CONFIDENCE

Lamont has pulled some bedraggled rabbits out of the hat, but the recession still dogs him

An initial welcome to the autumn statement has already faded, as soaring government borrowing threatens higher taxes in the spring budget, write **David Smith, Andrew Lorenz** and **Andrew Grice**

EVEN for a government that has made U-turns its recent stock-in-trade, last Thursday was breathtaking. Ministers, after years of heaping abuse on Denis Healey's mini-budgets of the late 1970s, were now proclaiming their own. Norman Lamont, having stubbornly insisted that low inflation would automatically bring recovery, had now decided that "a return to growth is more essential than ever" and that a recovery package was needed to secure it.

Never, said one observer, had so many of the Treasury's sacred cows been sacrificed in one afternoon. Lamont even did his best to accommodate every industrial lobby, once contemptuously ignored, that had trooped to his door in the past few weeks. He had, against Treasury tradition and advice, made tax changes in an autumn statement: the chancellorial announcement usually reserved for public spending.

In the build-up to the autumn statement there had been growing fears that the public sector's gargantuan appetite for borrowing would require higher taxes in the statement. In the event, there were none, much to the relief of the City and industry.

However, relief may be shortlived. Ministers and officials have already started to warn that any setbacks for the economy over the winter and spring could force the government to put up Vat and National Insurance in the March budget.

The City is also fretting that Britain's "free lunch" period since leaving the European exchange-rate mechanism (ERM) could be coming to a close. Huge government borrowing coupled with the economy's stubborn failure to recover are conditions for a run on sterling that even a government with a floating exchange rate may be unable to ignore.

Lamont underlined the political nature of last week's one-point base rate cut by announcing it in his statement. Sir Geoffrey Howe did this in 1981, but most chancellors have preferred to maintain the pretence that the markets help determine interest rates. They may end up doing so, but not in a way that Lamont and his cabinet colleagues want.

FOR THOSE industrialists who had pressed the Treasury for special help there was something to cheer last week. Geoffrey Whalen, managing director of Peugeot UK and a leading light in the Society of Motor Manufacturers and Traders, was watching Lamont on television when he announced the end of car tax. "I almost fell off my chair," he said. For the past five years, Whalen has led industry delegations down the corridors of Whitehall in a bid to end the hated tax. "I saw [Nigel] Lawson. I've seen Lamont and [Peter] Lilley when they were financial secretaries to the Treasury ... We have been pressing hard for the last five years, and my predecessors tried for the previous five years. But I was very surprised."

Sir David Lees, chairman of GKN, the motor components-to-scaffolding group, had attacked the government two days earlier at the Confederation of British Industry's Harrogate conference. He wanted two points off interest rates and 100% first-year capital allowances (compared with the 40% announced). But he was grateful for small mercies: "Some people will say it's not enough, some will say it's too much. My own view is that it's a good package."

Lees had fought for three years, through his post as chairman of the CBI's economic situation committee, to persuade the Treasury to encourage capital investment through more generous tax allowances. Most of that time, he has hit a Whitehall brick wall. Then, last week, he heard his own arguments coming back at him from the mouth of the chancellor.

IN THE Treasury, experienced hands know that such reactions mean nothing if there is no follow-through. Officials, many of whom campaigned against an autumn recovery package on the grounds that it would be gimmicky and ineffective, concede that the economy was facing a crisis of confidence. The government, therefore, had to be seen to be doing something.

One Treasury minister admitted that much of the problem of confidence emanated from government mistakes, including the debacles over ERM and the miners. But, he said: "If we go on having days like last Thursday, we will be a long way on the road to restoring confidence".

In the Treasury, the impact of Thursday's package will be judged according to whether it restores business and consumer confidence. Officials argue, unconvincingly, that the recent run of economic data, in particular for high-street sales and factory output, does not justify the gloom over the economy.

> *"The rhetoric about growth fails to match up with reality"*

Others disagree, both with the Treasury's assessment and the likely impact of the package. Tim Daniels, managing director of Selfridges in London and president of the Oxford Street Association, said the chancellor's measures had come too late to revive trade this Christmas and were insufficient to restore consumer confidence. Even if the Treasury is right in its forecast of 1% growth in 1993, unemployment will rise to at least 3.25m from its present 2.87m. For Keith Skeoch, chief economist at James Capel, the package was "stimulus by magic mirrors", adding that "the rhetoric about a growth-orientated policy fails to match up with reality".

The idea of specific measures to assist the housing and construction industries was first put up in the Treasury in early September, before Black Wednesday. Officials and ministers were growing increasingly gloomy about the prospect of recovery, particularly with base rates apparently stuck at 10%.

The housing market, which Treasury economists see as closely linked to consumer-recovery prospects, had embarked on a renewed decline after the end of the eight-month stamp-duty holiday. Last week's announcement will direct an additional £750m of housing association funds for this purpose, allowing the purchase, for rent, of 20,000 properties. But this, according to John Wriglesworth of Phillips & Drew, has to be set against record mortgage arrears and repossessions. It would, he said, "have about as much effect in reducing the overhang of unsold housing stock as picking a snowflake off an iceberg".

Paul Tayler, director of Savills' London estate agency, said Lamont's growth strategy failed to take account of fears about unemployment. "If people are worried about their jobs, they are not going to be moving house," he said.

Internal Treasury discussion of a recovery package was suspended when sterling was swept from ERM on September 16. Officials argued that, with the chancellor free to cut base rates, a fiscal package was no longer needed. But surveys showed that Black Wednesday, and the government's subsequent difficulties, had produced a dive in business and consumer confidence. Against Treasury resistance, John Major insisted on a recovery package, "a strategy for growth is what we'll have", he told ITN.

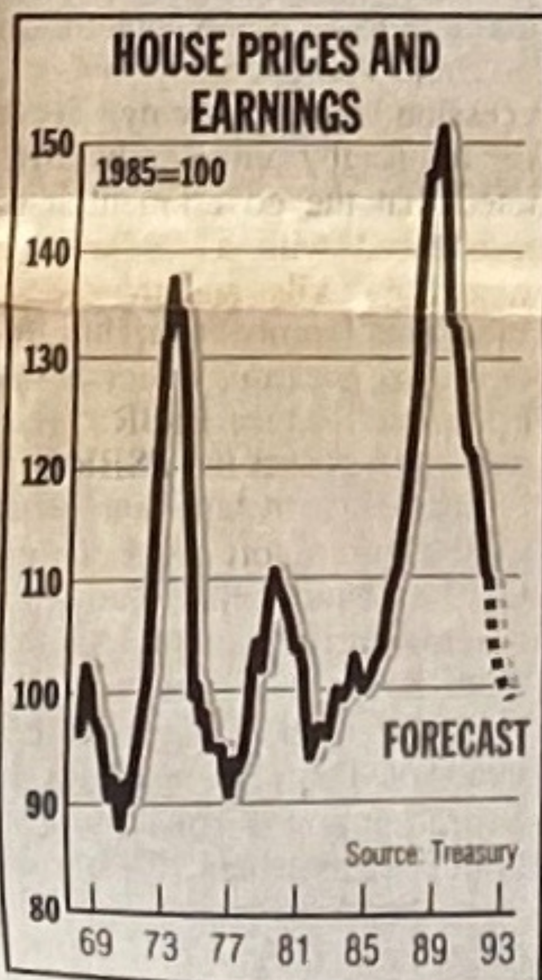
On his insistence, the package was to include a relaxation of Treasury rules on private-sector involvement in public-sector projects. The prime minister, who had championed the cause of private-sector involvement while chief secretary to the Treasury three years earlier, had been irritated by the lack of progress.

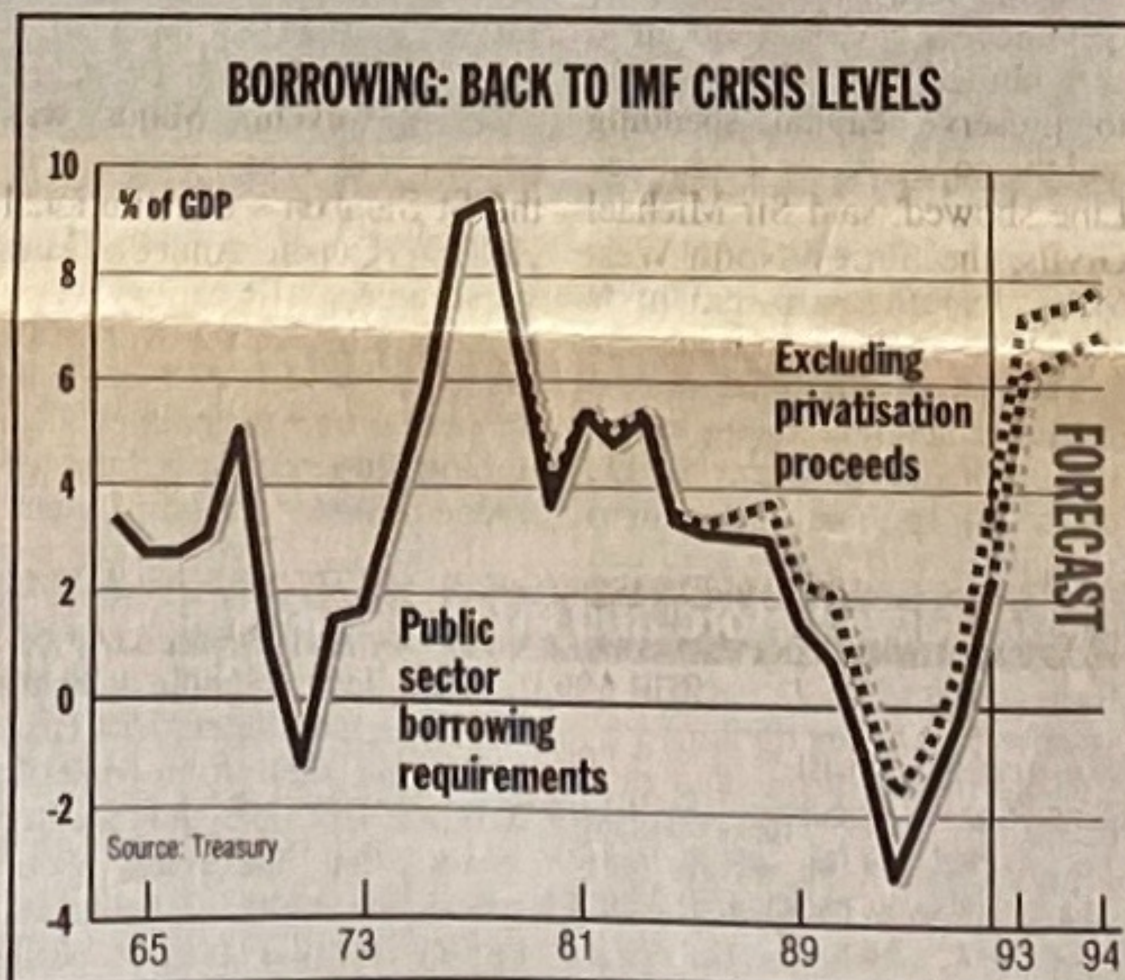
The old rules on private finance for public projects were drawn up so as to rule out virtually any proposal. The private sector had to prove its proposal represented value-for-money in comparison with a similar state-financed project. But, since governments can always raise finance on finer terms than the private sector, virtually no projects could qualify. This catch-22 has now been removed, but any impact on the economy will take years to come through.

Car tax was Lamont's pet project. He had halved it from 10% to 5% in the March budget and intended to abolish it next March. But, with the political pressure on him to do something, he brought it forward. Once the decision had been taken to include tax changes in the autumn statement, the door was open for a boost in capital allowances. First-year allowances against corporation tax are being raised from 25% to 40%, for 12 months. A 20% allowance against investment in agricultural and industrial buildings is being introduced.

GKN's Lees, who pushed for such action, says: "People might say that capital allowances aren't much help if you don't have a tax liability. That's a superficial argument, because they must open the possibility of a lower leasing cost."

Treasury officials deny, despite intense speculation last





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ACT–OR TRICK?

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week, that there was a plan to increase National Insurance contributions in the autumn statement. One minister said: "Our approach to the public-sector borrowing problem is clear. We needed a tough spending round; we need a recovery in the economy. Only if all that failed would we consider raising taxes." A rise in NI contributions, ministers knew, would have risked souring the reception for the package with the second key audience: Tory backbenchers. Lamont, and Major, were fighting for their political life.

Lamont, who in eight weeks has logged up more calls for his resignation than most politicians in a lifetime, was warmly received when he addressed Tory backbenchers at Westminster 90 minutes after finishing his statement. One MP told him it was "a mini-budget, which would have maximum effect in securing economic recovery".

There was concern on the government front bench when, after the speech, Nicholas Winterton, the Tory arch-rebel, stood up. They need not have worried. The Macclesfield MP said: "I am pleasantly surprised by the statement and I shall have no difficulty voting for it."

More Tory MPs stood up to congratulate him. The decision to preserve capital spending and the go-ahead for the Jubilee Line showed, said Sir Michael Grylls, the Surrey North-West MP, "that the government is rolling out the cement mixers".

Major had a special reason for the statement to go down well with the Tory troops. On Thursday evening, coincidentally, he was to attend the annual dinner of the 100-strong 92 group of right-wing Tory MPs. It promised to be tricky. Last weekend, leaders of the group called on Major to promote more rightwingers into his left-of-centre cabinet in an early reshuffle, and intended to raise their demand on Thursday.

In the event, Major was given a rapturous reception at the St Stephen's constitutional club in Queen Anne's Gate, Westminster. "It was as warm a reception as we ever gave Margaret Thatcher," said one of the 92 group officers. The rightwingers put aside their differences over Maastricht and did not even raise their cabinet demands. "The autumn statement had gone down so well it was not appropriate," said one.

Some Tories looked beyond the immediate political gains from a one-point cut in interest rates and a chancellor who at last appeared to be doing something to bring the economy out of recession. James Pawsey, Tory MP for Rugby and Kenilworth, noted that the government had been faced with a choice between two evils, and the chancellor was "probably right" to decide that unemployment was a bigger evil than the PSBR. "But I am worried that the PSBR has risen so much. A few years ago, we were paying off national debt and that should still be our aim."

Prospects before and after Black Wednesday

	GDP 1993	Retail Price Inflation Q4 '93
New Treasury forecast	1.0%	3.5%
Effect of base-rate cuts	+1.0%	—1.5%
Effect of sterling's fall	+1.0%	+2.5%
Impact of recovery package	+0.2%	0
Implied forecast on previous policies	—1.2%	2.5%

Source: Treasury, Ernst & Young Item Club

THE soaring borrowing requirement is also the big concern of the Treasury's third constituency, the City. Lamont's announcement that this year's PSBR will be £37 billion (an overshoot of £9 billion) and next year's £44 billion (up £12 billion) was a shock.

Gerard Lyons, chief economist at DKB International, the Japanese bank, says: "The whole perception of the UK has changed. International investors regard these figures as alarming. Sterling will invariably have to fall and the only way out will be to inflate this debt away."

The funding arithmetic facing the government next year is daunting. City financial institutions will receive £35 billion of cashflow in 1993-4, says Ian Harnett of Société Générale Strauss Turnbull. Gilt sales by the Bank of England of £50 billion or more will, he says, crowd out equity issues by companies and require big capital inflows from abroad.

Michael Saunders, economist at Salomon Brothers, is even more concerned. "Rather than rebalance the fiscal and monetary policy mix, the chancellor is loosening both policy levers," he warns.

With last week's package Lamont has got industry off his back and bought time with his own backbenchers. But, if the economy fails to recover, the markets will insist on action to rein back government borrowing that will make the latest spending plans look like a tea-party.

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