of OPEC and other surplus countries will have to be recycled for many years to come, and that if some net repayment of debt should prove necessary after all, room for this should be found by general economies, not by cutting down on uses planned for oil funds.

c. Tax reductions

38. The Government’s immediate policy of reducing the burden of taxation on working people, before the oil revenues have built up, has already been noted. There is a longer-term question whether oil revenues should be used to finance a significant further reduction in taxation. It is argued on the one hand that following a period when living standards have had to be squeezed there are great pressures to improve take home pay by increasing money wages. North Sea oil provides some scope for reducing the burden of taxation so that the real take home pay of working people can be increased without inflationary rises in money wages which raise industry’s unit costs and are inevitably reflected in higher prices and fewer jobs.
39. Other reasons are also suggested for reducing direct taxation with the help of oil revenues. In 1960/61, a married man had to be earning 40 per cent of the average wage before paying tax, the same man now has to earn only 35 per cent before paying tax. The Government has taken steps to raise tax thresholds and the TUC has indicated it seeks further progress on this front as well as giving a priority to the introduction of a reduced-rate band. Such measures are costly and unless a proportion of the benefits from North Sea oil are used are likely to be unattainable.

40. Against, it is argued that using oil revenues for long-term tax cuts would pre-empt funds for public services and benefits, creating a divided and unequal society with poverty for the unemployed, elderly and sick and great wealth for successful businessmen and managers; that it would do little for declining regions; and that it would provide a consumer-led boom for German and Japanese suppliers without providing much help to hard-pressed British industries. On the other hand, any attempt to reduce inequality by increasing social payments would have much the same effect on imports and the regions as cuts in income tax.

41. But the restructuring of benefits and taxation would be an important consequence and benefits if the oil revenues themselves were used for economic recovery.

d. Public services and social infrastructure

42. Oil revenues could be used to finance substantial new public spending, restoring services and construction which have had to be cut in the recession. This would provide extra employment; it may therefore be an essential counterpart of industrial investment and reorganisation which might not itself substantially increase jobs in manufacturing. Using oil revenues for public expenditure will also expand the economy and raise consumption by providing extra employment.

43. As the economy expands and ordinary tax revenues increase, a portion of the oil revenue might be set aside to initiate new
programmes will need to keep pace with the expansion of the economy.

f. Investment in energy

49. Major efforts will be needed to secure Britain's energy position after the oil runs out, including conservation measures, more efficient conversions of primary fuels into usable forms of energy, and development of new sources of primary fuel supply. At present substantial research and public investment is already being undertaken in all these fields. Although the overall build-up of investment expenditure may be gradual, it is likely that after the mid-1980s a high level of expenditure will be needed to meet growth of the economy and to adapt to the post-oil era.

50. Investment in the North Sea itself is already funded through allowances deducted before the main oil taxes are charged. There may be a case for allocating some of the oil revenue to finance other forms of energy investment, particularly if the investment programme has to be accelerated in the late 1980s.
SECURING THE MAXIMUM BENEFITS FROM UKCS OIL

1. Since 1974 the Government has carried through a comprehensive programme of measures designed to maximise the benefits accruing to the state from UKCS oil. This has involved a judicious mix of new controls, taxation and stimuli. A balance has been achieved which encourages further investment - there were 133 applicants for 51 blocks in the 5th licensing round and a series of companies successfully concluded new field financing arrangements in 1975/76 - while substantially increasing direct state involvement, the state share of the financial benefits and the extent of state authority over offshore and onshore operations and the oil produced.

2. Taxation

   Government take from offshore oil is made up of
   1) royalty at 12\% of the value of the oil;
   2) Petroleum Revenue Tax (PRT) at 45\% on profits before Corporation tax;
   3) Corporation tax on net revenue after deduction of royalty, PRT and expenses.

The Oil Taxation Act 1975 introduced PRT. PRT applies to each field separately so that the tax on the profits on one field cannot be deferred by offsetting against it the costs of another field. Safeguards are incorporated to provide for adequate return on marginal fields. The Corporation tax yield from the North Sea is protected by the erection of a "ring fence" round UKCS activities for tax purposes. Together these three taxes should secure on average some 70\% of the profits derived from UKCS operations: where BNOC has a 51\% equity interest the overall return to the state should rise to some 85\%.
3. **Direct State Involvement**

A further financial return to the state is provided for by the creation of the British National Oil Corporation (BNOC) with a right to a 51% equity stake in all licenses from the 5th Round onwards. The Corporation raised $825m in 1976 by the forward sale of oil without prejudicing control over the disposal of that oil.

BNOC is also involved, through negotiated participation agreements, in the operation of commercial oilfields licenced under previous rounds. The Corporation is building up knowledge of UKCS operations at first hand in support of its advisory role to Government.

4. **Direct Access to Oil**

The Petroleum and Submarine Pipelines Act 1975 (PSPA) provided the Secretary of State with a right to take in kind the 12 1/2% royalty on production. Together with BNOC's substantial equity and participation rights, this will provide the state with direct access to some 40-45m tons of oil in 1980 and hence with control over its disposal not available by other means because of international obligations.

5. **Regulations**

The PSPA tightened controls over exploration and over the manner and timing of development and production of discoveries. It provided the Government with the means to implement policy on the rate at which reserves should be depleted. Government consent is required for gas flaring and for the construction and operation of submarine pipelines. The construction and extension of refineries also requires Government consent, apart from normal planning procedures.
6. **Guidance**

A Government statement in 1974 said that up to two-thirds of the oil UKCS produced could be expected to be refined in the UK, subject to the level of production and the way in which world markets developed. Participation agreements provide for wide-ranging consultation between producers and the Department of Energy, advised by BNOC, permitting, amongst other things, the monitoring of disposal policies and pricing.

7. **Stimuli**

The Offshore Supplies Office has been created to stimulate the maximum UK industrial contribution to offshore activities. A memorandum of understanding, securing for UK industry a full and fair opportunity to compete for offshore business, was concluded with the Offshore operators in 1975. The UK share of the offshore supplies market has increased from 40% in 1974 to 57% in 1976.

The Government has been prepared to give assurances about the manner in which its regulatory powers will be used, in order to ensure confidence in investment in UKCS operations. Assurances about use of the new powers to control rates of depletion were given in 1974 and contractual undertakings have been given to certain banks. Power has been taken to refund royalties in order to stimulate or sustain production from a field which would not otherwise satisfy normal commercial criteria.

The Government has been instrumental in the creation of a joint public sector/private sector study company, Gas Gathering Pipelines (North Sea) Ltd, to finance and execute detailed evaluation of the economic case for a gas gathering system in the Northern North Sea.
8. Possible Hazards to Realisation of Fuel Benefits

The timing of the realisation of UKCS oil benefits could be affected by many factors including, notably, a fall in the world oil price but also the imposition of restrictions following a major pollution disaster or a sudden and differential surge in the costs of exploitation of the UKCS. But the forecast increase in the real cost of oil in the long term, if right, means that such benefits will be deferred rather than lost. There is a constant balance to be struck between, on the one hand, maintaining sufficient incentive to the private sector to ensure an adequate scale of exploration and of commitments by oil companies and financial institutions to new developments at the controlled rate calculated to maximise benefits and, on the other, increasing progressively the direct state share in the benefits, for example through an enhanced role for BNOC in future licensing and through tax changes.
CABINET

THE PAY SCENE

Memorandum by the Chancellor of the Exchequer

1. This is an appropriate moment to take stock of our pay policy in the current round. By taking firm action from August to October on proposals for excessive settlements, mainly in the private sector, we removed the immediate prospect of a wage explosion. As a result, with the help of the Trades Union Congress' (TUC's) agreement on the 12 month rule and self-financing productivity deals, almost all Stage 2 settlements have now been satisfactorily concluded. The 12 month rule is holding. Since October, we have successfully completed the critical negotiation with the local authority manuals, which is likely to set the pattern for many settlements in the public sector, and have faced the special cases of the police and firemen. The settlement with the local authority manuals will greatly reinforce the authority of the policy for the present round.

2. There is growing evidence that the Government's pay policy has overwhelming public support. But there are some large and important negotiations ahead from February to April. Moreover, we must begin to think about the longer term. In particular, some aspects of current negotiations may compel us to formulate an agreed policy for the public sector in the next round well before the end of the current round.

THE SHAPE OF THE CURRENT ROUND

3. The main features of the round so far are as follows:

a. There has been much less flexibility between settlements than originally hoped. Because very few groups have been prepared to settle for an earnings increase significantly below 10 per cent, the Government has been compelled to oppose settlements significantly above 10 per cent. Nevertheless opportunities are being taken to widen differentials within settlements by giving unskilled workers a little less than 10 per cent and the minority of skilled workers a few percentage points more.
b. Productivity deals are adding perhaps 1 per cent or 2 per cent to the average level of settlements. They are providing a useful flexibility in many cases. Although they may not all be genuinely self-financing, they are probably generating some genuine improvements in productivity. It is proving very difficult for us to discover, evaluate and monitor all such deals although we must continue to do our best to do so.

4. The prospects for the rest of the round include the following features:

a. An appraisal by officials of the 50 or so main negotiations over the next four months concludes that there is a real chance of settling every individual case at or around 10 per cent, provided that the line can be held generally elsewhere, but that any major breach of the guidelines would have a disastrous domino effect.

b. Forward commitments are a potential source of trouble: they have been accepted explicitly for firemen and implicitly for the police. Officials are preparing a study of cases where forward commitments may be demanded and will make recommendations on handling the problem. Such demands may arise from the recommendations of the Review Boards for the Armed Forces, doctors and dentists and top salaries, as well as from claims by university teachers and from the analogous pay research problem of the non-industrial Civil Service. It will be necessary to limit forward commitments to the absolute minimum unless they are to create formidable difficulties for policy in the public sector as a whole during the next round. This is perhaps the main factor which may compel us to formulate a comprehensive policy for the public sector in the next round by early summer next year.

c. Wage drift may be somewhat less this round partly because of the greater flexibility and partly because in areas of the public sector overtime is as likely to fall as to increase, and many private employers cannot afford to fiddle on a large scale.

THE NEXT FEW MONTHS

5. In the immediate future we still risk serious trouble over oil tanker drivers, and there could be others. Following the settlement of local authority manuals, we must get the same pattern adopted in the related cases of National Health Service ancillaries, water and gas manuals, and clinch the deal with firemen without further concessions. But two groups of future settlements stand out in importance:

a. Power workers in the gas, electricity and coal industries could quickly bring the economy to a halt. It is particularly difficult to assess the prospects, timing and interrelationships of their negotiations. Much will depend on the climate which is built up before any crunch comes.
b. Public services: A large proportion of white-collar public services is due to settle in April, with some very strong linkages between different groups within the total. These include most of the candidates for forward commitments. Quite apart from any damage which could be done through failure to reach agreement in individual negotiations, if we show weakness in managing these groups we would risk reopening satisfactory settlements achieved in earlier months. By the same token, if we are successful in settlements with earlier groups, particularly the power workers, we will find it much easier to settle with the white-collar public services.

6. There are three areas of action to which the Ministerial Committee on Economic Strategy Sub-Committee on Pay Negotiations (EY(P)) attaches particular importance:

a. Although public opinion is solidly behind the Government there is still the impression in some quarters that the current round represents another year of sacrifice. In fact, living standards have been increasing since the summer and will continue to increase throughout the round if settlements are within the guidelines, even without further tax cuts in the spring Budget. This fact should be rammed home in speeches by Ministers and general Government publicity.

b. Contingency plans for dealing with industrial action have been prepared, and are being implemented where appropriate (for example adequate stocks are being built up at the right locations). There are however limitations on the ability of the Armed Forces to handle two or more contingencies at the same time. This makes it particularly important not to use the Armed Forces except where the risk to life or national interest plainly requires it.

c. Ad hoc official groups are being set up to keep track of the prospects and developments on the power groups - and later the public services. Ministers will be advised on steps which might be taken - or should be avoided - before and during negotiations.

AFTER PHASE THREE

7. If we persevere in seeking to influence individual settlements there is now a good chance that the current policy will not only avoid a wage explosion but also achieve an earnings outturn compatible with single figure inflation in 1978. But this will be at the cost of greater rigidity than we would have wished and of at least a few damaging forward commitments. It is difficult to feel confident that we could return to full freedom of collective bargaining in the next round without risking an increase in wage costs which
would raise both prices and unemployment. Moreover there is a growing feeling in the Labour movement itself that total freedom in collective bargaining is incompatible with both social justice and economic efficiency.

8. There are special reasons for believing that we are moving into a period in which some sort of pay policy will be not only more necessary than at most times in the past but also more feasible.

9. The central problem of our economy for more than a generation has been that, although our productivity has grown more slowly than that of our competitors, we have seen annual wage increases of the same order as theirs. So our inflation has risen faster than in other countries and we have been able to maintain price competitiveness and full employment only by a series of devaluations which have further added to inflation and increased the pressure for excessive wage increases. In the era of North Sea oil it will be more difficult to devalue our currency to maintain price competitiveness. So unless we can keep wage increases close to the level of productivity increase we shall face rising unemployment and a further erosion of our industrial base.

10. It is the aim of our industrial strategy to increase the trend ingrowth of productivity. But we are likely also to need a policy which will help to keep the increase in our wage costs close to whatever growth in productivity we do achieve. Otherwise we risk finding that North Sea oil simply produces rising living standards allied to rising unemployment, followed by a major political and economic crisis when the oil runs out, because we have lost the industrial capacity to earn such high living standards without the oil. This is why pay policy is likely to be more and not less necessary in the period ahead.

11. On the other hand there is now a better understanding than ever before among all sections of our people that high inflation is not only a major social evil but is also incompatible with high employment. Trade unionists are tired of being paid in confetti money. The current dramatic fall in our inflation rate is rightly seen as mainly due to moderation in pay settlements. So there is a better chance than ever before of getting support for a continuing policy to discourage excessive pay increases.

12. The need for such a policy in the public sector is inescapable and has been recognised recently by the leaders of public sector unions like Mr David Basnett and Mr Geoffrey Drain. Forward commitments already accepted in the public sector make this more necessary still. But it would be difficult to operate a pay policy successfully in the public sector if freedom is exercised irresponsibly in the private sector. In the private sector, however, and to a lesser degree in the public sector too the rigidity of pay policy over the last three years has produced damaging distortions. The problem is not only the excessive compression of existing differentials but also the difficulty of changing differentials which are incompatible with
economic need. For example, the widespread shortage of skilled labour at present seems due less to the absence of the necessary skills than to the unwillingness of those with the skills to accept jobs which pay them less than they can earn elsewhere.

13. It is not too early for us to consider finding an answer to these problems. The remaining seven months of the current pay round will not be too long. We already know that if we are to get our inflation rate down to that of our international competitors and keep it there we shall have to achieve an earnings outturn in the next round which is not significantly higher than our trend growth in productivity which is still well below 5 per cent.

14. It would be worth exploring with Mr Basnett and other leaders of unions in the public sector how we could hope to achieve such an outturn in the public sector as a whole, and how to approach demands for forward commitments in the light of this.

15. At the appropriate time we should also approach the TUC more generally about the role of pay policy in the strategy on which we fight the next Election, and about the contribution they might be prepared to make. We should seek to persuade them, for example, to reaffirm the 12 month rule while making some provision for synchro-pay in areas like British Leyland where this is likely to conduce to better industrial relations and to accept the inevitability of some forward commitments without treating them as a general base for all new claims.

16. I put these ideas forward for discussion in a tentative spirit, since I am unclear myself about how best to proceed. But I am convinced by our experience over the last three years that a more rational approach to pay policy is both necessary and possible in the longer run, and that we must begin to face the implications of this now.

D W H

Treasury Chambers

20 December 1977
1. This paper argues that it should now be our objective to re-examine with the Trades Union Congress (TUC) a wide range of policies that go beyond the 12 month rule and pay. If the Government has to rely on the control of pay as its central policy, it will be consistently weakened in the run-up to the Election.

THE BACKGROUND

2. The Government faces two threats to its support. One arises from continuing unemployment and public sector pay restraints, the other from the risk that the Government may progressively lose its ability to hold the loyalty of the unions and their members without confrontation.

3. The greatest weakness facing both the Government and trade union leaders is that now, after two-and-a-half years of wage restraint, cuts in living standards, cuts in public expenditure and high unemployment cannot be quickly reversed. The prolonged world slump, industrial closures, lack of investment, and continuing cutbacks in public services have combined to remove the credibility of our pledge of a phased return to full employment. Those who have accepted real cuts in living standards are now faced with further wage restraint, plus long dole queues and public services under strain. A long slump of this magnitude damages the social fabric and cannot in the end be accepted by trade unions and the Labour movement.

PAY PROBLEMS

4. The risk of confrontation over pay is growing because our commitment last July to "an orderly return to collective bargaining" and a policy based on "good sense and realism" has become transformed into a rigid 10 per cent policy in the public sector and an ineffective attempt to use sanctions to prevent higher settlements in the private sector. As private sector earnings move ahead, workers in the public sector feel that they are being discriminated against. In seeking to hold the line against firemen or
other groups in the public sector we are faced with a choice of evils. If we enforce the ceiling strictly, we do so at the cost of alienating those who looked to a Labour Government to defend them; the tactics for winning each 10 per cent battle force us to mobilise public opinion against successive groups of public employees which must embitter those against whom we are in conflict. But if we seek to win by gentler persuasion, public opinion may side with the workers concerned, against the Government.

5. If we were to slip into a head-on clash with a powerful section of workers we could find ourselves saddled with the "Who Governs Britain?" dilemma which brought Heath down. Since the Labour Government's strongest point with the public was - and remains - our claim that we could work with the unions and their members, a collapse of that approach would prove to be our downfall and pave the way for electoral defeat and a Conservative Government.

THE NEED FOR A NEW PROGRAMME

6. It must be our prime objective to restore our relationship with the Labour movement by re-examining, with the TUC, a wide range of present policies that go far beyond pay. The new context for these policies is the run-up to an Election and the opportunities provided for the 1980s by North Sea oil.

7. The new programme must help us and trade union leaders to resolve the outstanding problems over public sector pay. It must provide real hope for national recovery. And it must provide a new orientation towards international problems so that we can gain acceptance for measures we need to take.

THE INTERNATIONAL CONTEXT

8. We must press extremely hard for constructive and definitive international measures to deal with the slump, if for no other reason than to justify continuing or new defensive measures that we may have to take unilaterally if the international context does not improve. In particular we should urge:-

a. Trade guidelines with an element of restraint on imports from Japan, Germany and any other industrial country with a chronic surplus.

b. Acceptance by the European Economic Community that Britain, Italy and the three candidate members have long-term industrial problems which require special measures.
c. Large and repeated issues of Special Drawing Rights to ease debt problems until the world recession abates.

d. Funds for commodity stabilisation, bringing world prices for food and raw materials to levels which are sustainable in the long term.

THE MAINTENANCE OF LIVING STANDARDS

9. To assist living standards, we should pledge to the TUC that we shall continue to use tax measures to help with the short-term pay problem and hold down basic elements in the cost of living by:

a. refusing to accept increases in food prices under the Common Agricultural Policy;

b. freezing mortgage payments and public sector rents; and

c. freezing fuel prices.

10. In addition to this we should discuss proposals to resolve the impasse on public sector pay. One approach would be to offer a fund worth 3 per cent of public sector pay (about £700 million) on top of the 10 per cent guideline, to compensate for the comparative inflexibility of public sector pay bargaining. Another would be to accept indexation for public sector pay if prices rise about 10 per cent in the current pay round. A third would be to look again at low pay generally as constituting a special category.

A PROGRAMME FOR NATIONAL DEVELOPMENT

11. A National Development Fund should be established into which oil revenue would be channelled together with a fixed proportion of pension funds and other financial resources - to be underwritten by the Government on a financially "no better, no worse" basis. This fund should be available for the following purposes:

a. The National Enterprise Board, the Scottish Development Agency, the Welsh Development Agency and the Industry Act.

b. Investment in manufacturing industry by public enterprises.

c. Support for small businesses.

d. Expanded public service expenditure in health, housing, education and welfare, which will create jobs.
12. Major companies should be told that all discretionary Government assistance will in future only be available through planning agreements which will become virtually obligatory - as with North Sea Participation Agreements which were pushed through without statutory backing. Small businesses should qualify for special assistance on the presentation of plans discussed with and acceptable to their workforce in the form of a joint declaration. Industrial democracy should be accelerated through planning agreements and joint declarations for smaller businesses.

13. A National Development Commission should be set up to supervise the formulation and execution of policy on the same basis as the Energy Commission. A Minister of State should be appointed to co-ordinate the work for each English Region, covering both industrial expansion and public services, as already happens in Scotland and Wales under the Development Agencies.

14. These proposals for a National Development Programme should first be discussed with the TUC informally then at the TUC-Labour Party Liaison Committee and finally published as a White Paper. This should then form the basis for future Government policy on industry, public services and employment.

THE CAMPAIGN FOR SUPPORT

15. We have to seek public support on the basis of policies which measure up to the problems which confront the electorate as workers, families and as a nation. The proposals outlined above therefore include four essential elements:

   i. An approach to resolution of the impasse on public sector pay.

   ii. A continuing programme to assist living standards by tax measures and action on basic items in the cost of living.

   iii. A programme for recovery of industry, public services and employment.

   iv. A new orientation to international problems.

16. On the basis of a programme of this kind we could consolidate our relationship with trade unions and campaign with confidence for public support.

   A W B

Department of Energy

20 December 1977