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PREM 19/707

PART II

CONFIDENTIAL FILING

Economic Strategy

Pay & Prices Monthly Economic Report

The Economic Prospect

Economic

Policy.

PART I May 1979

PART II December 1979

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
2-12-81							
4-12-81							
2-12-81							
10-12-81							
24-12-81							
4-1-82							
8-1-82							
- ends -							

PREM 19/707

PART 11 ends:-

8.1.82

PART 12 begins:-

15

End of 7 year Interview

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
PY (81) 25	10. 12. 81
MISC 14 (81) 12	21. 12. 81
E (81) 132	31. 12. 81

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate CAB (CABINET OFFICE) CLASSES

Signed *W*ayland Date 16 August 2012

PREM Records Team

010
FROM: M M DEYES AND
S RIDLINGTON
DATE: 8 JANUARY 1982

leap

- RA 11.1
1. MR ALLEN - if you agree
 2. CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State (L)
PS/Minister of State (C)
Mr Burns
Mr Kemp
Mrs Gilmore
Mr Norgrove
Mr Mercer
Mr Perfect
Mr Page
Mr C H K Williams
Mr McSharry
Mr Ridley
Mr Cropper
Mr Harris

Mr M Scholar - No. 10

BULL POINTS

We attach copy of the latest Bull Points sheet.

M M Deyes

S Ridlington

M M DEYES
EB

S RIDLINGTON
EB

(i) Signs of recovery

- Total output (GDP) rose about $\frac{1}{2}$ per cent in 3Q 1981 (revised estimates).
- Manufacturing and construction output both increased $2\frac{1}{2}$ per cent between 2Q and 3Q. Latest (October) figures show improvement maintained; manufacturing output some $2\frac{3}{4}$ per cent up on October compared low point 1H 1981.
- Short time working in manufacturing fallen to $\frac{1}{4}$ of January peak; total hours worked have been stable since beginning of 1981.
- 3Q figures for manufacturers and distributors show rate of destocking reduced by $\frac{4}{5}$ compared with 1H 1981.
- Latest 1981 figures show volume of engineering and construction orders up about 17 and 10 per cent respectively on 2H 1980.
- Private sector housing starts in 3 months to November up by 34 per cent on same period, 1980.
- Most recent major independent forecasts assess low point in activity reached in 1H 1981; prospect of some recovery in 1982.

(ii) Earnings and settlements. Increases halved in 1980-81 pay round. Public sector in line. CBI pay data bank for manufacturing settlements suggests some further moderation.

(iii) Productivity. Indications that productivity increasing. Output per head in manufacturing in 1981 3Q 10 per cent higher than in 1980 4Q. Investment in plant and machinery holding up.

(iv) Unit labour costs: Pay moderation and higher productivity has meant dramatically low increase in manufacturers unit wage costs in latest 12 months - up 4 per cent in year to September.

(v) Competitiveness. Up over 10 per cent in 1981, reflecting pay moderation combined with exchange rate fall.

(vi) Industrial and commercial companies' gross trading profits rose (net of stock appreciation) over 10 per cent between 2Q and 3Q 1981. Profits of ICC's excluding North Sea operations also rose.

(vii) Exports are holding up well; non-oil export volumes in 3 months to November up 4 per cent on 1980.

(viii) Expanding export markets. Increasing percentage of UK exports go to developing countries (who now buy 24 per cent of UK exports), particularly oil-exporting developing countries (who now buy 12 per cent, compared 9 per cent in 1979).

(ix) Unemployment. Rate of increase in unemployment in 2H 1981 a little over half that in 1H. Some increase in number of vacancies over recent months. Short-time working in manufacturing in October just $\frac{1}{4}$ of January level. Overtime working has increased by about 12 per cent in 3 months to October over previous 3 months. Total hours worked in manufacturing stable since beginning of 1981.

(x) Special employment measures. Total provision on Job Release Scheme, Temporary Short-Time Working Compensation and Community Enterprise Programme in 1982-83 now planned to reach over £520 million, with additional £61 million for young worker scheme (starting January 1982). Spending on Youth Opportunities Programme to rise to £700 million in 1982-83.

(xi) Training. Over next 3 years £4 billion to be provided to bring training schemes up to date. New Youth Training Scheme for school leavers to be introduced September 1983 represents major step towards comprehensive provision for young people.

(xii) Industrial relations. Cumulative total of days lost through stoppages in first 11 months of 1981 was only a little over 4 million. This is second lowest total in last 14 years for comparable period.

(xiii) Retail prices. Inflation almost halved since peak in spring 1980 (21.9 per cent). 12 monthly increase in November of 12.0 per cent. [NB Progress will for a while remain affected by lower exchange rate and higher interest rates.]

(xiv) Share Ownership Schemes: Number of schemes has increased from 30 in May 1979 to over 350. Number of employees covered roughly doubled between first and second years in office. Profit sharing schemes alone now cover about 250,000 employees.

(xv) Loan Guarantee Scheme. Over 1500 guarantees issued by end November on loans totalling over £52 million. Over half of loans going to new businesses.

(xvi) Enterprise Zones. 10 out of 11 zones already in operation. Last one (Isle of Dogs) expected to start in April. Encouraging amount of interest shown; eg new project at Dudley expected to provide 300 jobs by 1985. At Corby, a good proportion of sites already allocated for development with 32 factories already under construction on designation day. On Clydebank, 45 companies with potential for 600 new jobs have either moved in or are expanding existing operations.

(xvii) Examples of British export successes reported in the Press include: over £500 million worth of business in Nigeria won in last 6 months; £250 million bank construction project won in Hong Kong; £170 million trans-Pacific cable contract won by (STC); £150 million contract for construction of university in Oman (Cementation International); £140 million gas storage contract (Chicago Bridge and Iron Co) in Abu Dhabi; contracts worth over £100 million for supplying generators and spares for the Soviet natural gas pipeline project (John Brown); £100 million motorway project in Iraq (Kier International).



171 JAN 1992

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Prime Minister

2

I asked the Treasury
for this - in case you

Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

8

January 1982

get asked
about it
on Sunday

Michael Scholar Esq
Private Secretary
No.10 Downing Street
LONDON SW1

MUS 8/1

Dear Richard,

We spoke this morning about the Chancellor's weekend meeting which is mentioned in today's Times.

As in the past, the Chancellor thought that it would be helpful to have a full discussion of future economic strategy and current public expenditure issues with his Ministerial colleagues, advisers, and senior Treasury officials. It is not a meeting at which any operational decisions are to be taken, but rather is intended as a mind-clearing exercise in preparation for the work of the next few weeks.

In the Chancellor's view, such a discussion gains from being held away from the interruptions inevitable in Whitehall. The last such meeting was held at Sunningdale; on this occasion the venue is Chevening, where the Foreign Secretary has, I understand, held a similar meeting.

Although some wives will be at Chevening for the weekend, they will not of course participate in any of the discussions, but will follow their own programme of activities. A charge is being made to cover the cost of their board and lodging at Chevening.

In response to Press enquiries we are explaining the purpose of holding the meeting away from usual office pressures; that its cost is modest as it is taking place in the Government establishment; and that wives are paying their own way.

Yours ever,
J O Kerr

J O KERR
Principal Private Secretary

FROM: R I G ALLEN
DATE: 8 JANUARY 1982

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B 1
Econ (A)

MR WARNER (PARLIAMENTARY SECTION)

cc Principal Private Secretary
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir D Wass
Mr Burns
Mr Cassell
Mr Kemp
Mrs Lomax
Mr Buckley
Mr Wicks
Mrs Woods
Mrs Case
Mr R Wilson
Mr Norton
Mr Gulvin
Mr Williams (OR)
Miss Deyes
Mr Ridley
Mr Harris

LIBERAL PROGRAMME: "A CHANCE TO WORK"

I attach, as requested, a note for No. 10 on today's press reports about the new Liberal Programme "A Chance to Work". I am afraid we have not been able to unearth, in the time available, a copy of the source document. As the attached note explains, this makes the interpretation of the macro-economic effects of the package very difficult indeed. But the press reports suggest that Mr Steel has taken little account of the possible inflationary consequences of the package, nor of the implications for taxation or interest rates. The PSBR effects will clearly depend, inter alia, on whether monetary policy is or is not assumed to be accommodating. The note suggests that, even on optimistic assumptions, Mr Steel has exaggerated the employment benefits of his programme, but the Prime Minister would be advised not to use the ready-reckoner results in public.

2. I have also included some notes on the detailed proposals on which the Prime Minister might want to draw.

3. I am grateful to several divisions for their contributions.

2. A
R I G ALLEN
EB

LIBERAL PROGRAMME: "A CHANCE TO WORK"

This programme was published yesterday (7 January). Of the reports which appeared in the press this morning (copies attached) the one in the Guardian is the fullest. We have not yet seen the source document. In its emphasis on infrastructure investment and training measures, the proposals are similar to the 10-point Programme for Economic Recovery published by the Liberals in January 1981.

Macro-economic effects

2. The costings of the programme, as described in the press reports, are not at all clear (the position may become clearer when we have seen the source document). The proposals involved seem to be of two kinds:

(a) Extra spending on employment subsidies and training programmes of roughly £1.4 billion. This might reduce registered unemployment by perhaps 200-250,000 if schemes of this magnitude could actually be put into effect, and assuming the same degree of deadweight, substitution, etc as in present programmes (we currently spend roughly £1 billion gross on SEMs with an effect on registered unemployment of some 350,000).

(b) Extra public sector investment of various kinds amounting to about £4.3 billion. On the usual Treasury ready-reckoners, this might reduce unemployment by 150-200,000 by the end of 1983.

3. Thus in total the measures would appear to have a gross cost of £5.7 billion rather than the £9 billion referred to by Mr Steel, and might reduce unemployment by 350-450,000 by the end of 1983. In terms of extra jobs the increase might be close to $\frac{1}{2}$ a million, compared with the one million claimed by Mr Steel. The counterpart of this would be higher inflation - although the extent of this would depend on whether or not monetary policy was accommodating, and on the extent to which the employment measures delayed pressures for realistic wage bargaining, and/or higher interest rates and taxation.

4. The total effect on the PSBR would again depend on whether or not monetary policy was accommodating but, if it was, the PSBR cost of £3 billion a year for gross expenditure of roughly £6 billion is not unreasonable.

Employment and training measures

5. The proposed £1 billion of subsidies for the long-term unemployed will involve the usual, probably greater, deadweight and other losses. There would be additional costs in terms of extra bureaucracy, etc. On youth training, the proposal appears to be that "every young person should be offered a two-year traineeship between 16 and 18". It is hard to see how this could be done for the money (£375 million). Mr Tebbit has proposed extra spending of £600 million a year, but this is largely for 16 year olds and is for one year only. The Liberals also say that the Tebbit allowance of £14 a week is "typically mean and purely cosmetic". This further worsens the credibility of their costing.

Severn Barrage

6. The Bondi Committee which reported last July said that a barrage was technically feasible and might be economically viable, and it recommended further studies. The Government is seeking comments on the Barrage Committee's report but there is no prospect of starting to build a barrage in the next few years. A committee of officials has concluded that it would not be competitive with nuclear power and was a very high risk project (costing perhaps £5-6 billion).

Energy Conservation

7. The Government has considered expanding the domestic insulation programme but has turned down larger schemes on grounds of cost, because house owners will reap most of the benefit, and the fact that it is not a particularly cost effective way of creating employment. The Liberals plan of £250 million over 3 years might create perhaps 3,000 jobs on optimistic assumptions (and ignoring second round effects of a higher PSBR). The net cost might be £50 million or so a year.

Private loan capital for British telecom and the National Water Council

8. The idea of nationalised industries borrowing direct from the market is an attractive one, provided this is done under conditions which impose market discipline. That idea lies behind the British Telecom Bond now being considered. But these Liberal proposals, with their reference to the alternative of Government stock, seem to involve no substantive change of this sort. As the Treasury Select Committee has pointed out, this would increase the cost of their borrowing without bringing any offsetting advantages.

British Telecom Investment

9. BT's investment programme this year is about £2 billion, and reflects £200m extra agreed last spring. Present plans are that the figure should rise substantially next year. There is nothing new in Mr Steel's advocacy of private loan capital for BT. The Government is already considering proposals for a BT bond. If agreed it will allow BT access to further investment funds. However, such a bond would need to provide a spur to BT's efficiency as well as an opportunity to investors. Investment can also be raised by savings generated by improved efficiency. BT have ample scope for this, as Sir George Jefferson is aware.

Channel Tunnel

10. The case for a Channel Tunnel has still to be made on economic grounds. To divert resources to finance uneconomic investment causes lasting damage for the sake of short-term gains. There is no justification on regional grounds for promoting uneconomic investment in the south-east of all places.

Investment for British Rail Modernisation

11. Any amount of taxpayers' money can be pumped into British Rail. The problem is getting value for money. The sort of attitudes we are now seeing do not advance rail modernisation: the future of the railways lies in their own hands. In the 1970s productivity was virtually stagnant (5 per cent up in the ten years 1970-1980). The Government

has made it clear it will play its part in electrifying the railway when the railways put their own house in order.

More investment on roads

12. The proposal to spend more money on roads is, of course, a familiar one though the Guardian report does not indicate how much of the £500 million over 3 years would be allocated to this as compared to rail modernisation. Whilst no doubt more money could be spent on roads, the difficulty is that the most economic projects are already in DTp's programme. The effect of higher expenditure would be to accelerate the decline in the economic value of the road construction programme and hence the point at which it would no longer make sense to go on spending at the increased rate. Thus, whilst it might help the construction industry in the short term, the longer term effect would be to accelerate the rate at which it would need to be cut back. From the point of view of the health of the industry, the more steady workload offered by DTp's current programme is arguably a better recipe.

Extra Investment on Water and Sewrage

13. The Liberals propose an extra £250 million for this. The Chancellor's December announcement on public expenditure implied a decrease in water capital spending in 1982-83. The industry have been informed of the figures for 1982-83 and have not reacted adversely, although they are lower in total than authorities initial bids. Because construction costs have levelled off recently, the impact of the reduction should not be severe. The Government too would like to see more investment here, as elsewhere. But public spending must be kept within bounds.

Demand for more building and youth training

Three-year Liberal plan to create a million jobs

By Stephen Cook

The Prime Minister's assertions that there is no alternative to current policies were challenged by the Liberal Party yesterday with the publication of a programme for creating a million jobs over three years.

The jobs would come from extra spending on house building programmes, home insulation and energy conservation, regional projects such as the Severn barrage, extra youth training, and the lifting of investment restrictions on public corporations such as British Telecom and the National Water Council.

Mr David Steel, the party leader, said that the programme would cost £9 billion over a period when the Public Sector Borrowing Requirement is expected to fall by £6 billion; so the cost to the public purse would be an extra £3 billion.

"We have taken up Mrs Steel said that the programme for employment which is not inflationary and is fully costed," he said. "The increase in the level of the PSBR is not substantial."

Mr Steel said that the programme, called A Chance to Work, would be fed into the Economic Commission set up

THE Liberal proposal is for spending an extra:

- £1,000 million on subsidies for the long-term unemployed.
- £375 million on youth training.
- £250 million on new technology training in schools.
- £2,000 million on major investment programmes, especially in the regions, like the Severn Barrage and Channel Tunnel.
- £500 million on road and rail modernisation.
- £500 million on housing.
- £500 million for investment in British Telecom.
- £250 million on domestic energy conservation.
- £250 million investment in water and sewage industries.
- £75 million on improved welfare services.

by the Liberal-Social Democratic Party Alliance, which is expected to produce an interim report later this year on what Alliance election policies should be.

"The document has been mentioned to the SDP, but not discussed with them," he said. "It was agreed that both parties should continue with their interim studies. It would be wrong for us to sit and do nothing, waiting for the commission to announce."

On employment subsidies, the document says the Government should subsidise private sector employees who take on people who have been unemployed for more than six months, paying at a level between the dole and the lower end of average weekly wages and monitoring firms to make sure they do not use the scheme as an opportunity to get rid of non-subsidised labour.

On youth training, it says every young person should be offered a two-year traineeship between 16 and 18. "The Tebbitt proposals for one-year training courses at £14 a week are typically mean and purely cosmetic," it says.

On British Telecom and the National Water Council, it says both corporations should be granted permission by the Government to raise private loan capital, for example to install modern electronic telephone exchanges and replacing leaky water mains.

"City institutions like pension funds would welcome the chance to have enterprises like this to put their money into instead of government stock," Mr Harry Cowie, principal author of the document said.

A Chance to Work. 60p, plus 17p postage and packing, from Liberal Publication Department, 1, Whitehall Place, London SW1A 2HE.

The bar to hiccupps

By Andrew Veitch

A BARMAN'S cure for alcoholic hiccupps—a wedge of lemon, soaked in angostura bitters, with a little sugar to taste, consumed rapidly (except for the rind)—may soon be given the medical seal of approval.

Two Baltimore doctors, Jay Howard Korman, and David S. Nolan, tried it on 16 sufferers for whom other methods had failed.

Fourteen stopped hiccupping within a minute. The other two were subjected to a second helping and both stopped within five minutes.

The active ingredient remains a mystery.

"Further clinical trials are in progress," the doctors report in the New England Journal of Medicine.

Man gaoled for hoax accusation of murder

A man was gaoled for three months yesterday for wasting police time during a murder hunt. Brian Hunter telephoned detectives to tell them a friend had confessed to strangling Janet Cheetham, aged 17, at Rainhill, Liverpool.

An innocent man was dragged from bed to face tough questioning by murder squad officers, the prosecution told magistrates at St Helens, Merseyside.

The hoax wasted 168 hours of police time. Mr Hunter, aged 32, a father of three made his call at 1.35 a.m. on New Year's Eve—12 days after Janet's body was found in an alley 10 yards from her home.

Senior detectives were called from their homes when he told a duty sergeant at murder control that his friend—who had convictions for sex offences—was the killer. They went to

Mr Hunter's home and he accompanied them to another house where he pointed out the suspect, said Mr Patrick McLoughlin, prosecuting.

Mr McLoughlin said that Mr Hunter, of Park Road, St Helens, told police in a statement: "Lately I was feeling depressed. I knew this particular man had been in for sex offences and I knew they hadn't caught anybody at Rainhill. I thought of a way to get him into trouble."

The two men met five years ago when Mr Hunter had been receiving hospital treatment for a nervous complaint.

Mr David Lloyd, for Mr Hunter, said: "This man does have psychopathic tendencies. There was no animosity or vindictiveness towards the person who was interviewed by the police."

Campania unlocks 'peace' cells

By Malcolm Wright

Six cells which were intern conscientious during the First World War, Richmond Castle, Northshire, may soon be open to the public, following a campaign by Quaker Peace.

The cells are currently for storage but the Dept of the Environment will find alternative uses they can be opened permanently for public visit.

In future anyone with access to the cells allowed in, where possible they needed a special pass issued from London.

Money might also be available to protect the walls, where the listed their religious aff principles in a vast graffiti.

Yesterday a DOI said a full photograph of the graffiti had been taken by a regional Mr John Weaver, and mounted for public interest in the cell.

The cells in the castle are not mentioned in official 1971 Department of Environment guide to century Norman fort. They have remained closed since men were imprisoned in 1916.

Conscientious objectors all over the north of England left a remarkable record of their two-month stay in the cell with their chronicle is not away after 65 years of

Quaker groups from Yorkshire and Cleveland mounted a campaign Christmas to have their unique social role on show to the public. Britain's first official to peace.

Leading the campaign Mrs Ruth Gardie, of Great Ayton, Cleveland, late husband, Norman, of the internees, taken out to prison threatened with death squad for cowardice.

Their sentences were finally commuted to penal servitude for a period of independence.

Mrs Gardie, whose husband died in 1975, said: "This is excellent news. I knew that my husband had some time of his story of these objectors should be

NEWS IN SUMMARY

Suspended teacher sent home

Powys County Council yesterday complied with a High Court ruling to suspend Mr Wayne Williams, a Welsh language activist, from his job as a teacher at Llandidloes High School in mid Wales.

Earlier this week the High Court had granted an injunction to Mr Lawrence Smith, a parent, preventing the county council from allowing Mr Williams, a former chairman of the Welsh Language Society to teach until a completion of a judicial enquiry.

Mr Williams resumed work on Tuesday to face a protest by a parents' action group. He was released from prison at Christmas after serving six months for conspiring to damage broadcasting equipment.

1,000 queue for hotel jobs

More than 1,000 people queued for hours in the ice and snow in Glasgow yesterday hoping for one of 160 jobs at the city's Grosvenor hotel, which is reopening soon after being devastated by fire.

Mr Tim Kelly, the Grosvenor manager, said everyone in the quarter-mile queue would be interviewed for the jobs as cleaners, cashiers, kitchen and bar staff. The Grosvenor has cost £6½m to rebuild.

Policemen accused of insulting solicitor

Detective Inspector Albert Kirby of Merseyside Police is to stand trial accused of wilfully insulting a solicitor. Mr Thomas Cooper has summoned the officer under the Contempt of Court Act, 1921, alleging that he was insulted at Liverpool magistrates' court in November.

Honor jailed

A man was jailed for three months by magistrates at St Helens, Merseyside, yesterday for wasting police time during a murder hunt. Brian Harvey, aged 32, of Park Road, St Helens, told detectives that a friend had confessed to sitting Janet

Liberals unveil three-year package on jobs

By Derek Barnett

A detailed Liberal plan to cut unemployment by more than one million over three years at a net cost of just over £3bn was announced by Mr David Steel, the party leader, in London yesterday.

The 10 point investment programme, Mr Steel contended, would need a gross outlay of about £9bn. But he said much of the money would come from North Sea oil revenue and pension funds from which investment had been going overseas after the collapse of British industry.

In *A Chance to Work*, a party document laying out the programme, Mr Steel states: Two thirds of the gross outlay would flow back to the Exchequer through lower unemployment expenditure and a more buoyant revenue. It represents a bargain price to pay for revitalizing our economy.

The plan envisages a regional regeneration programme to create 220,000 jobs at a cost of £2bn. This is the most expensive item put forward.

Local government, industry and commerce should all be encouraged, the document says, to put forward new

investment ideas. Other schemes with an emphasis on conservation should be tackled.

Some regions, through their regional councils and associated development corporations, might opt for projects in partnership with private industry in areas of high technology.

The document also calls for a new housing drive in the inner cities and other high unemployment areas at a gross outlay of £500m which would create 70,000 jobs.

Another outlay of £500m would, it is stated, bring 70,000 new jobs in transport where there is "a powerful case for new investment in roads, electrification of railways and development of commuter services," and another £500m, Liberals believe, should be provided to boost British Telecom and provide 50,000 jobs.

Other areas for suggested investment are domestic energy conservation, essential services like water and sewerage, employment subsidies, voluntary community work schemes, improved education and youth training.

Summer time chaos troubles the Lords

By George Clark

Lack of uniform arrangements on the beginning and ending of summer time in the European Community results in chaotic rail and road timetables, the House of Lords Committee on the European Communities stated in a report published yesterday.

It was told by Group Captain P. W. Jameson, a witness from the Home Office, that the chaotic arrangements cost British Airways about £5m a year. There were other costs for ferry operators and the railways; the total cost might be £8m in the United Kingdom.

Captain Jameson told the committee there was agreement for 1981 and 1982 on a common starting date.

"Under the old arrangements there were four changes; we made two and Continental countries made two. These make for great complications and are costly.

passengers, but the airlines need to reschedule services in order to fit in with airport timetables", he said.

The committee recommends that the Government should agree with the European Commissions compromise proposals for uniform dates of summer time changes.

"At the end of the summer, the problem is more difficult", the Lord's committee, under the chairmanship of Lord Wolfenden, states, "because under the proposals summer time would end on the second Sunday in October, and thereby the United Kingdom and Ireland would lose two weeks in most years and three in a few".

On the other hand it points out that eight of the ten member states of the EEC would be asked to lengthen their summer time by a two-

IT paper racially insulting, court told

Joseph Pearce, editor of *Bulldog*, the National Front youth newspaper published shrill articles likely to stir up racial hatred among impressionable young people, it was alleged at the Central Criminal Court yesterday.

Mr Alan Green, for the prosecution, told an all-white jury that Mr Pearce, aged 29, had clearly broken the law by carrying material in the newspaper which was threatening, abusive or insulting to coloured or Asian people.

Mr Pearce, of Dagenham, Essex, denies eight charges of publishing written material between January, 1980 and December last year, which was likely to stir up racial hatred.

The readers of the newspaper which cost 5p and for which Mr Pearce had written 90 per cent of the contents were young and impressionable. "What is considered by an adult in the quiet of his study may receive a very different reception when it comes into the hands of young people", Mr Green said.

Mr Pearce's complaint in *Bulldog* that the race law had destroyed freedom of speech was absolute rubbish, Mr Green said.

"What may on the one hand be a perfectly sensible debate about the very difficult problems of race and of society, may degenerate, as has in this material, in a matter which is threateningly abusive or insulting".

In issue No 15, there was an item alleging that a girl had been raped during "Indian magic ritual". The report had come from a national newspaper and related to a trial in Switzerland.

An allegation in the same issue that "Coloured immigrants can seriously damage your health" was not only bad taste but also insulting, he said.

Issue No 16 carried a call: "Join the resistance become a white free fighter." Mr Green told jury. "Analogies of wars fighting are often used metaphorically. The prosecution invited you to consider whether the words that article are in a threatening way".

Even remembering "terrible troubles" of summer, the allegation in issue No 17 that the black British "have declared on the whole of your society" was an exag-

Fr.
8/1/82

Steel unveils £9bn scheme to reduce unemployment

BY PETER RIDDELL

A £9bn proposal to create more than 1m jobs within three years was unveiled yesterday by the Liberal Party.

Mr David Steel, the Liberal leader, said the measures represented "a bargain price to pay for revitalising our economy."

The proposals mainly involve extra public sector investment to improve the infrastructure of the economy, as well as subsidies for the long term unemployed.

Mr Steel said at a London press conference yesterday the programme could not be achieved without an Alliance government which could bridge the two sides of industry.

The detailed scheme will be on the agenda of the SDP-Liberal commission which is discussing the Alliance's employment policies.

The Liberals insist that the proposal are not inflationary. They estimate that the gross

outlay will be £9bn spread over three years.

The proposals include:
 • An extra 1500m on new housing, especially in inner cities.
 • £270m for domestic energy conservation.
 • An extra £2bn on major investment programmes in the regions, such as the Severn bridge and the Channel tunnel or bridge.
 • An additional 5500m for investment in British Telecommunications.
 • £500m for new roads and rail electrification.
 • £250m for investment in water and sewage.
 • A further £1bn in employment subsidies for those unemployed for more than six months.
 • £250m for new technology training in schools.
 • £375m for voluntary community work schemes.

THE SP...
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 last week...
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 stituencies

Joint negotiations...
 restart in about half the seats in England where talks were already under way or dates have been fixed for meeting. But now new negotiations will start until a meeting of the joint national negotiating committee on January 6 reviews progress.

The meeting yesterday of the eight members negotiating terms from... attempted to defuse the rift between SDP and Liberal members which has up to 100 places before... over who should...

Labour's

EUPHORIA surrounded the conclusion of the...
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Mr Clive...
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 Mr...
 Tony Penn...
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 Breakall, president of the...
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A Vision for the Blind

How do you manage your own life when you cannot see, when other handicaps have piled up on you, and when you have no home, no help or work?



June is partially sighted and had polio and TB as a child resulting in additional physical handicap. She is the only deaf-blind child in the school, her mother and sister who has cerebral palsy are Royal School.

The Royal School is about to start to be independent and to be responsible for everything that is possible for each individual. We are looking forward to a future for 150 blind and deaf children. They have come to the Royal School for the first time, so no other school here could be responsible for them. It is the responsibility of the Royal School to make a home for them, to help them to be independent for their sight, this Christmas, to give them a chance to write for their mothers to say 'I am a Royal School child'.
 The Royal School for the Blind, 1-11, St. Mary's, Surrey GU12 7TH.
 Telephone: 1-11-11-11-11.

Royal School for the Blind
 1-11, St. Mary's, Surrey GU12 7TH
 Expenses free by Nov 25, 1982

4 January 1982

POLICY UNIT

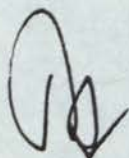
PRIME MINISTER

STRATEGY MEETING: TUESDAY 5 JANUARY

1. I thought it might be helpful background to our discussion with David, Alan and Ian tomorrow, if I gave you the opening sections of the report of our Westwell Weekend discussion. This is attached.

2. As you will remember, the Westwell Weekend followed from a discussion between Cecil Parkinson, David Wolfson and myself and was very much a first bite at the cherry. Approximately 12 hours of actual discussion, to an agreed agenda, produced a full transcript of 84 pages of single spaced typing. From this transcript, the enclosed first draft report was prepared by me before Christmas. It runs to a further 25 pages, making 30 pages of single space typing in all. This 30-page first draft report has not yet been discussed, paragraph by paragraph, with those who came to the Westwell meeting, to ensure that it is complete and correct. This will be done at a half-day meeting next week. I will then, as quickly as possible after that, produce an agreed second draft of the report for you. However, the attached pages, which give the table of contents and the general approach, are not expected to change significantly.

3. I suggest that our meeting tomorrow could start by talking through the attached pages (ie the first three sections of the draft report) and then go on to discuss the organisation and timetable needed to move from this first rough and ready starting point to a fully worked out strategy and the organisation (No. 10 advisers, CPRS, Central Office and Research Department, CPS and their part-time advisers, Department's long-term planning units) needed to make it all happen.



JOHN HOSKYNS

THE WESTWELL REPORT

Stepping Stones to 1986

"Failure is less frequently attributable to either insufficiency of means or impatience of labour than to a confused understanding of the thing actually to be done."

Ruskin

"Working hard to think clearly is the beginning of moral conduct."

Pascal

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WESTWELL REPORT

(First attempt to summarise and structure the transcript of the discussion)

1. INTRODUCTION

- 1.1 The first phase of this Government's programme is now complete, though of course far from perfect. It covered the period mid-1977 to end-1981; a 4½ year period which covered the development of the basic strategy (a sustained monetary deceleration, a sustained effort to reduce public spending as a percentage of GDP, a step-by-step programme of trade union reform, the start of a long process of supply side measures to free-up the workings of the private sector).
- 1.2 While we cannot ourselves be satisfied with progress to date (that would be a very unhealthy sign) it is probably fair to say that no post-War Government has had such a clear understanding of its central objectives, has stuck to them so single-mindedly, or has wasted so little time on short-term political expedients and gimmicks. On the debit side, understanding of the Government's purpose and method has been weak in the country and, even within the Party, has not been thorough enough to give our own troops the convictions - and thus the courage - to stick it out. The Government is thus very vulnerable to the propaganda from Labour, and even from SDP (whose more intelligent members know perfectly well that we are doing what has to be done) that the whole strategy is a ghastly blunder, from which neither the economy nor the Conservative Party will recover.
- 1.3 The Westwell discussion was a first attempt to identify the stepping stones needed to get us from here, via a resounding electoral victory, to 1986 - the next 5 years. The group comprised:
- 3 politicians: David Howell, Cecil Parkinson, Norman Lamont
 - 2 economists: Alan Walters, Douglas Hague
 - 3 businessmen: David Wolfson, Norman Strauss, John Hoskyns.

2. THE "STEPPING-STONES" APPROACH

2.1 Conventional political thinking makes a strategic approach almost impossible. Life proceeds in a series of short-term hops. For example, the final 2 years in Opposition, obsessed with how to win the coming Election and thus only a sketchy preparation for the task of Government; followed by a chaotic first year in Office, in which the lack of really fundamental thinking in Opposition leads to many mistakes; a second year in which the Government begins to get into its stride and things get done; thereafter, the time horizon shortens week by week from 2 years finally to a few weeks. as, once again, winning the Election at all costs becomes the overriding concern. The Government appears to run out of intellectual steam and energy, and mandarins and nationalised industry Chairmen start to mark time and prepare for a possible change of master.

2.2 We believe that this is a hopeless way to proceed. It means that the last 2 years of Government may be largely wasted, and the first 2 years of the next Parliament (assuming Election victory) less effective than it should be; and probably a smaller rather than a larger chance of winning that Election. Instead, we propose a 5-year Stepping Stones programme. It is concerned not simply with "how to win the next General Election", because that question cannot be addressed unless we are clear about where we want to get to in those 5 years (ie by the end of 1986). The objective is national recovery, not winning the right to preside over the next chapter of decline.

2.3 We therefore have to rethink a complete and credible 5-year programme which includes, contributes to, and requires a resounding Conservative Election victory. In effect, we are taking the MTFs concept and enlarging it, and also rolling it forward rather than letting it end arbitrarily after 4 years.

Of course all this involves a lot of work & thus a lot of people (No 10 advisors, CPRS, Central Office/Reserve Dept, CPS etc). Part that

2.4 Properly developed, this approach has more to it than meets the eye. By forcing itself to think ahead to its long-term objectives, and then "map backwards" to see how to reach them, it has a much better chance of anticipating problems in time to solve them, and ~~to~~ ^{to} ~~be~~ ^{be} ~~at~~ ^{at} work in hand in time to meet both the electoral and the next Parliament's timetable. It maintains the

putting

is a good thing (see top of page 3 overleaf)

momentum of work in the Departments; it gives opportunities for back-benchers and Research Department staff to identify more closely with the Government's aims and policies, at the critical mid point when morale is typically lowest and doubts are strongest. *Above all it should make for greater unity in the Cabinet.*

2.5

Of course none of this is enough to solve the country's problems or win the Election, but it must be better than doing nothing. And at best, it will close the ranks, multiply among them a sense of purpose, hope and greater confidence, and this must eventually affect the impression the Government and the Party convey to the media, to constituents and to the public at large. As in military matters or in business, any plan is enormously preferable to no plan. Opinion-formers (media, academics etc) will see that this Government is behaving calmly and responsibly on the assumption it will be back again after the Election. This very confidence (and it is a sort of confidence trick) will make it easier for the Government and the Whitehall machine to continue to perform competently - itself important in electoral terms. The more this approach can demonstrate depth and quality in our thinking, and integrity and intellectual honesty in our motives, the more the superficiality of the SDP in particular will become apparent.

3.

THE QUESTIONS WE HAVE TO ANSWER

3.1

Most efforts at strategic planning move from simplicity and order towards complexity and confusion instead of, as was intended, the opposite direction. A great deal of time and effort is therefore needed in the early stages, to ensure that this does not happen. A complete Stepping Stones programme which will actually achieve its objectives (ie make the future different from what it threatens to be) has got to be complete from "macro" to "micro", from the broad brush outline of the battle plan right down to a specific Minister making specific points, on the right medium (eg TV) on selected issues, at a particular moment when the opportunity offers. The "micro" activity will only happen ~~if~~ the "macro plan" required it.

3.2

When we talk about a Stepping Stones programme, therefore, we are talking about:

- 2 -
- (a) The clearest ^{& fullest} possible statement of "the nature of the thing actually to be done". This will be a (fairly substantial) piece of paper.
- (b) It can never be complete or perfect, but it is the "architect's drawing", without which nothing ~~much~~ ^{else} can start.
- (c) Opinion research on key issues.
- (d) Outline design of policy measures for the next Parliament.
- (e) Completing the implementation of ^{"first term"} policy which turns out to be essential before the Election.
- (f) Developing a "game-plan" to change attitudes on the key issues identified in (a) above.
- (g) The preparation of speeches, broadcasts, films, "events" required by the game-plan.
- (h) Some sort of day-to-day operating system to respond in "real time" to day-to-day events; eg getting the right Minister, properly briefed, in the right place to turn a problem into an opportunity and then make the most of that opportunity.
- (i) Meticulous preparations by the Government for the more predictable "crisis management" tasks - usually public sector strikes. These are important for their economic consequences and the evidence they provide to the electorate of a Government's skill and nerve when the chips are down. *They should also be used to educate the public about economic & moral principles at stake.*

3.3

The initial Stepping Stones document - item (a) in the list above - must answer the following questions:

- Economic outlook. What will the economic situation look like by the next Election, on the "momentum" of present policies? What measures are still possible (ie not too late) to improve the outlook?
- Election issues. What will the key Election issues be? What voting criteria must be established? Myths created or demolished?
- Policy measures for 1984-6. What are the main policy measures the Government will want to take during the period 1984-6?
- The Election mandate. Which measures will require a specific mandate? Which pledges must be included in the Manifesto? Which pledges must be carefully avoided; which current commitments must be undone in the Manifesto?
- Making it happen. How is the broad strategy agreed, and by whom? What human resources to do the work and how organised? *Composition* of the Stepping Stones Steering Group? How are day-to-day communications handled?
- (~~Insert earlier.~~ A qualitative snapshot of 1989. What we want the country to look like and feel like at the end of a second term.)

3.4

The Westwell group discussed the first two and the last of these items: economic outlook, key Election issues and making it happen. The rest of this paper attempts to summarise the points that arose in discussion, most of them under these three headings but some of them fitting into other headings on the list. (Westwell also discussed the rationale for the Stepping Stones approach* as a whole, four of the members having been involved last time round.)

* As outlined in Section 2 above.

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MR. HOSKYNS
MR. WOLFSON
MR. WALTERS
MR. GOW

The Prime Minister would like to have a general Strategy Meeting starting at 1100 next Tuesday, 5 January. This meeting will be followed by lunch in the flat.

CAROLINE STEPHENS

30 December 1981



✓
PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

23 December 1981

New John,

ECONOMIC GUIDANCE FOR MINISTERS OVER THE NEW YEAR

... The Lord President has agreed that the attached note, which has been approved by the Chancellor of the Exchequer, should be circulated to Cabinet colleagues for their use as necessary over the New Year.

I am sending copies of this letter and attachment to the Private Secretaries to all members of the Cabinet with the request that they should draw it to the attention of other Ministers in their Departments.

Yours ever,
D.C.R.

D C R HEYHOE
Private Secretary

John Halliday Esq
Home Secretary's Office

THE RECOVERY HAS BEGUN

As we enter the New Year, I know that many colleagues will find themselves asked about recent economic developments and the prospects for the year ahead. I hope you will find these notes helpful to have by you, to draw on as necessary.

Points to make

1. Economic recovery has begun. The latest figures suggest that there has been an increase in manufacturing output of about 1½ per cent in the three months ending October over the previous quarter, the largest increase for 2½ years.
2. How strong the recovery is, and how long it lasts, is up to all us. If we expect to cash in immediately, and take out all we can in extra pay, we shall lose everything we have gained so far.
3. But if we're patient, and accept that a sustained effort is needed over several years in order to get our economy fully competitive again, the prospects are good.
4. Look at the evidence of the underlying improvements in the way we do things:
 - We're getting more productive. Productivity in manufacturing industry (output per man) rose by about 5 per cent between the last quarter of 1980 and the second quarter of this year. The CBI estimates a 10 per cent increase during the year as a whole.
 - We're keeping our labour costs down. The rate of pay settlements this year has been halved compared with last year; and for the first time for several years our unit labour costs have risen more slowly than the average of our competitors: only 3.9 per cent in manufacturing in the year to September.

- We're getting more competitive. In the last year our improved productivity, our more realistic pay settlements and the fall in the value of the pound has meant that competitiveness improved by at least 10 per cent - a considerable achievement in the depths of a recession.
- We're winning orders. The evidence is growing of the business we're winning back from our competitors. For instance, engineering export orders are over 20 per cent higher this year than in the second half of 1980, and the CBI reports the highest level of optimism over exports since 1977. Home orders for engineering and construction work are also substantially higher.
- Investment prospects are improving. The latest Department of Industry intentions survey points to prospect of rising investment over next two years in manufacturing, distribution and services. Private sector housing starts were up 40 per cent this year compared with second half of 1980.
- We're having fewer industrial disputes. The number of strikes has been fewer in the last two years than in any comparable period since the war.

5. The tide of unemployment though still too high is now slackening. It's rising only half as fast as a year ago, and in recent months there's been less short-time working, more overtime and more notified vacancies.

6. So the Government's policies are right. We're going to get inflation down further, and we're going to create the best possible conditions for industry to take advantage of the recovery. If others also play their part - particularly by moderate pay settlements - that is the way to more jobs and lasting prosperity.

23 DEC 1981

10 11 12 1 2 3
9 8 7 6 5 4

copy filed on
Prime Minister Dec 81
Mrs MG with Sir E Harrison
of Racal Electronics Ltd



10 DOWNING STREET

[Handwritten signature]

[Handwritten signature]

[Handwritten signature]

From the Private Secretary

21 December 1981

Sir Ernest Harrison of Racal called on the Prime Minister at 1700 hours this afternoon. Your Minister was present.

Sir Ernest opened by discussing the development of Racal's business, and the company's strategy. He made a strong plea for a government policy of selective support for the UK electronics industry. The Ministry of Defence provided a lot of business for the UK industry, but very little of this had export potential; the industry would need government help if its competitive position in world markets was to be assured. There were areas in which the UK industry had led the world in innovation, such as the development of liquid crystal displays, fibre optics, and the use of lasers in telecommunications; but UK industry had been bad at exploiting these developments commercially. In reply, the Prime Minister said:-

- (a) The electronics EDC had reported on this subject to the NEDC in November. The report was being considered within the Department of Industry. The subject would come up at the NEDC in February, which would be chaired by the Prime Minister. She would welcome a short tutorial on this subject before the Council meeting, with plenty of visual displays. The presentation of the paper in the Council itself should also be accompanied by visual displays. The Treasury will wish to take account of these comments in arranging the NEDC meeting on 3 February, and the Prime Minister's briefing meeting on 2 February.
- (b) More should be done to recognise those who had made these innovations. Your Minister agreed to discuss with the Department of Education and Science the possibility of encouraging scientists to nominate the engineers and scientists concerned for Nobel Prizes. The Prime Minister had particularly in mind the recognition of the developments mentioned above.

Sir Ernest went on to say that introducing new technology into industry was essential to the future survival of British industry; much of industry needed to make the step from using electro-mechanical processes to using electronic processes;

/many more

[Handwritten mark]

many more scientists and engineers were needed in this country if the UK was to achieve this. Sir Ernest felt that 80 per cent of places in universities and polytechnics should be assigned by the Government to scientific subjects. In reply, the Prime Minister said she would consider holding a lunch, or dinner, to discuss what more the higher education sector could do to help in this area. I will be in touch with you and the Department of Education and Science when I have consulted the Prime Minister about whether, and how she wishes to pursue this.

There was some discussion of the problem of unemployment. Sir Ernest Harrison said that he was depressed by how few employees of Racal ever tried to set up small businesses of their own. He was sure that more would do so if they felt they could remain a part of the Racal Group; but the rules on the taxation of subsidiary companies did not encourage this, nor did the incentives open to small businesses apply to subsidiary companies. Your Minister said he would take this up with the Treasury. Sir Ernest also asked why more could not be done to encourage early retirement, or even to reduce the retiring age. The Prime Minister said that in general it was more expensive to support a pensioner than an unemployed person; Sir Ernest's suggestions would be expensive to implement unless the indexation of pensions was abandoned, and that would be extremely difficult.

I am sending a copy of this letter to Peter Jenkins (H.M. Treasury) and Peter Shaw (Department of Education and Science).

Jonathan C. Hudson, Esq.,
Office of the Minister of State,
Department of Industry.

*Copy
Strategy*

PPS/CHANCELLOR

Prime Minister

*Sections A & B could be
helpful for questions
tomorrow.*

MA 21/11

file no TEB/CA/01

copied to:

- Mr Salveson (for transmission to No.10)
- PS/CST
- PS/FST
- PS/EST
- PS/MST(C)
- PS/MST(L)
- PS/Home Secretary
- PS/Lord Chancellor
- PS/Foreign Secretary
- PS/Secretary of State for Education and Science
- PS/Lord President of the Council
- PS/Secretary of State for Northern Ireland
- PS/Secretary of State for Defence
- PS/Minister of Agriculture, Fisheries and Food
- PS/Secretary of State for the Environment
- PS/Secretary of State for Scotland
- PS/Secretary of State for Wales
- PS/Lord Privy Seal
- PS/Secretary of State for Industry
- PS/Secretary of State for Social Services
- PS/Secretary of State for Trade
- PS/Secretary of State for Energy
- PS/Secretary of State for Transport
- PS/Chancellor of the Duchy of Lancaster
- PS/Secretary of State for Employment
- PS/Paymaster General
- and officials in HMT, Revenue Departments and other Departments in Whitehall.

TREASURY WEEKLY ECONOMIC BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 14 December, are sidelined.

M M Deyes

M M DEYES

RA

R I G ALLEN

21 December 1981

EB Division
HM Treasury
01-233-3364

A	GENERAL ECONOMIC STRATEGY	EB
B	ECONOMIC ACTIVITY AND PROSPECTS	EB
C	LABOUR MARKET	EB
D	TAXATION	FP1/2
E	PUBLIC EXPENDITURE AND FINANCE	GEP1/2
F	SOCIAL SECURITY	SS1
G	PUBLIC SECTOR BORROWING	GEA1
H	MONETARY AND FINANCIAL POLICY	HF3
J	PRICES AND EARNINGS	IP2
K	BALANCE OF PAYMENTS	EF1
L	FOREIGN EXCHANGE RESERVES AND IMF	EF1
M	EUROPEAN MATTERS	EC1
N	INDUSTRY	IP1
P	NATIONALISED INDUSTRIES	PE1/2
R	NORTH SEA AND UK ECONOMY	PE3/MP2
S	WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE	EF2
ANNEX	AIDE MEMOIRE: RECENT ECONOMIC INDICATORS	EB

A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

Main objectives are to achieve, over a period, a sustained improvement in the economy through reduction of inflation and promotion of enterprise and initiative. Reduction of inflation requires strict adherence to firm monetary and fiscal policies. Improvement of supply side depends on restoration of flexible and competitive market economy and better incentives.

2. Relative importance given to inflation and unemployment?

Government is equally concerned about both. These are complementary not competitive objectives; unemployment will not be reduced by relaxing struggle against inflation.

3. PM's views on TCSC Report?

Always read these reports with interest. House will not expect me to agree with all the conclusions.

4. Has Government downgraded EM3 and PSBR?

That is an extraordinary conclusion to draw from the Chancellor's statement on December 2 and from the evidence the Chancellor gave to the Committee. Consistent emphasis on need to keep downward pressure on monetary variables and to restrain government borrowing.

5. Government has abandoned strategy?

Government remains committed to reduction of inflation and to creating conditions for growth. Actions, as well as words, show this. The Chancellor's next Budget is the right occasion, as in past two years, for restatement of the strategy.

6. Expectations for next year disappointing?

[Industry Act Forecast, published 2 December: details at B2]

No. Further falls in inflation in prospect. A rise in output instead of a fall. Good export prospects and current balance will remain in surplus. Admittedly a gradual undramatic recovery, but UK operating in difficult economic environment.

7. Unemployment next year?

Prospects for unemployment very uncertain and depend on a number of factors. [IF PRESSED on unemployment prospects: IAF broadly consistent with assumptions in Government Actuary Report that unemployment in 1982-83 will be 300,000 higher than in

1981-82. But if things go well - pay settlements, recovery in world trade - then reasonable to hope for fall in unemployment before end 1982-83.]

8. OECD Report?

[OECD Economic Outlook report due out 23 December - but may be "leaked".]

Encouraging that report recognises upturn in UK economy, and expects recovery to continue next year, with inflation falling towards 10 per cent. In broad terms OECD forecast closely in line with IAF.

10. Announcements reflationary/deflationary?

Neither. Announcements have to be seen in context of overall fiscal and monetary policies. On conventional assumptions set out in the IAF, figures point to a PSBR next year broadly in line with 1981 Budget projections. Further announcements only one half of picture. Cannot anticipate at this stage decisions on tax etc which fall to be taken at Budget time.

11. Effect of higher NIC, rent, health charges?

[Announcements increase RPI by 0.6 per cent (mainly higher council rents) and TPI by 1½-2 per cent (reflecting also higher NICs) from next April.]

Should not exaggerate effect on prices of Government's decisions. Widely recognised to peg all prices over which Government has influence not lasting solution to inflation. Appropriate fiscal policies, of which measures to limit rise in public expenditure are part, are essential for containing inflation.

12. Government has failed to check public spending?

No. Have made positive decision to increase spending in some areas but remain determined to stick to plans once set. This year, cash limits are generally holding; determined to set (and keep to) tight but realistic limits next year. [See also E2-3 and 17.]

13. Tax increases necessary?

Cannot foreshadow Budget. Undoubtedly, higher public spending makes prospects for PSBR, interest rates and burden of taxation next year more difficult. But, as rhF said in 2 December statement, on conventional assumptions figures point to a PSBR next year broadly in line with projections published at time of Budget. Final assessment must await Budget next year. Will need to assess appropriate fiscal stance in light of circumstances at time, including monetary prospects and outlook for inflation.

14. Distributional effects of 2 December statement

NIC increases will take a larger proportion of net income from the better paid, up to the earnings limit. Council rent increases will not be flat-rate because of rebate system: lower-paid get more rebate. Pensions and unemployment and other benefits are planned to increase by more than the expected rise in earnings, implying a redistribution from the working population to the unemployed and elderly.

15. Government has failed to allow accommodation to the recession?

On the contrary. Have been flexible within the limits of prudence over the levels of public spending and borrowing. But experience shows that attempts to "buy" jobs only temporarily beneficial. Repercussions weaken economy and worsen job prospects in longer run.

16. Failure to control monetary growth?

Judged by results rather than precise numbers, strategy successful. Growth of money GDP fallen sharply. Inflation rate halved. Some good features in monetary picture - outturn for PSBR in 1981-82 should be close to forecast; funding programme on track. [Nevertheless, bank lending disturbingly high, particularly personal lending.]

17. Why are high interest rates needed?

Current level of interest rates has reflected developments overseas and strength of bank lending. Although sterling has recently firmed, high level of bank lending continues. However it should be noted that bank base rates have come down by 1½ per cent since September.

18. Government should change course?

(a) Moderate reflation the answer?

Government recognise need to respond flexibility to economic situation, within framework of overall strategy. But no question of abandoning that strategy. Cannot throw away gains made so far by return to discredited policies. Fallacy that we could "spend our way out of recession" (i.e borrow much more) without seeing resurgence of inflation and undermining financial markets, and, as a consequence, interest rates rising further and faster. Even large reflationary packages yield relatively small benefits eg NIESR £5 billion package would reduce unemployment by only 150-300,000 after 5 years.

(b) £10 billion package proposed by Professor Wynne Godley?

[Letter in The Times 18 December]

that

Not true, Government does not believe that "unemployment cannot be reduced by fiscal and monetary policy" (Godley's first paragraph). On the contrary, appropriate fiscal and

monetary policies are essential if the right conditions are to be created for sustained economic growth. Nor can Government be accused of "inflexibility" (Godley's second paragraph): PSBR forecast for this year is some £3 billion higher than planned in the 1980 Budget; Government is planning to spend some £3 billion on employment programmes next year; etc, etc. (see C8). Godley's own arithmetic decidedly odd. The combined revenue this year from NIS and manufacturing employers' NIC is only about £7 billion. To raise £10 billion the Government would have to abolish NIS and cut employers' NIC by about two-thirds across the board.

(c) Reintroduce exchange controls and join EMS?

EMS is not a panacea. But Government does fully support EMS as an important step in monetary co-operation and closer integration in the European Community. Have stated that UK will participate in the EMS exchange rate mechanism when conditions appropriate both for the system and ourselves. Question is kept under constant review.

(d) More capital spending in public sector?

Projects must be economically sound. Not all capital spending virtuous nor all current spending bad. Cost of public sector investment in terms higher borrowing pushing up interest rates could outweigh immediate boost to jobs.

B ECONOMIC ACTIVITY AND PROSPECTS

1. Latest information on output, production and stocks - recession over?

Fall in output now over. GDP output on latest - revised - figures, is rising. Q3 up $\frac{2}{3}$ per cent on Q2. Manufacturing output increased by 2 per cent in same period. (Fuller information has led to revision of first assessment that output broadly flat between Q2 and Q3.) Q3 figures for manufacturers' and distributors' stocks show rate of destocking one-third that of H1 1981. October industrial production figures show continued improvement with manufacturing output up $2\frac{1}{2}$ per cent from low point (H1 1981). New Industry Act forecast sees continuation of recovery in output.

2. Other evidence of improvement in economy?

September engineering orders show new orders total up 17 per cent on H2 1981; within this, export orders figure up 21 per cent. Retail sales figures for November up 2 per cent on average for 1980. November cyclical indicators continue to confirm recovery under way. (Coincident indicator has been rising since May; longer leading indicator - weakening since May - improved slightly in November.) [IF PRESSED over weakening of longer leading indicator : decline halted in November; recall temporary weakness in last cycle.]

3. Government assessment of prospects

[New Industry Act forecast (2 December) assessed recovery to have begun.]

	Increase in 1982 per cent
GDP	1
Manufacturing output	4
Exports	$2\frac{1}{2}$
Investment	$2\frac{1}{2}$

End to destocking. Consumers' expenditure and Government expenditure flat.]

Industry Act forecast sees prospect of some recovery. (Last two Government assessments of economy were broadly correct.) Exports and investment up. Resumption of decline in inflation. Further progress depends on continued moderation in domestic costs and restoration of competitiveness.

4. CBI Economic Situation Report?

[Published 21 December: shows little change from previous month.]

Welcome apparent continuation of improving trend in total order books.

5. Investment prospects gloomy?

[Revised Q3 figures show little change for manufacturers and distributors' capital investment between H1 and Q3 1981, but down 13 per cent on previous year for 1981 as a whole (even after allowance for leasing). December DOI investment intentions survey indicates 2 per cent rise in 1982, bigger increase in 1983, combined total manufacturers distributors and services (MDS), but 1 per cent fall for manufacturers in 1982 (upturn in H2 1982).]

Welcome new signs that decline in MDS investment is over. DOI intentions survey points to prospect of rising investment over next two years.

[IF PRESSED on manufacturers sector (decline masked by increase in distributors and services investment):

Survey points to pick-up in manufacturing during 1982.

IF PRESSED on consistency Treasury forecasts: Early days yet; but latest information not inconsistent with IAF.]

6. Outside forecasts

[GDP profile in major forecasts released since June:

	H2 1981 on H1 1981	H1 1982 on H1 1981	per cent
LBS (Nov)	$\frac{1}{3}$	1	
CBI (Nov)	0	$\frac{2}{3}$	
Phillips & Drew (Dec)	0	$\frac{3}{4}$	
OECD (July)	$-\frac{1}{3}$	0	
(IAF - for comparison)	$\frac{1}{2}$	1	

November NIESR Review contains only annual data, but commentary suggests low point reached in H1 1981, with prospect of some recovery.]

Recent major independent forecasts assess that low point in activity was reached in first half of year, with prospect of some recovery in the coming year.

7. Higher interest rates will abort recovery? Business confidence weakened?

Understand concern over interest rates, but it is absolutely essential to contain inflation. Inflation is inimical to sustainable recovery. Interest rates only one of factors affecting industry. Other costs, particularly labour costs, more important for improved profitability and competitiveness.

8. Recession worse than in the 1930s?

Any such comparisons must of course be subject to a statistical health warning. It is true that the fall in output is comparable to the 1930s, but structure of the economy and society is much changed.

C LABOUR

1. Unemployment continues to rise?

[November total count was 2,954,000 (12.2 per cent) - second consecutive month showing slight decrease. Seasonally adjusted excluding school leavers figure was 2,764,000 (11.4 per cent). Note November unemployment and vacancies figures to be published Tuesday am 22 Dec]

Unemployment rising much less rapidly. Increase in recent months less than half those at end of last year [44,000 per month in 3 months to November 1981 compared with 115,000 per month in Q4 1980]. Also should note within manufacturing short time working sharply cut -(down $\frac{1}{4}$ from January level), overtime showing signs of picking up and fall in employment much less. Result is that total hours worked have stabilised and now show signs of some pick up. Vacancies improving too.

2. Employment continues to fall?

[Total employment fell further $\frac{1}{4}$ million in Q2 1981, much the same as in Q1. Total decline since mid-1979 1.7 million or 7 $\frac{1}{2}$ per cent.]

Decline in manufacturing employment showing signs of further marked slackening in August and September (25,000 compared with about 50,000 per month earlier in year), and 80,000 per month in H2 1980.

3. Government forecasts for unemployment

[Government Actuary's Report published 2 December uses working assumption of an average level of 2.6 million unemployed in Great Britain (excluding school leavers) in 1981-82 and 2.2 million in 1982-83. (222,000 school leavers and adult students in 1981-82, 225,000 in 1982-83).]

Like previous administrations Government does not publish forecasts of unemployment, though some Government publications, eg Government Actuary's Report, contain working assumptions. Government is concerned about unemployment. Scale of special employment measures (SEMs) adequate evidence of this. Prospects depend on further progress on productivity and competitiveness. [See 4 below for independent forecasts.]

IF PRESSED on whether unemployment will "peak next year". [Headline to report in The Times 8 December of Mr T Burn's evidence to TCSC.] Mr Burns referred to unemployment assumption given to Government Actuary; said it was not far from Treasury assessments, GA figures consistent with the prospect of some fall in total unemployment before the end of 1982-83. They do not however necessarily imply this. If things go well - lower pay settlements, recovery in world trade - then reasonable to hope for fall in unemployment before end 1982-83.

4. Independent forecasts?

[Consensus is for medium term rise in "narrow definition" unemployment, reaching about 3 million in Q4 1982.]

History shows unemployment forecasts to be very uncertain (this is a major reason why Government does not publish one). This is reflected in range especially for beyond next year.

5. Unemployment higher than in other countries?

[OECD standardised data show UK Q1 1981 at 10½ per cent compared with OECD average of 6½ per cent.]

Unemployment has been rising sharply in major industrialised countries, given weakness of world economy. In our case we are suffering the cumulative effects of lost competitiveness and low productivity and implications of inflationary pay settlements in 1978-79 and 1979-80 pay rounds. This is why the rise in UK unemployment has been higher than in most other countries, and points to the need to improve productivity and competitiveness.

6. What is the cost to the Exchequer of the unemployed?

[MSC estimate £438 million per 100,000 additional registered, private sector unemployment; (figure of £450 million estimated by Institute of Fiscal Studies); when "grossed up" gives £12½ billion for total unemployment. Treasury's internal revision of figure published in February Economic Progress Report not published so far - further article likely in EPR in near future.]

All such calculations depend critically on and are sensitive to exact assumptions adopted eg composition (especially whether public or private sector workers), previous earnings, and benefit entitlement of the additional unemployed. As explained in detail in Treasury's Economic Progress Report for February 1981, cannot gross up estimates by naive arithmetic to give cost of total unemployed - or of resources available for costlessly reducing unemployment. [IF PRESSED: No economy has zero unemployment: Moreover, any major change in policy would have implications for inflation, thereby affecting estimates by changing earnings, prices, taxes and benefits.]

7. Spend money on new jobs rather than unemployment benefit?

Cannot switch employment on and off like a tap. But Government doing a great deal to help. Special employment and training measures currently cover almost 700,000 people at a cost of over £1,100 million this year. Not easy to assess just how many being kept off unemployment register by SEMs, but Department of Employment estimate at around 345,000.

8. Should spend more on reducing unemployment especially for young people?

The total provision on Job Release Scheme, Temporary Short Time Working Compensation Scheme, and the Community Enterprise Programme in 1982-83 has now been increased by £160 million to over £520 million, with an additional £61 million for the young worker scheme which starts on 6 January 1982. The new Youth Training Scheme will be introduced in September 1983: cost in a full year £1 billion. The Youth Opportunities Programme will cost £600 million in 1981-82 and £700 million in 1982-83 as courses are improved and lengthened. Spending on special employment and training measures will be almost £800 million more than last White Paper (revalued).

9. Need to bring system of industrial training up to date?

Agree. The White Paper 'New Training Initiative' sets out the action required in industry and education as well as setting out the lead the Government are giving. The new Youth Training Scheme will guarantee a full year's foundation training to those leaving school at the minimum age. Government objective is that employers and unions should accept that by 1985 all training should be to standards without regard to age. Government assistance for skill training will increasingly be conditional on reaching that objective and removing restrictions. An Open Tech programme is being developed to make technical training available to those with ability to benefit from it.

10. Is the likely level of allowances on the new Youth Training Scheme-around £750 16 year olds (who will not get SB) older trainees £1250 - too low?

Allowances under the new Youth Training Scheme should realistically reflect the trainee status of participants and the benefits of comprehensive higher quality provision.

D TAXATION

1. Burden of taxation

[Total taxation in 1978-79 was 34½ per cent of GDP (at market prices), 36 per cent in 1979-80, 37½ per cent 1980-81. It is forecast to be 40 per cent in 1981-82.]

This has inevitably increased during a time when national production has not been growing. But, for the vast majority, real personal disposable income is still higher than for most of the period when the Labour Party was in Government. Recent OECD report showed that the Government's total 'take' (by way of taxation and national insurance contribution) as percentage of GDP is less than in many other industrial countries - UK eleventh in OECD rankings, behind most other EC countries, including France and W Germany. [NB: HMG's position is that national insurance contributions are not a tax].

2. What are implications of 2 December announcements for 1982 Budget?

Cannot anticipate Budget decisions which will be taken in light of circumstances at the time. In spite of higher projected level of public expenditure, as rhF the Chancellor said in his statement, we have no reason to depart from the projections for the PSBR published at the time of the last Budget. Other factors will also be important, including monetary targets and outlook for pay and inflation.

3. Government policy has harmed incentives?

Marginal rates of income tax for most taxpayers lower than when the Government came to power. Basic rate still 3p below rate inherited from Labour.

4. Reduce National Insurance Surcharge?

Well aware of view of many in industry that a reduction in NIS would be greatest help. But could not prejudge Budget judgment both on whether could afford tax relief on that scale and on whether a reduction in NIS should have priority. But position of employers was taken into account in decision to load increase in National Insurance contribution on to employees.

5. NIS burden in fact increased?

True that as in previous years increase in earnings limits for NICs will also apply automatically to NIS. But increase in upper earnings limits is expected to add only £47 million (in 1982-83) to NIS burden (which is expected to total £3.8 billion this year). Major part (£225 million) of increase expected in NIS burden in 1982-83 will arise solely from increase in earnings. Total NIS/NIC burden on employers likely to fall in real terms in 1982-83 - for second year running.

6. Heavy fuel oil duty

Costs involved mean that it would not be in the national interest to go beyond the Budget decision not to increase the duty in heavy fuel oil. Terms of North Sea gas contracts a commercial matter for the British Gas Corporation.

7. Progress with examining corporation tax structure?

[Promise to re-examine corporation tax structure in 1980 Budget Speech]

It is hoped to produce the Green Paper on corporation tax this winter.

8. Progress so far on tax reform/simplification?

Substantial progress has already been made in improving incentives and simplifying the tax system, eg switch from direct to indirect taxes in 1979, correction of worst features of Capital Transfer Tax, improvement in Capital Gains Tax and Development Land Tax regimes; introduction of Business Start Up scheme etc. But reform of the tax system must be pursued within a financially responsible framework.

9. North Sea fiscal regime?

See R3.

E PUBLIC EXPENDITURE AND FINANCE

[The Chancellor announced main decisions for public spending 1982-83 on 2 December. Main increases on programmes are for local authority current expenditure (£1.3 billion), employment measures (£0.8 billion), defence (£0.5 billion) and finance for the nationalised industries (£1.3 billion). Increases will be offset in part by general reduction in most cash limited expenditure and by specific cuts - including increases in prescription charge and other health charges. Planning total for next year will be in the region of £115 billion against £110 billion for the White Paper revalued.]

1. Further announcements?/Questions on later years?

Full details will be in the White Paper to be published at the time of the Budget.

2. 1981-82: Overspending?

[Outturn for the current year is expected to be in the region of £107 billion against £104½ billion in the last White Paper.]

Spending is expected to be higher in 1981-82 than was planned in the last White Paper. The major reason for this is the present level of spending by local authorities. But too early to be certain about likely outturn because civil service dispute has affected monitoring, and changes in circumstances could well lead to a higher or lower total than the £107 billion we now provisionally expect.

3. Plans for next year unrealistic, given likely overspending this year?

No. Realism, particularly in respect of local authorities and nationalised industries, is one reason why our plans for next year are higher than in last White Paper (revalued).

4. Are plans for 1982-83 reflationary or deflationary?

As my rhF the Chief Secretary said during the debate on 8 December, the changes are neither reflationary or deflationary.

5. Fall in real terms?

We have increased cash provision for next year. In real terms this means that spending next year will be broadly at level planned for this year. Expect public expenditure will fall as proportion of GDP, which is what really matters.

6. Failure to cut spending?

Our decisions to increase spending next year reflect a flexible but prudent response to changed circumstances. The increases we have decided were however offset in part by reductions elsewhere.

7. Implications for tax and monetary policy?

A matter for the Budget. But a high level of spending does mean taxation higher than it would otherwise be. The alternative would be more borrowing and higher inflation and interest rates.

8. Increase spending during recession?

It is not the Government's intention to try to spend its way out the recession. That would only lead to more inflation and higher interest rates and taxes. But we are responding, within the limits of prudence, to the needs of current circumstances.

9. Increase spending on worthwhile infrastructure projects?

Our first concern must be with realistic public expenditure levels. Within these, our aim is to encourage worthwhile capital projects wherever possible. The 2 per cent cut in cash-limited programmes reflects in part a reduction in administrative costs, in most cases of 2 per cent or more. But (as my rhF the Chief Secretary said during the debate on 8 December), social security spending is the only other area of major possible attack if we seek savings in current expenditure to make room for capital expenditure.

10. Public capital investment in 1982-83 cut by £500 million compared with 1981-82?

[Claimed by The Times in leader 8 December.]

As my rhF the Chief Secretary said during the debate on 8 December, the figure mentioned in The Times is not accurate. As far as the nationalised industries are concerned, so long as they ~~restrain~~ ^{restrain} their current costs the extra cash provision we have given them should allow them to maintain their investment next year at broadly the same level in real terms as this year - and that is in real terms 15 per cent up on the 1980-81 level. Other public capital expenditure will be a little lower in cash next year compared with this but keen tendering will mean the programmes should be carried out as planned.

11. Number of cash limits breached last year?

In aggregate, central government voted cash limits in 1980-81 were underspent by just over 1 per cent. There were 6 individual breaches of cash limits (4 on central government and 2 on local authorities) compared with 13 in 1979-80, and amounts involved were marginal. A full statement of provisional outturn of spending compared with cash limits in 1980-81 was published as a White Paper (Cmnd 8437) on 4 December.

12. Position on 1981-82 cash limits?

Provisional outturn figures for first half year were published with Winter Supplementary Estimates in Financial Secretary to the Treasury's note on 4 December. Central government

cash limited expenditure overall is on course. For a number of individual cash limits expenditure was well in excess of profile for first half year. In many cases the excess is due to a shift on timing of expenditure and/or receipts; in other cases there have been cash limit increases. In remaining cases position is being discussed with relevant departments to ensure that corrective action, if necessary, can be taken in good time.

13. Cut public sector pay bill?

We have limited the provision for public service pay increases next year to 4 per cent. Administrative costs of central government are not far short of 10 per cent of total public expenditure. We are determined to reduce that proportion, and to maintain the drive for more efficient management throughout the public sector. Only one third of current expenditure is on wages and salaries and much of that is for nurses, teachers, members of armed forces, police and so on.

14. Cut staff numbers in public services?

Numbers in public service have already fallen since we took office. Civil Service has been reduced by over 7 per cent to 679,800. This is the smallest for over 14 years and we are well on target to achieve our aim of having 102,000 fewer staff in post in April 1984 than when Government came into office; this will be smallest Civil Service since the war. Local authority manpower has been reduced by nearly 70,000 (over 3 per cent).

15. Moves to cash planning announced in Budget mean that Plowden system is being abandoned?

Government does recognise case for medium term planning. But it must be planning in relation to the availability of finance as well as in relation to prospective resources. Illusion to suppose there can be unconditional commitment to forward plans for services.

16. Ratio of public spending to GDP is getting back to the peak levels of the mid 1970's?

The ratios in 1980-81 (44½ per cent) and 1981-82 (45 per cent forecast) remain below the level of 1974-75 and 1975-76 (46½ per cent in both years). The large rise from 41½ per cent in 1979-80 is partly because of the "relative price effect" and partly because the volume of expenditure rose at a time when real GDP has fallen.

LOCAL GOVERNMENT

17. Spending plans for 1982-83? Too tough? Too weak?

In order to set local authorities reasonable and realistic targets, we have increased the plans by £1.35 billion. But substantial economies will still be required as plans only allow about

2 per cent more cash spending than latest budgets for this year. Pressure to curb overspending through RSG system and otherwise will be maintained.

18. Cut in RSG percentage will mean large rate increases?

Not at all. If local authorities budget to spend in line with Government's plans, rate increases should be very low. Where they are high, it is because local authorities have chosen to overspend.

19. Increased burden on industry?

Very conscious of harmful effect of large rate increases. But remedy lies with local authorities. Realism of Government's plans means that there is no need for high rate increases.

20. Local Government Finance (No.2) Bill: will not control spending?

The prevention of supplementary rates will oblige local authorities to budget responsibly at the start of the year. This will prevent a repetition of the irresponsible increases in spending planned by a minority of authorities this year.

21. Scotland and Wales?

Plans have also been increased. Rate increases will be very moderate if local authorities budget in line with Government's plans.

22. Green Paper on Domestic Rating System: rules out change?

No, it reaffirms our long-standing commitment to reform which we want as quickly as circumstances allow. The issues are complex and highly important to domestic ratepayers. The Green Paper sets out the requirements of any alternative source of revenue and describes the advantages and disadvantages of the alternatives in order to present the best basis for consultation.

23. No protection for industry?

An alternative to non-domestic rates involves much wider, more difficult questions. But interests of non-domestic ratepayers will be a most important consideration in developing a policy on domestic rates. Government's continuing pressure on local authorities to reduce expenditure (through Bill, block grant, cut in RSG percentage) will help all ratepayers.

F SOCIAL SECURITY

[Note: 2nd Reading of Social Security Bill on 16 December]

1. Increase in employees' national insurance contributions?

[Chancellor and Social Services Secretary announced on 2 December 1 per cent increase in employees' national insurance contribution from 7.75 per cent to 8.75 per cent to be made from April 1982, as part of review of National Insurance Contributions. Increase will help to increase TPI from April - see J4. Bill to implement this published on Thursday 3 December].

An increase in contributions was necessary to pay for increased benefit expenditure (notably retirement pensions), increased redundancy payments and to maintain expenditure on the health service. Relative share of these costs met by employers has increased in recent years; we considered it essential to avoid placing this additional burden on them. Employers will still be bearing a higher proportion of the burden than they did ten years ago.

2. What about Treasury Supplement?

[Bill also provides for a 1½ per cent reduction in the Treasury Supplement - from 14.5 per cent to 13 per cent].

Treasury Supplement represents only one part of cost of benefit expenditure met by the general taxpayer. If all such expenditure taken into account, general taxpayer still be funding as high a proportion of benefit expenditure next year as this year - and substantially more than a few years ago. Not, therefore, unreasonable for contributors, rather than general taxpayer, to meet these extra costs.

3. Burden on employers?

We have avoided making any increase in employers' rate of contributions. Some increase in cash burden is, however, inevitable simply because of higher earnings. In addition, upper earnings limit has been raised by £20 to £220 - which adds a relatively small additional cash burden. Cash payments to increase by around 7 per cent, that is, slightly less than our estimate of the movement between 1981-82 and 1982-83 in earnings (7.5 per cent) and substantially less than the movement in prices (10 per cent).

4. Balance on the Fund?

We are budgeting for a very small deficit (£9 million) this year. The accumulated balance in the National Insurance Fund is of order of £5 billion. This may seem large as a proportion of expenditure; it has, however, been falling, and now represents about 13 weeks benefit expenditure - as compared with 25 to 30 weeks ten years ago. A balance of some weeks

expenditure is necessary to cope with emergencies such as flu epidemics and industrial disputes.

5. Restoration of shortfall on unemployment benefit, etc?

As my rhF the Chief Secretary said in the House on 8 December , the decision on the level of benefits in November 1982 is announced at the time of the Budget, when account can be taken of the latest forecast of price inflation. In reaching our decision we shall of course take into account everything hon Members said during the debate. They will no doubt continue to give their views.

G PUBLIC SECTOR BORROWING

1. PSBR in 1981-82

[Industry Act forecast published 2 December shows PSBR in 1981-82 was £10.2 billion; PSBR in April - September was £10 billion]

The Civil Service dispute has greatly affected the PSBR so far this year, but the underlying PSBR looks to be in line with the Budget forecast of £10½ billion.

2. Effect of civil service dispute on CGBR?/Revenue still outstanding?

[CGBR April-November was £9.4 billion.]

The shortfall of net revenue outstanding at the end of November from the start of the dispute was about £4 billion, of which around £3 billion related to the current financial year. Interest costs so far on the additional borrowing caused by the dispute are around £350 to 400 million.

3. Will the Government be able to collect all delayed revenue this financial year?

Some revenue is expected to be outstanding at the end of March.

4. Public expenditure likely to overrun this year?

[On 2 December, Chancellor referred to £107 billion - £2 billion above Budget time plans.]

It is too early to be certain what the outturn for the current year will be. The local authorities are, admittedly, spending above the Government's plans. We are taking measures to deal with that but these measures cannot be effective this year. Expenditure which is under the Government's direct control is running broadly according to plan in total.

5. Recession means that PSBR should be higher, not lower?

In my rhF's Budget statement earlier this year he explained that this year's PSBR would be larger on account of the recession. But experience shows that attempts to buy jobs with reflation simply fuel inflation and quickly have to be reversed. Our policies are designed to cut inflation and secure a sustainable improvement in output and employment.

6. What are implications for next year's PSBR of 2 December statement?

No decisions have yet been made on 1982-83 PSBR. Must await Budget. But on conventional assumption, set out in Industry Act Forecast, figures point to a PSBR next year broadly in line with 1981 Budget projections. [IF PRESSED: This means PSBR is expected to decline as proportion of GDP (even before taking account of revenue delayed by civil service dispute).]

H MONETARY AND FINANCIAL POLICY

1. Lower interest rates?

[Bank base rates rose to 15 per cent in September but have since fallen to 14½ per cent. Market rates have firmed a little in December, in particular reflecting increases in US market rates]

Of course we want to see lower rates. But must proceed cautiously if we are not to let up in the fight against inflation. Clearing banks have already reduced base rates by 1½ per cent from their peak. But wrong to think that rates could safely drop much further in near future without potentially dangerous consequences for inflation.

2. Why so much emphasis on cutting PSBR if efforts undermined so easily by high overseas rates and rapid pace of bank lending?

Interest rate decisions must take account of all potential risks of inflation. If we had not reined back the PSBR, interest rates would be still higher.

3. The death knell for the recovery?

Agree that higher interest rates will increase difficulties of industry. But companies' financial position generally much stronger than a year ago. No purpose served by allowing higher inflation, whether due to falling exchange rate or credit-financed consumer spending.

4. Two tier system of interest rates?

Not practicable in highly sophisticated financial market like UK's. Very difficult to prevent money borrowed at lower rate being on-lent at higher. A lower rate for specified borrowers would require extra Government subsidy which would push up borrowing or require cross-subsidisation by the banks. In either case the level of interest rates to other borrowers would be increased.

5. Will there be an overshoot of money supply?

[£M3 increased by ½ per cent in banking November, bringing recorded increase in first nine months of target period to 13 per cent. Position remains seriously distorted by effect of civil service dispute and aftermath. Advice below is based on Industry Act forecast.]

Recorded figure for target period as a whole may be somewhat above top of target range. But too early to say by how much. Interpretation of recent figures very difficult because of civil service strike distortions. Some good features in monetary picture: 1981-82 PSBR should be close to forecast; funding programme is on track. But bank lending is disturbingly high.

6. When will the strike distortions be eliminated?

Distortion will continue for some months yet. The distortion to the CGBR was reduced by over £1 billion in (calendar) November. In eight months ending November the effect of strike was to add around £3½ billion to the CGBR.

7. Status of MTFS if money supply overshoots for second year running?

MTFS remains basic framework of Government's economic policy. But as Chancellor said in Budget speech, also take account of other monetary indicators as well as sterling M3. Will continue to maintain steady but not excessive downward pressure on monetary aggregates.

8. Plans for modifying MTFS?

We shall consider the MTFS published with last year's Budget - but have no plans to revise the broad objectives. Too early to comment precisely on what form this will take, or how next year's financial targets will be presented.

8. But increase in bank lending not inflationary: house prices stagnant, retail sales flat or falling?

Very hard to distinguish upward pressure on prices due to bank lending from downward pressure due to other factors, especially falling real personal disposable incomes. Effect of higher bank lending will not be felt on prices immediately, but only with a lag. Could be some leakage from mortgage lending into general consumption.

10. Ceilings on non-priority bank lending?

In UK's complex financial system, ways would be found of by-passing credit controls. Any improvement to money figures would prove to be cosmetic. Would create distortions and inhibit competition between banks.

J PRICES AND EARNINGS

1. Inflation has increased under this Government?

Considerable progress has been made in bringing down inflation from a peak of 21.9 per cent in May 1980 to 12 per cent in November.

2. Inflation back on a rising trend?

[Year-on year rate of inflation rose to 12 per cent November compared with 11.7 per cent in October and lowest recent level of 10.9 per cent in July. Effect of mortgage interest increase estimated at just under $\frac{1}{2}$ per cent on November RPI. Industry Act forecast: 12 per cent by Q4 1981; 10 per cent Q4 1982.]

Progress in reducing inflation has been hindered by fall in exchange rate, and by higher mortgage interest rates. Government is confident that downward trend in inflation will be resumed.

3. Effect of 2 December measures on RPI/TPI?

[Measures include 1 per cent increase in employees' NIC, higher prescription charges, and council house rents.]

Effect of measures on RPI will be roughly 0.6 per cent from April 1982 [reflecting mainly increase in council house rents; higher prescription charges will have negligible effect].

Effect on TPI will be $1\frac{1}{2}$ -2 per cent from April 1982 [reflecting also higher NICs.]

4. Nationalised industry prices

Nationalised industry price rises have been due in substantial part to the ending of the previous Government's policy of artificial and distortionary price restraint. The rate of nationalised industry price rises is now coming more closely into line with the RPI.

5. TPI

The fact that the TPI has been increasing faster than the RPI ($3\frac{1}{2}$ per cent faster over the year to November) reflects the measures which have been taken to restrain Government borrowing, which is essential if inflation is to be controlled.

6. A 4 per cent pay policy?

The 4 per cent factor announced on 15 September [for calculations in Public Expenditure Survey] is not a pay norm. It is a broad measure of what the Government thinks reasonable and can be afforded as a general allowance for increases in pay, at this stage of fixing the programme from which the public service wage bill has to be met.

7. Does the 4 per cent apply to the Civil Service?

The 4 per cent factor does not imply that all public service pay increases will or should be 4 per cent. Some may be more; some less. [IF PRESSED: In response to enquiries from the civil service unions, they have been told that the assurance they were given earlier in the year about next year's pay negotiations are unaffected by the announcement of the 4 per cent factor.]

8. Local authority settlements ignoring 4 per cent pay policy?

[Firemen have settled at 10.1 per cent; LA manuals considering offer worth 6 - 7.8 per cent on basic rates, 6.9 per cent on current pay bill].

Pay negotiations in local government are a matter for the parties concerned. There is no pay norm. Offer to LA manuals higher than the Government thought right to provide for in RSG settlement, and the financial consequences will therefore fall squarely on the local authorities.

9. Nationalised industry pay

[NUM have rejected revised offer worth 9.3 per cent on basic rates (Not to be quoted: 7.4 per cent on earnings); water manuals considering offer worth 9.1 per cent on rates, 8.8 per cent on earnings].

Nationalised industry pay negotiations are a matter for the parties concerned, as are the financial consequences of any settlements reached. [IF PRESSED on prospects of miners' pay: I am confident that good sense will prevail].

10. Private sector pay

[BL settled at 4½-5 per cent, National Engineering Agreement added only 5.1 per cent to basic rates; however Vauxhall manuals have settled at 7.9 per cent, Ford unions rejected 7.4 per cent. Cumulative average for private sector in round so far estimated at 7½ per cent by DE [NOT TO BE QUOTED], 8 per cent by CBI Databank survey].

There have been some welcome signs of lower wage settlements in the private sector so far in the pay round. The need is for continuing low settlements which are consistent with maintaining economic recovery and improving employment prospects.

11. Government aiming to cut living standards?

Government seeking to create conditions for sustained improvements in living standards. This requires creation of more competitive and profitable industrial sector. Means that less of increase in nominal incomes should be absorbed by higher pay. The lower the level of settlements, the greater the headroom for output and employment to expand.

12. Average earnings index

[Drop in year on year growth from 9.38 per cent in September to 11.9 per cent in October may attract attention, though (unpublished) underlying increase unchanged at 11 per cent]

Recent buoyancy of earnings partly reflects increase in hours worked, which is an effect of the emerging revival of activity, particularly in manufacturing. Change over the 12 months to October does not, however provide a useful indicator of recent trend in pay settlements.

12. Comparison of TPI and index shows that real take-home pay has fallen over the past year

Yes. But follows growth of $17\frac{1}{2}$ per cent in personal living standards in three years 1977-80.

14. Layard's wage inflation tax?

Like any other attempt to rely on incomes policy, Layard's proposal (picked up by SDP) would entail all the familiar problems of setting norms and interfering with market forces. Experience gives no encouragement to the idea that incomes policies can be made to work on a permanent basis. They always succumb to the distortions they create.

15. Index-linked pensions and the Scott Report?

We are considering question of index-linking of public service and other public sector pensions, including the question of contributions made by public servants for their pensions. Changes in these arrangements could produce further savings in due course.

K BALANCE OF PAYMENTS

1. Balance of payments in third quarter 1981

[Figures for invisibles and capital transactions published 9 December]

The capital account outflow in Q3 was much smaller than earlier in the year. Portfolio investment abroad (estimated at £1.3 billion in Q1) was only £0.6 billion in Q3. Total surplus on invisibles was £303 million.

2. What is happening to the trade account?

[November trade figures expected to be published 23 December]

November figures are not yet available. September and October trade figures show a small surplus; this is probably the best guide.

3. Trends in exports

Export figures for September/October very uncertain: but appear to have held up well under difficult circumstances, despite sluggish world trade and earlier losses of competitiveness. Export orders for British engineering industries show a 40 per cent increase since the summer.

4. Trends in imports

The increase in import volumes in October confirms recent evidence of slowdown in destocking, and recovery in output. Import volumes are 16 per cent higher than in the first four months of 1981 but are only 1 per cent higher than in 1980.

5. Trends in invisibles

Invisible earnings continue in substantial surplus and are likely to rise to about £200 million a month in the fourth quarter of 1981 due to budget refunds from the EC.

6. Capital flows

The net capital outflow in 1981 Q3 was about £0.7 billion compared with £1.9 billion in 1981 Q2. These capital flows represent overseas investment which will provide a valuable source of overseas income in future years. There is no evidence that outflows deprive UK firms of capital to invest.

L FOREIGN EXCHANGE, RESERVES AND IMF

1. Sterling still too high?

[Since July sterling has remained broadly stable against the dollar but has depreciated against the Deutschemark due to a slacker oil market and improved German current account. Recent "lows" have been \$1.77 on 14 September, DM4.07 on 20 October. Rates at noon on 18 December were \$1.8710; DM4.294 and an effective rate of 89.99. Reserves at end November stood at \$23.5 billion, compared with \$23.2 billion at end October]

Our policy is to allow the rate to be determined primarily by the balance of market forces. The effective exchange rate is only slightly higher than when the Government took office. Manipulating the rate is no answer to problems in the real economy.

2. Has the Bank intervened to support the rate?

The Bank intervene to smooth excessive fluctuations and preserve orderly markets. They do not seek to maintain any particular rate.

3. Does the Government have an exchange rate target:

No. As my rhF the Chancellor has frequently made clear (most recently before the TCSC last month) it is very difficult to make judgments about the 'right' level for the exchange rate or to resist strong market trends. That continues to be the Government's view. However, the Government is not indifferent to exchange market developments: account is taken of the level and movement in the exchange rate when taking decisions on interest rates.

4. Sterling should join the EMS?

[See M13]

5. Exchange rate and competitiveness?

I welcome the improvement in UK cost competitiveness of perhaps 10 per cent so far this year. This is partly due to a decline in the exchange rate; more importantly because there are signs that our domestic unit labour costs are now growing more slowly than those of our major competitors.

6. Debt repayments

We have made substantial progress with our plans to reduce the burden of external debt substantially during this Parliament. We have now pre-paid the \$2.5 billion Eurodollar loan and are continuing with other scheduled repayments. Official external debt has now been reduced to around \$14 billion, compared with over \$22 billion when the Government took office - a cut of over one third.

M EUROPEAN MATTERS

MEMBERSHIP OF EUROPEAN COMMUNITY

1. 'Mandate negotiations'

Foreign Ministers to meet again early in January.

2. Net UK contribution to community too high?

A lot lower than it would have been without the refund agreement of 30 May last year.

3. Lower Commission estimates of net contributions in respect of 1980 and 1981?

We are examining the new Commission estimates. If our adjusted net contribution in respect of 1980 and 1981 turns out to be lower than expected, that is very satisfactory, because the 30 May Agreement left us paying a large net contribution even though we are one of the poorer Member States. The problem of 1982 and later years remains to be solved.

4. Budget refunds reduced if net contribution less than originally estimated?

The UK is clear that the minimum net refunds payable under the 30 May agreement are 1175 million ecus (European Currency Units) for 1980 and 1410 million ecus for 1981.

5. Do supplementary measures grants lead to additionality?

There is additionality in that refunds enable public expenditure in the regions and elsewhere to be higher than would otherwise have been possible.

6. Policy for CAP reform

Key measures are price restraint, curbs on surplus production and strict control of the growth of guarantee expenditure.

7. Costs of CAP to UK consumers

My rhF, the Minister of Agriculture, has dealt with a number of questions on this. Costs to consumers of the CAP as such depend on nature of alternative support system that is envisaged. Arrangements leading to a reduction in the cost of food to the consumer could well involve increased costs to taxpayers.

EUROPEAN MONETARY SYSTEM

8. What is the current attitude of the UK Government?

We fully support the EMS, and acknowledge the contribution which it has made to stability in the exchange markets. However, we do not yet feel able to join the exchange rate mechanism. We must wait until conditions are right for the system and for ourselves.

N INDUSTRY

1. Recent increases in interest rates - damaging for industry and investment?

(Each 1 per cent in interest rates raises interest payments on industry's borrowing by around £250 million.)

Government believes best way it can help industry and promote investment is to create a climate in which business can flourish. Essential to get rate of inflation down so as to create a stable environment for business decision-taking. Recent rise in interest rates must be seen in context of priority attached to reducing inflation and need to control growth in money supply underlying the MTFS. (See brief H).

2. Prospects for industry - recovery?

Encouraging evidence that fall in output has now come to an end. Too early to talk about recovery: but index of manufacturing output rose 1½ per cent in the third quarter with chemicals and engineering performing particularly well.

3. Company sector finances improved?

[Gross Trading Profits of industrial and commercial companies (ICCs) other than North Sea activities net of stock appreciation were around £3¼ billion in Q2 1981 for third successive quarter. Borrowing requirement of ICCs has improved over last year, and financial deficit turned into surplus. DOI's latest survey of company liquidity (published 4 December) shows further marked improvement in third quarter (particularly in manufacturing) bringing liquidity ratio back to 1979 Q3 level. NB figures difficult to interpret, however, particularly because of uncertain impact of CS dispute].

Figures mildly encouraging (but not wildly so). Company financial position is in any case confused by effects of civil service dispute. After adjustment for stock appreciation and excluding North Sea, ICC profits have stabilised since mid-1980. Improvement in financial position partly reflects destocking and action to reduce overmanning.

4. Industries' claim that 2 December package adds £600 million to employers' costs?

[Higher NIC £200 million; higher rates £400 million.]

In real terms burden of NIC/NIS on employers likely to fall in 1982-83, for second year in succession. And company sector now in rather stronger financial position than a year ago, partly through Government policies to switch fiscal burden.

SMALL FIRMS

5. Government help for small firms

Over 70 measures taken which help important small firms sector: in particular the Business Start-Up Scheme, the pilot Loan Guarantee Scheme, the Venture Capital Scheme, and reduction in the burden of small firms' corporation tax.

6. Response to Loan Guarantee Scheme?

Scheme has got off to very good start. We have already issued more than 1500 guarantees - well over half to new businesses. Total lending under scheme is already over £52 million. Substantial demand for loans has led the Government to double this year's lending limit under the scheme. Ten new banks were admitted to the Scheme in November: a total of twenty-seven financial institutions are now participating.

ENTERPRISE ZONES

7. Progress with setting up Enterprise Zones?

Excellent progress being made. Ten of the eleven zones are already in operation. We expect the final zone - Isle of Dogs - to come into operation early next year.

8. Response from private sector?

Initial response has been very encouraging. Many new firms are setting up in the zones, existing firms are expanding their activities and vacant land has been brought into use. Too early to assess success of zones.

P NATIONALISED INDUSTRIES

EXTERNAL FINANCING LIMITS

1. EFLs for 1982-83?

Despite constraints on public expenditure as a whole, Government has recognised the problems faced by the industries in a period of recession and has increased provision for 1982-83 by £1.3 billion cash. This is larger than the increase in any individual Departmental programme.

2. Pay assumptions?

Government does not set a uniform pay assumption for the industries. But industries' own assumptions have been discussed, and external financing limits have been set on assumption that reasonable settlements will be reached. Moderate pay settlements - and restraint of current costs generally - essential if investment programmes to be maintained and prices to consumers kept down.

3. Government simply forcing financing burden on to the consumer, ie through higher prices?

Some further prices rises have been assumed in reaching decision on EFLs as in previous years. Should be possible to avoid large real increases experienced in 1980-81, but this will require continuing effort to keep down current costs, particularly pay.

4. Why not give British Telecom more?

The £340 million EFL is still relatively large, particularly for a profitable industry. Ministers will be looking to British Telecom, as to others, to make a substantial contribution through reduced costs. There could be a higher figure if the bond proves feasible.

5. Government still cutting back the industries savagely?

Not so. The industries made very large original bids for additional external finance in 1982-83, totalling about £2.5 billion, in their medium-term financial plans presented to the Government in early summer. This would have brought their total external finance to around £4 billion. The agreed increase of £1.3 billion is roughly halfway between the industries' original bids and the White Paper figure.

INVESTMENT

6. Current year?

Last Public Expenditure White Paper showed nationalised industry planned investment 15 per cent higher in real terms this year than a year ago. Quantity of investment frustrated by tight EFLs is less than often implied. TSSC report published in August estimated in range of £250-500 million this year.

7. Future years?

Investment approvals for the years 1982-83, 1983-84 and 1984-85 have yet to be settled. They will be communicated to the industries in due course and will be published in the forthcoming Public Expenditure White Paper.

8. But announced EFLs for 1982-83 will make it hard for the industries to keep up their investment?

The industries should be able, in total, to maintain broadly the same level of investment in 1982-83 as planned in the last White Paper, despite lower revenue, with higher investment in important industrial priorities, eg telecommunications. This will enable the 15 per cent real increase over the 1980-81 level, which was included in the 1981-82 plans to be sustained. These plans, in turn, represented the highest real level of investment in the industries since 1975-76.

9. Take nationalised industry investment out of the PSBR?

Since nationalised industries are part of the public sector, their borrowing - for whatever purpose - must by definition form part of the public sector borrowing requirement. The real problem of pressure on resources cannot be solved by changing statistical definitions.

10. Private finance for NI investment?

(The NEDC Working Party's study of nationalised industry investment was discussed at the Council's 5 October meeting; agreed that there should be a review of progress to be completed by June 1982]

We have indicated our willingness to consider new financing proposals, most recently in the context of the review carried out by the NEDC Working Party. But direct market finance can only be justified if there is a genuine element of performance-related risk for the investor, in order to improve incentives to management efficiency, and if new forms of saving are tapped, so as to avoid adverse monetary consequences. Market financing does not of itself reduce the PSBR, nor does it lessen the burden on financial markets.

11. Finance more nationalised industry investment by cutting current spending?

Yes. In particular, moderate pay settlements are essential. The ability to finance new investment in the nationalised industries is bound to diminish if excessive pay settlements are agreed.

12. But you cannot finance much investment by cutting current costs alone?

Not true. Each 1 per cent off wage costs would save about £140 million per annum; and each 1 per cent off total costs saves £350 million this year.

NATIONALISED INDUSTRY PAY AND PRICES

13. Nationalised industries' prices have risen more rapidly than RPI?

True over last year or so, while adjustments from artificial and distortionary price restraints introduced by the Labour Government were working through the system. Unwelcome but inevitable: the only alternative is an increased burden on the taxpayer and a distortion of market forces.

14. What is happening now?

Nationalised industry price increases are falling relative to the RPI (14 per cent above in year to January, 3 per cent above in year to October). Fully expect them to come closer to RPI in next few months.

15. And the future?

Better price performance depends on improvements in efficiency and control of current costs, particularly pay. We are determined to see those improvements brought about. Privatisation and increasing competition have an especially important role here.

PRIVATISATION

16. The Government simply selling valuable national assets to achieve PSBR target?

Of course, the cash is welcome, but the benefits run wider than that. Not only will the main financial benefit be that future borrowing of these undertakings will be outside the PSBR and no longer burden the taxpayer, but the organisations concerned will be made responsive to market forces and thus have greater incentives to improve efficiency.

17. Does the Government have more privatisation plans to announce?

Legislation already passed to enable public to hold equity stake in British Airways, British Transport Dock Board, subsidiaries of British Rail; and to dispose of some of British Telecom's peripheral activities. We shall be announcing further measures in due course.

R NORTH SEA AND UK ECONOMY

1. Benefits of North Sea should be used to strengthen the economy?

[Direct contribution of North Sea oil and gas to GNP is estimated to rise from 3 per cent in 1980 to about 5 per cent in 1984; expected contribution to Government revenues estimated at £3½ billion in 1980-81 and £6 billion in 1981-82 (at current prices). Less susceptible of measurement is boost given by North Sea to local employment and to industry in offshore equipment].

Yes. Government's strategy derives greatest possible long-term benefit from North Sea. Revenues ease task of controlling public borrowing. This will help to achieve a lower level of interest rates to the benefit of industry and the economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Only one-twentieth of total general government receipts in 1981-82.

2. Will HMG change North Sea fiscal regime in line with oil industry's proposals?

[Memoranda lodged with Treasury and D/Energy 22 October].

I commend UKOOA (UK Offshore Operations Association) and BRINDEX for the hard work which they have put in. Obviously full study of their proposals is required. We shall look at their suggestions with an open mind, in close liaison with UKOOA and BRINDEX.

3. North Sea oil depletion policy?

Secretary of State for Energy announced in June that the Government would review in the Autumn the possibility of oil production cuts in 1982. We shall give the industry proper notice of our intentions.

4. Government revenues from the North Sea should be used to finance cheap energy for industry?

It would be inequitable and inefficient to use the benefits of North Sea oil to subsidise some users. The age of cheap energy is past. Energy prices should recognise the cost of marginal supply and reflect the competitive position of industrial fuels. Only then can consumers receive reliable signals on which to base their energy consumption and investment decisions.

5. North Sea revenues should be channelled into a special fund to finance new investment, particularly in energy?

North Sea revenues are already committed. Setting up a special fund would make no difference. More money would not magically become available. So the money for this

6. North Sea oil bond?

As my rhF(Economic Secretary) announced on 17 December, we have abandoned plans to issue a North Sea oil bond. The sale of 51 per cent of BNOG's assets next year means that an oil bond is no longer necessary.

7. Government "frittering away North Sea riches"?

[The Times 14 December].

No. Benefits of North Sea are being put to best advantage by reducing PSBR, interest rates, and non-oil taxes below what they would otherwise have been. Investment, both at home and overseas, is thus encouraged. And oil thus provides a valuable contribution to Government's economic objectives.

S WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Governments' policies pushing world economy into recession?

[Output in OECD area grew modestly in first half 1981. Little information on Q3; but small rise in US, Japan and French GNP. Industrial production picture in Q3 mixed, with falls in Germany, Italy and Canada offsetting rises elsewhere. Average unemployment rate rising. CONFIDENTIAL: NOT FOR USE before publication on Wednesday 23 December. OECD believe output of member countries will have stayed flat in second half of this year, and will recover gradually in 1982.]

No. Healthy growth only possible if anti-inflation policies persevered with. Some recovery of output expected next year. And unemployment should level off during the year.

2. Official forecast of export prospects too optimistic?

[Dr Paul Nield of P & D claims that IAF forecast of a 4-5 per cent increase in world trade in manufactures in 1982 (weighted by UK share of markets) is too optimistic.]

Forecasting world trade never easy. Forecasting relationship between trade and output particularly difficult at an economic turning point such as the present when exchange rates have been highly volatile. [IF PRESSED on how OECD compare with IAF - if OECD Report "leaked" before 23 December: Industry Act forecast in line with OECD's - indeed OECD slightly higher.]

3. Anti-inflation policies not working?

[Year on year consumer price inflation in major countries around 10 per cent in September. Underlying rates increasing in US and France. OECD and IMF expect some decline next year.]

Takes time to squeeze inflation out of system. Year-on-year consumer price inflation in major economies down from peak of 13 per cent in April 1980 to around 10 per cent in September 1981. Further decline expected next year.

4. Governments' policies have failed or worsened situation?

No. Adjustment to second oil shock better than to first. Investment has performed better, impact on wages better contained and dependence on oil reduced. But these gains must be reinforced by continued firm policies.

5. Countries disagree over direction of policy?

No. Both Ottawa Summit and IMF Interim Committee agreed that a clear priority had to be given to firm policies to reduce inflation. They stressed importance of steady and careful restraint on growth of monetary aggregates and emphasised need, in many countries, for reductions in size of budget deficits.

6. Other countries giving priority to unemployment rather than inflation?

No. All major countries agree that lasting reduction in unemployment can only be achieved when inflation brought down. France, an exception till October, is now acting to curb inflation. This best way to secure lower interest rates, encourage productive investment and achieve better rates of economic growth and employment.

7. Other governments not following such stern policies as UK?

[US, Canada and Germany have announced lower monetary targets for this year compared with last. Most major countries (US, Japan, Germany, Italy, Netherlands, Australia, Sweden) have recently announced measures to cut planned public spending. France has announced the deferral of FF15 billion (£1½ billion) of capital investment. Recent Canadian Budget will reduce deficit.]

Most governments persevering with firm policies to lay foundations of renewed non-inflationary growth. In particular, continuing with their efforts to control monetary growth, offset effects of recession on budget balances, and keep public spending in check.

8. US are pursuing mad policies and care nothing for their impact on rest of world?

US authorities have widespread international support in their battle against inflation. Sound \$ is in everyone's best interests. Concern is over monetary/fiscal mix - a problem all countries familiar with.

9. Deeper-than-expected US recession will kill recovery in other countries?

Some fall of output in the US may be inevitable before inflationary expectations are reduced. In everyone's interests that US inflation should come down. A sustainable recovery will then be possible.

11. Recent international interest rate developments?

True that international interest rates have been high over last year, but glad to see some easing of US prime rates - down to under 16 per cent from peak of 21½ per cent; also German rates declining.

12. Prospects for international interest rates?

Always difficult to forecast interest rates with certainty, but firm policies should over a period bring lasting reduction in both inflation and interest rates.

PRESENT SITUATION

Most recent major outside forecasts (NIESR, P&D, CBI, LBS, Industry Act Forecast (IAF)) assess recession's trough was reached in H1 1981, with some recovery in year to H2 1982 (in range $\frac{1}{2}$ - $2\frac{1}{4}$ per cent). Item are more pessimistic, seeing output fall a further 2 per cent in 1982, recovery thereafter. Unemployment (UK adult sa) forecast to increase to around 3 million by end 1982. (IAF does not assess unemployment prospects). Most major forecasters see year-on-year inflation in range 11-12 $\frac{1}{2}$ per cent for Q4 1981, falling to 9-11 per cent in Q4 1982. Item and St James are more pessimistic; forecasting range of 13-15 per cent. Item see a sharp drop, well into single figures in 1983. The IAF which sees inflation falling to 10 per cent in 1982 Q4, lies at the centre of the range.

GDP output estimate rose $\frac{1}{2}$ per cent in Q3 1981 the first rise for 7 quarters. In the 3 months to October 1981 industrial output and manufacturing output both rose $1\frac{1}{2}$ per cent.

Consumers' expenditure fell by $\frac{1}{2}$ per cent in Q3 1981 returning to the level of Q3 1980. Retail sales in the 3 months to November 1981 were unchanged. In September and October the volume of visible exports was 4 per cent above the average in January and February while the volume of visible imports rose 21 per cent on the same comparison. DI investment intentions survey conducted in October/November suggests volume of investment by manufacturing, distributive and service industries (excluding shipping) will rise by about 2 per cent in 1982 following an estimated fall of 4 per cent in 1981. A large rise is tentatively expected in 1983. Investment by manufacturing (including leasing) is expected to rise during 1982, but for the year as a whole it is likely to be 1 per cent lower than 1981. An appreciable rise is expected in 1983. Manufacturers', wholesalers' and retail stocks dropped by £0.1 bn (at 1975 prices) in Q3 1981 compared with destocking of £1.0 bn in H1 1981 and £1.9 bn in 1980 as a whole.

Unemployment (UK, seasonally adjusted excl, school-leavers) was 2,764,000 (11.4 per cent) at November count, up 36,000 on October. Vacancies rose slightly to 104,000 in November.

Wholesale input prices (fuel and materials) fell $\frac{1}{2}$ per cent in November; the year on year increase fell to 16 $\frac{1}{2}$ per cent. Wholesale output prices rose $\frac{1}{2}$ per cent and remain 11 per cent above a year ago. Year-on-year RPI increase was 12.0 per cent in November. Year-on-year increase in average earnings was 11.9 per cent in October. RPDI fell by 2 $\frac{1}{2}$ per cent in Q2 1981 after a 1 $\frac{1}{2}$ per cent fall in the previous quarter and a 17.5 per cent rise over the 3 years 1977 to 1980. The savings ratio fell 2 per cent to 12 $\frac{1}{2}$ per cent in Q2 1981.

PSBR £9.5 bn in the first half of 1981/82 and CGBR in April to November - £9.4 bn; but both ported upwards by the civil service dispute. Underlying PSBR believed in line with Budget forecast (£10½ bn).

Sterling M3 estimated to have increased by ½ per cent in banking November.

Visible trade showed an estimated surplus of £13 million in September and £116 million in October compared with an average monthly surplus of £368 million over the period July 1980 to February 1981. Invisibles surplus in first ten months of 1981 estimated at £2.4 billion. Reserves at end-November \$23.5 bn. At the close on 18 December the sterling exchange rate was \$1.8742 and the effective rate was 90.0.

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Prime Minister

MUS 18/12

PRIME MINISTER

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PAY BRIEF

I attach my Department's pay brief for December. I am sending copies to members of E, E(PSP), and E(EA) Committees, and to Sir Robert Armstrong.

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18 December 1981

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PAY BRIEF: POSITION IN MID-DECEMBER

1 Since the November pay brief 62 settlements covering 306,000 employees, all in the private sector, have been reported. The weighted average level of these is about 6½% and is dominated by a 5.4% settlement for the British Clothing Industry (105,000). A settlement giving 4.6% to 5.1% on rates for Motor Vehicle Retail and Repair (4 January-370,000) is not included in the figures as the effect on earnings is not yet available.

2 The 5.1% increase in minimum rates for Engineering Workers (1 November - 1¼m) has been ratified by both parties. (The National Engineering Agreement is excluded from the average figures as pay, in general, is set by domestic agreements negotiated throughout the year).

3 The cumulative weighted average level for the whole economy this round - 189 settlements covering 986,000 employees - is 8½%, compared with about 9½% last month, but less than 10% of employees about whom the Department expects to receive information have reached settlements.

4 In the private sector the cumulative average is just over 7½% (185 settlements covering 802,000 employees). For manufacturing the average level is about 6% and in non-manufacturing is just over 9%. There is a wide range of settlements, but recent settlements have tended to be in a 5% to 8% band which covers about 2/3 of settlements and just over ½ the employees.

5 There have been no settlements reported in the public sector since the November pay brief; the cumulative average remains at about 12½% (4 settlements covering 185,000 employees).

6 About 2¼ million workers are covered by 27 separate Wages Councils. Fifteen covering 2,026,000 workers have either made or agreed to make orders to come into effect during the current pay round. The average increase in representative statutory minimum rates, which does not necessarily result in a corresponding increase in earnings, is about 7½%.

NEGOTIATIONS

7 In the PUBLIC SECTOR, Coalmining manuals (1 November - 198,000) have submitted a claim for £100 basic minimum rate for surface workers, worth about 23.7% on rates, reduced hours, improved holiday pay and other benefits. An improved

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offer of £102m (previously £100m) estimated to be worth about 7.4% on earnings has been rejected. The NUM are to hold a delegate conference on 18 December to decide on future action. The outcome is likely to be put to ballot on 14/15 January. Water Service manuals (7 December - 30,600) are being consulted on an offer of 9.1% on basic rates (8.8% on average earnings). The result is expected in early January. Union negotiators on behalf of UKAEA, manuals (1 October - 4,750) have not yet responded to an improved offer of 5% on rates in reply to their claim for a substantial pay increase. Next meeting is to be arranged in January. An offer to Local Authority manuals (4 November - 1,077,000) of £4.60 increase on basic rates (6.9% on current paybill) plus a commitment to a one hour reduction in the working week from November 1982 is being put to a ballot of members without a recommendation. A decision is expected on 25 January. The Non-Industrial Civil Service unions (1 April - 508,000) have submitted a joint claim for an increase of 13% with an underpinning minimum increase for adults of £12.50 per week plus improvements in annual leave - estimated to add about 14% on average to basic pay rates. An early meeting is expected to discuss the claim and supporting evidence. Teachers E & W (1 April - 460,000) have submitted a claim for increases in line with inflation. The next meeting of the Burnham Primary and Secondary Committee will be 19 January 82. A 4% offer has been rejected by Municipal Buses platform and non-craft maintenance staff (4 January - 15,200) who are claiming a substantial increase in basic rates, reduction in the working week, improved holidays and other benefits. Talks will continue after Christmas. Industrial action is threatened unless the offer is increased substantially. The British Steel Corporation (1 January - 108,000) is not prepared to negotiate a national pay award for 1982 and has stated that any pay rises must be linked to productivity deals negotiated at local level. The craft, service and management unions have agreed to the proposals in return for some productivity consolidation, a 39 hour week from 1 January 83 and pension improvements. The ISTC (some 60,000 members) are seeking further concessions on hours and consolidation. Gas supply manuals (17 January - 41,300) have submitted a claim for an increase in rates in line with the cost of living, a reduction in the working week and other benefits.

8 In the PRIVATE SECTOR, unions representing Ford Motor Co manuals (24 November - 54,000) have rejected a 'final' offer of 7.4% plus a one hour reduction in the working week - to 39 - from January 1983. Workers have endorsed the Unions' call for strike action from 5 January. In the Road Haulage Industry (Nov/March - 97,000) most of the 21 areas have submitted claims for increase in pay, holidays and other benefits estimated to be worth about 50% overall. Thirteen areas are considering offers of between 2.5% to 6.2% on basic rates. Negotiations in the

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Electrical Contracting Industry (1 January - 45,000) resume on 17 December. An offer understood to be worth 6% to 7% has been rejected. The union is seeking an increase of about 20%. In response to a claim for a substantial increase in pay and other benefits Multiple Baking production workers (30 November - 20,000) have been made an offer of 7.5% plus 0.5% for improvement to night shift allowances. Talks with ACAS have failed and the offer may be put to a ballot. Unions representing Newspaper Publishers Association, production workers (1 January - 33,000) are considering a 'final' offer of 5% and are expected to ballot members in January. Hosiery Trade employees (1 January - 100,000) are balloting on an offer of 5% with a recommendation by the union to accept. For Guardian Royal Exchange Staff (1 January - 8,700) the Banking, Insurance and Finance Union has submitted a claim for 11% increases and other benefits. An offer of 5% plus £50 lump sum has been rejected. A further meeting has been arranged for 17 December.

PRICES AND EARNINGS INDICES

PRICES

9 In November the year on year increase in retail prices was 12.0% compared with 11.7% in October.

EARNINGS

10 In October the year on year increase in average earnings for the whole economy was 11.9% compared with 9.3% in September. The underlying change, allowing for temporary influences such as back-pay in October 1981, was about 11%, similar to the figure for September.

REAL DISPOSABLE INCOME

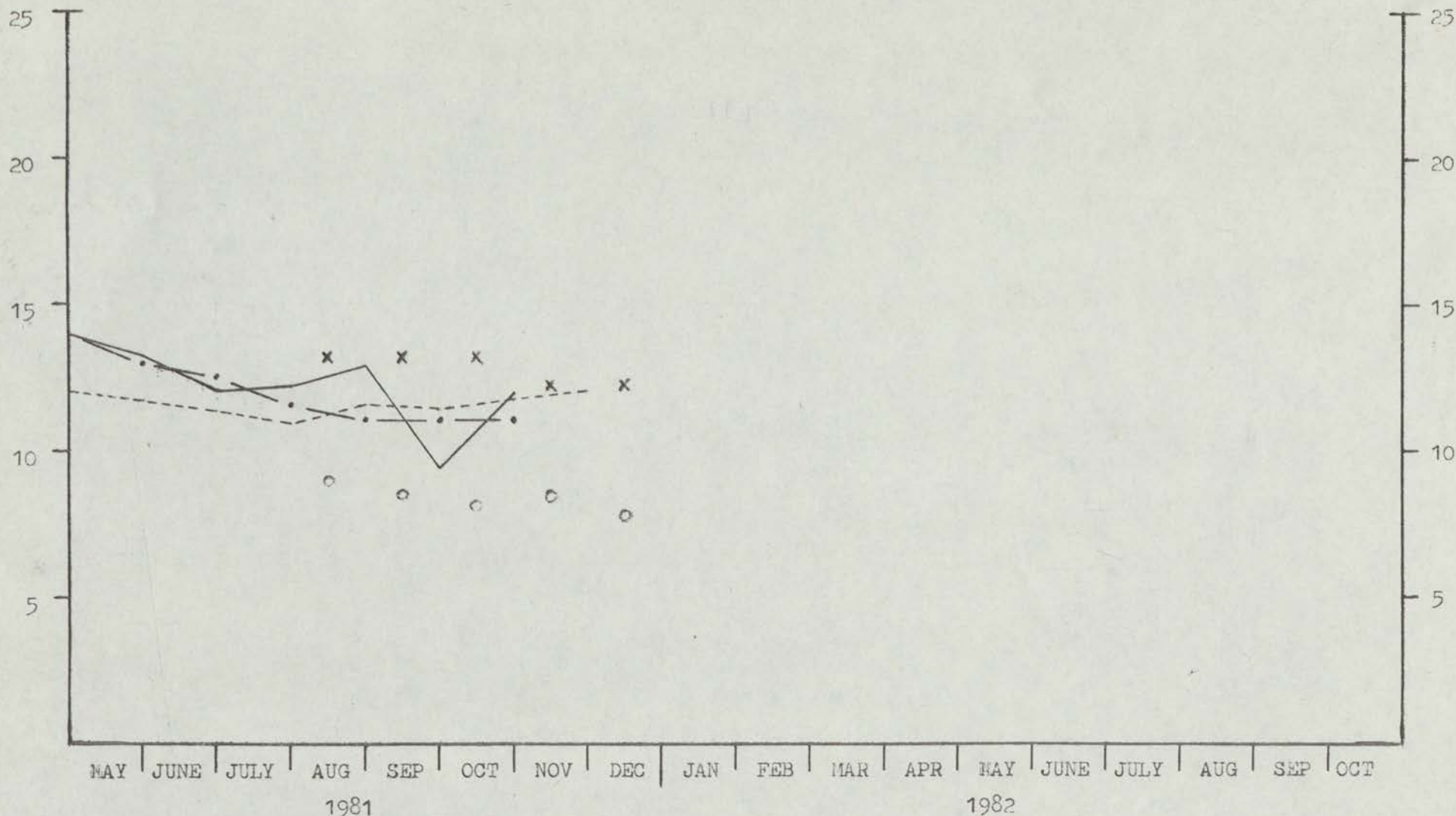
11 The real disposable income - taking account of the changes in earnings, prices and taxes - of a married man on average adult male earnings with a non-working wife and two children under 11 (with no other tax liabilities or allowances and not contracted out of the State Pension Scheme) fell by about 2% in the year to September.

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TRENDS IN EARNINGS AND PRICES

% increase on year earlier



%



- Retail Price Index
- Average Earnings Index (whole economy)
- Underlying rate of increase in earnings
- x Public Sector Settlements)
- o Private Sector Settlements)

Cumulative Average Increase in Earnings

DISTRIBUTION OF SETTLEMENTS IN THE PRIVATE SECTOR BY LEVEL OF SETTLEMENT FROM 1 AUGUST 1981

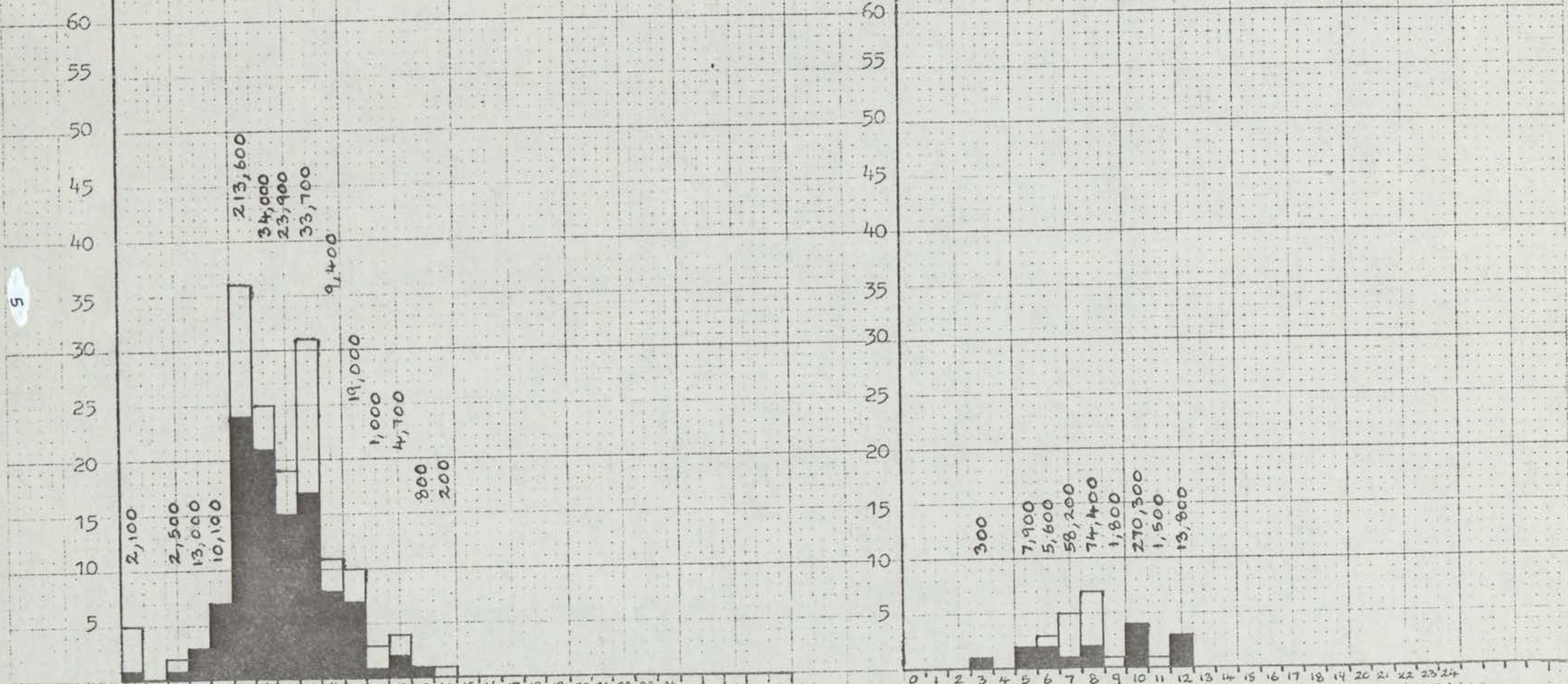
KEY  SETTLEMENTS UP TO THE LAST PAY BRIEF
 SETTLEMENTS SINCE THE LAST PAY BRIEF

Number of Settlements

MANUFACTURING

65

NON-MANUFACTURING



LEVEL OF SETTLEMENT (ROUNDED TO THE NEAREST WHOLE NUMBER)

NOTE - THE NUMBER OF WORKERS (ROUNDED TO THE NEAREST HUNDRED) AFFECTED BY THE SETTLEMENT IS GIVEN ABOVE THE APPROPRIATE INDICATOR.

EMBARGOED UNTIL 12.15 PM

FRIDAY 18 DECEMBER 1981

The Treasury and Civil Service Committee have agreed to the following report:

THE GOVERNMENT'S ECONOMIC POLICY: AUTUMN REVIEW

A. INTRODUCTION

1. This report is the fourth in a series of short twice-yearly reviews of the Government's economic policy. As required by the Industry Act, the Treasury publish two economic forecasts a year - one at the time of the Budget and one in the autumn. At the same time as the autumn forecast is published, the Chancellor of the Exchequer makes a statement in the House. This affords us the opportunity to assess the economic situation and the Government's policy about half-way through the financial year.

2. This year we took the opportunity to hear oral evidence from the Chancellor of the Exchequer before he made his statement. We also took evidence from Treasury officials. As on previous occasions, we are indebted to our advisers, Dr Paul Neild, Mr Paul Ormerod, Dr Bill Robinson and Mr Terry Ward for their assistance in preparing the report.

3. The autumn statement is an event of growing importance in the Parliamentary and economic calendar. But it is unsatisfactory in two principal respects.

4. First, the Government now give a figure for the "planning total" of expenditure (which excludes debt interest) in the next financial year, but only give in summary form some of the changes inherent in that total figure. Furthermore, the Public Expenditure White Paper giving comprehensive information over the whole field - originally published in the autumn - is now delayed until the time of the Budget. There may well be a case for publishing the Public Expenditure White Paper and the Government's Budget proposals simultaneously and reforming the system so that they are produced on a comparable basis. At present they are not comparable and the two are only published together by delaying the White Paper until long after the Government have decided on its contents. This means that for several months Parliament is without information on substantial areas of public expenditure, both for the current

and next financial year, which it might wish to debate well in advance of the Budget - or even in certain cases before the publication of the Estimates for the forthcoming year.

5. Second, the statement - which is certainly not a Mini-Budget, whatever some commentators may say to the contrary - gives no indication of the Government's proposed budgetary policy for the next financial year. Still less does it foreshadow individual taxation changes which may be under consideration (except for National Insurance contributions, which have become regarded as a form of taxation). The Chancellor of the Exchequer can therefore state, with some justification, that it is not possible to pass judgment at this stage on the Government's overall economic posture, since only their expenditure plans are revealed and not their plans covering revenue.¹ This is unsatisfactory. Moreover, the effect of this is to extend the Chancellor's traditional state of 'purdah' prior to the Budget to a period of at least four months. This has created difficult problems for Parliament.

6. The relationship between expenditure and taxation is among the subjects dealt with in a wide-ranging study conducted by a Committee set up under the Chairmanship of the late Lord Armstrong of Sanderstead at the instigation of the Institute for Fiscal Studies in 1978. The Committee's report² contains a number of important recommendations. We propose, in line with a recommendation of the Select Committee on Procedure (Supply) of last Session, to follow up some of the matters dealt with in the Armstrong Report early next year. Other areas covered in the Report may be more appropriately considered by the proposed Select Committee on Procedure.

7. In 1979 the Government's forecast and the Chancellor's statement were made on 1 November and in 1980 on 24 November. This year they were delayed until 2 December which made it impossible for us to publish a report before the debate on 9 December. If the Select Committee are to have time to prepare

1. Official Report, 2 December 1981, Col 249

2. "Budgetary Reform in the UK". 1980

a report for the House it would be helpful if the Government's public expenditure statement and the Industry Act forecasts were made available by mid-November. We ask the Government to bear this in mind in future years.

Common Assumption Forecasts

8. In our Fifth Report last Session - on the 1981 Budget and the Government's Expenditure Plans 1981-82 to 1983-84 - we published a Table comparing the post-Budget Forecasts of the Treasury with those of the London Business School, the National Institute of Economic and Social Research, the Economist Intelligence Unit and Phillips and Drew. We summarised the main features brought out by the comparisons. It was apparent to us that in many important respects the assumptions fed into their economic models by the several forecasters were far from uniform. This made valid comparisons difficult.

9. We have expressed in Chapter 10 of our Third Report last Session - on Monetary Policy - our conviction that more work needs to be done in the field of inter-model comparisons.³ On this occasion therefore three of the four institutions were asked as an experiment to feed into their models certain common assumptions.⁴ In the Table of comparisons in the Annex these "common assumption" forecasts are set out alongside each institution's forecast based its preferred assumptions. Also included are the Treasury's own forecast and Phillips and Drew's forecast (which was produced immediately after the Chancellor's statement on 2 December and takes into account the impact of the measures then announced).

3 HC(1980-81)163-I, pp lxxxix-xci

4 See Annex

B - PUBLIC EXPENDITURE

10. This year the Chancellor's autumn economic statement included revised plans for public spending in the financial year ahead. Generally in previous years only a number of revisions to original plans for the coming financial year have been made known, and no revised estimate of overall spending plans given. We welcome this addition to the information previously provided.
11. On the other hand the revised plans contain gaps. In particular they contain no estimates for debt interest payments, and no information on asset sales. Full and proper discussion of the plans is hindered because they are expressed solely in cash terms; in order to make comparisons possible it would have been helpful if the March Budget plans had been restated on a comparable basis.

Expected Outturns and Revised Plans(i) Cash Terms

12. The planning total for public expenditure (which excludes debt interest) for 1981-82 is now expected⁵ to be around £107 billion in cash terms compared with a figure of £105 billion presented at the time of the March budget. The 1982-83 planning total has been raised from the £110 billion implied by the last Public Expenditure White Paper (Cmd 8175) to £115 billion, again measured in cash terms.⁶ This represents a rise of 7½% over 1981-82.

(ii) Volume terms

13. From the cash figures presented it is not possible to come to any firm view of the volume growth now expected for the present financial year. At the time of the budget a virtually unchanged level from 1980-81 was planned. We have not been told whether the likely outturn of £107 billion in cash terms compared with the original cash plan of £105 billion reflects

5. Official Report, 2 December 1981, Col 242

6. Table 1. Summary of Public Expenditure Decisions for 1982-83, H M Treasury

unplanned increases in volume or unexpectedly higher prices. Treasury witnesses⁷ informed us that the pay and price assumptions underlying the budget estimates had only been marginally revised, so much of the £2 billion extra presumably reflects an increase in the volume of public expenditure. We agree with the Treasury that measuring volume is sometimes difficult and that any estimates for 1981-82 must be tentative since the year has not ended. Nevertheless we feel that more could - and should - be said about volume.

14. Increases in public sector pay and in the price of goods and services purchased by the public sector of 4% and 9% respectively for 1982-83 over 1981-82 amount to a rise in projected public sector costs of 7½% overall. With planned cash spending also rising by 7½%, in theory neither an increase nor a decrease in overall volume terms is being planned; but if, as seems possible, public sector costs rise more than projected, there will be a decrease. The flat path now planned compares with the plans at the time of the Budget to reduce the volume of 1982-83 expenditure from the 1981-82 level by 2%.⁸ The upward revision illustrates the difficulty the Government have had in holding to the key elements of their Medium Term Financial Strategy.

(iii) Cost terms

15. To assess the tax implications of public spending the relevant measure is public expenditure in "cost" terms.⁹ The Treasury now estimate that pay and price increases will raise the cost of the public sector by 7½% in the financial year 1982-83. General cost increases as measured by retail prices are

7. Q172

8. Table 1. Summary of Public Expenditure Decisions for 1982-3, H M Treasury, March 1981

9. The various wages and prices paid by the public sector change at different rates from those of the private sector and this affects the relative cost of the public service as a whole to the economy generally. (See "The Government's Expenditure Plans 1981-82 to 1983-84", Cmnd 8175, pages 232-233.)

expected to be 10%.¹⁰ The Table below shows changes in public expenditure in cost terms since 1978-79.

Planned Changes in Public Expenditure Planning Total Compared with Outturn, 1979-80 to 1982-3. % changes in cost terms (i.e. including relative price effect)

	1978-9 to 1979-80	1979-80 to 1980-81	1980-81 to 1981-82	1981-82 to 1982-3
Preceding White Paper	+3.3	+1.1	-1.0	-2.3*
Outturn	0.0	+3.0	+1.7	

* Change implied by Chancellor's December 2nd statement.

16. In cost terms public expenditure has clearly been higher than expected; in order to achieve their 1982-3 plans, therefore, the Government will need to secure a substantial relative fall in public sector costs, as well as holding to their plan not to increase further the volume of public spending. Obviously it will prove difficult to keep public sector cost increases below other cost increases.

Gaps in the Figures Presented

17. The public expenditure totals presented with the Chancellor's December 2nd statement refer only to the "planning total" for public expenditure. This does not include debt interest payments. Without estimates of debt interest for 1981-82 and 1982-83 we are unable to form an overall view of public expenditure in these two years. In oral evidence Treasury officials were only able to tell us that interest payments would be higher this year than planned at the time of the last Public Expenditure White Paper but they were unable to give us fresh estimates.¹¹ Debt interest payments contribute significantly to public expenditure - last year's figure net of transactions within the public sector was £4.3 billion (1980 Survey Prices) equal to the housing programme for example.¹² We therefore recommend that estimates of debt interest be included in any future statements about the overall levels of public spending.

10. Treasury RPI forecast 4th quarter 1981 to 4th quarter 1982.

11. The reply to Q 198 states that the estimate given at the time of the Budget "is probably an under-estimate".

12. Cmnd 8175

18. Included in the planning total for 1982-83 are receipts broadly estimated for sales of assets. The precise size of these has, according to the Treasury paper 'Summary of Public Expenditure Decisions for 1982-83', yet to be determined with therefore presumably consequential effects on other items of public expenditure within the fixed total. (We leave aside here the question of the correctness or otherwise of deducting receipts from assets sales from the total of public expenditure.) Prospective large asset sales (in particular of BNOC) could occur during 1982-83 and significantly affect total public expenditure. It would have been helpful if firmer estimates for asset disposals had been provided.

Nationalised Industry Borrowing

19. Of the £5 billion increase in 1982-83 public spending in cash terms over 1981-82, £1.3 billion is attributable to higher external financing of the nationalised industries;¹³ this total does not of course include figures for other public corporations.¹⁴ In previous reports we have argued that planned levels of nationalised industry external financing have been too low and that their planned levels of internal financing were too high.¹⁵ The £1.3 billion addition is half of what the nationalised industries themselves wanted.¹⁶ It is possible that their external financing requirements are again being under-estimated and that either the limits will have to be raised or the industries may resort to generating cash by raising prices or cutting investment programmes. We note that none of the £1.3 billion extra is to go towards raising nationalised industry investment beyond the level previously planned at the time of the Public Expenditure White Paper.¹⁷

13. The Treasury were unable to supply information on all public corporations - letter dated 14 December to Clerk (not reported).
 14. A full list of the different classifications of public trading bodies is given in our 8th Report HC(1980-81)348-III, p.71.
 15. Second Report, 1979-80, HC 584, p.x. Fifth Report, 1980-81, HC 232, p.xii.
 16. Official Report, 2 December 1981, Col 240
 17. "Summary of public expenditure decisions in 1982-83", para 30.

1982-83 Public Expenditure Changes and the RPI

20. In seeking to keep down the increase in public expenditure in 1982-83 the Government have turned to measures some of which will have the effect of raising prices. As the Chancellor has acknowledged, the proposed higher council house rents would directly raise the RPI by half a percentage point.¹⁸ The reduction in the Rate Support Grant percentage will tend to raise rates. There is the possibility just mentioned that nationalised industries may raise their prices. This will be in addition to the rises in the prices of electricity and gas above the rate of inflation announced at the time of the Budget.¹⁹ All these price rises are occurring at a time when pay settlements are low and when private sector prices are showing only modest increases. Pressure to raise wages may also be increased as a result of the higher national insurance contributions.

18. Official Report 7 December, Col WA 317

19. See our Fifth Report HC(1980-81) 232-I, para 19.

C. THE GOVERNMENT'S MONETARY POLICY

The original aims of the Medium Term Financial Strategy

21. In our report on Monetary Policy²⁰ we examined the original aims of the Government's Medium Term Financial Strategy. It was clearly stated by the Government that part of the way in which the strategy was intended to work would be by influencing expectations. This depended on the credibility of the targets and the Government asserted that "there would be no question of departing from the money supply policy".²¹ Sterling M3 was chosen as the appropriate measure of the money supply and the 1980-81 Financial Statement and Budget Report stated that there should be a "progressive deceleration" in its growth over a four year period, to about 6 per cent in 1983-84. It was said such a strategy would "both result in a marked reduction in the rate of inflation and will prove the only way of achieving a permanent reduction".²²

The Strategy in practice

22. Last year the Treasury's November paper, "Economic Prospects", suggested that by the end of that financial year "underlying monetary growth ... will come back towards the top of the target range". In the event Sterling M3 grew over the period February 1980 to February 1981 by about 20%, compared with a target range of 7-11%; only about 3½% of this growth was attributed to the end of the "corset" arrangements.²³
23. In March 1981 the Sterling M3 targets were "rebased" to allow for the 1980-81 overshoot but it was stated that it was "the Government's intention to consider clawing back some of the past year's rapid growth of £M3 by permitting an undershoot as and when the opportunity arises."²⁴

20. HC (1980-81) 163-I, pp xvii-xix

21. FSBP 1980-81, p.19

22. HC(1979-80)450 Evidence, p.5

23. Note on 'Monetary Developments in Banking April' by the Treasury and Bank of England submitted to the Committee earlier this year. (Not reported)

24. FSBP 1981-82, p.16

24. This year the "Economic Prospects" paper suggests that the growth of Sterling M3 "may be somewhat above the top of the target range", i.e. the one which resulted from the upward rebasing, in part due to the Civil Service dispute and the move by the banks into the housing market. Treasury officials estimated that the tax revenue outstanding at the end of October as a result of the Civil Service dispute amounted to £5½ billion and that between £0.75 billion and £1 billion of this would still be outstanding at the end of the financial year. By the end of November the amount outstanding on this account had been reduced to about £4 billion. If all of the revenue delayed by the Civil Service dispute was paid to the Exchequer out of bank deposits rather than by increasing bank lending, the scale of the movement would be great enough to bring Sterling M3 growth within its current target range²⁵. However this seems unlikely to happen, since the Bank of England's note on the provisional estimate of the money supply in November²⁶ suggested that collection of delayed taxes "appears to have added substantially to bank lending" and Sterling M3 had already grown by nearly 13% over the nine months since the start of the target period. Even the rebased target range (6-10% at an annual rate) may be exceeded for a second successive year.

25. Despite the £M3 overshoot last year and £M3's increase so far in this financial year, the Treasury expect the annual rate of inflation to continue to fall slowly to about 10% in the fourth quarter of 1982 compared with 12% in the fourth quarter of 1981 and 15% a year earlier. In their current assessment of the prospects for inflation, the Treasury stress movements in the exchange rate and productivity rather than past changes in the money stock²⁷; we were told that these represented the "channels" through which monetary policy operates.²⁸

26. Sterling M3 was not mentioned in the Chancellor's statement of 2 December. This surprised us, given the importance originally attached to it, but we have been given no satisfactory explanation of the omission. In oral evidence, the Chancellor agreed that £M3 is an "accident prone" measure

25. Q.96 et seq. and Q.310

26. Press Notice, 8 December 1981

27. "Economic Prospects for 1982", paragraphs 3,7,20 and 21.

28 Q 223

of monetary growth²⁹. As it is not considered to be a wholly reliable indicator, its movements are assessed "in the context of what happens to other figures".³⁰ These include the narrower measures of money supply growth such as M1, the wider aggregates such as PSL1 and PSL2 and the exchange rate. The Treasury have not made clear however what would constitute satisfactory performance by those measures and no target ranges have been set in advance as is the case with £M3. If the yardsticks are unspecified, it is impossible to judge the policy.

Interest rates and the exchange rate

27. When we started our inquiry on 16 November it was clear that the level of UK interest rates had been increasingly influenced by overseas interest rates. But UK interest rates have not fallen as quickly as world interest rates in the last few months.³¹ We were told that if both monetary growth and the exchange rate were thought by the Government to be satisfactory, UK interest rates would be allowed to fall. The Chancellor was not able to specify the policy to be followed if one were satisfactory and the other not,³² saying that "both of them could produce evidence which pointed in the opposite direction. There is no uniquely satisfactory state of affairs but both of them have to be taken into account."³³
28. The increased emphasis on the exchange rate as a factor in assessing monetary conditions leads on to the question of whether it would be wise to have an explicit policy on the exchange rate. The Treasury have, at our request, set out the arguments for and against one such policy, membership of the exchange rate mechanism (ERM) of the European Monetary System.³⁴ This is a subject of increasing debate, but one which we have not yet examined, although it was the subject of a report by the Expenditure Committee of the last Parliament.³⁵

29. Q 30

30. Q 33

31. HC(1981-82)28-i, pp 1-5

32. Q 78, Q 79 and Q 124

33. Q 124

34. Appendix 3

35. HC(1978-79)60

The current state of monetary policy

29. The Government's current objectives were repeatedly expressed to us as the pursuit of "steady though not excessive downward pressure on [the] monetary aggregates making due allowance for events in the world beyond our shores".³⁶ What this means has not been explained to us. The growth of EM3 exceeded its target range last year and may do so again this year.

	Percentage Growth in EM3			
	1980-81	1981-82	1982-83	1983-84
MTFS Ranges	7-11	6-10	5-9	4-8
Outturn	16½(a)	13(b)		

(a) adjusted for removal of the corset

(b) growth over 9 months since beginning of target period; seasonally adjusted but unadjusted for effects of Civil Service dispute.

Given the original description of the MTFS, the apparent complacency of Treasury Ministers to these overshoots is important.

30. We welcome increased flexibility in the application of monetary policy. It is evident that the Government have had to modify the Medium Term Financial Strategy, which was originally intended to influence expectations and reduce uncertainty by making a clear commitment to the achievement of targets for a declining rate of growth of EM3 over a period of four years.
31. The effect of a high level of interest rates is of particular concern to the Committee, not least because a higher level in this country than abroad will tend to put upward pressure on the exchange rate; given the deterioration in UK competitiveness over the last few years this will damage prospects for recovery. Lower interest rates will partly depend on a reduction in the level of Government borrowing.

36. Q4 and passim

35. It is difficult to obtain precise information on the costs of unemployment. We are surprised to learn from a Treasury Note that it is not yet possible to estimate the proportion of those unemployed claiming benefit divided between Unemployment Benefit and Supplementary Benefit.⁴³
36. The turnaround in stockbuilding from de-stocking of £2.3 billion in 1981 (1975 prices) to an increase of £0.3 billion in 1982 is equivalent to an increase in GDP of 2.6%. However the effect on GDP is smaller than this since stocks have a high import content. Imports are forecast to rise by 8½% between 1981 and 1982.
37. There seems little reason to expect any of the other components of demand to boost 1982 GDP much beyond the Treasury's current forecasts. Consumers' expenditure is expected to remain steady despite falling post-tax real wages; so a fall in the savings ratio is anticipated although inflation is only expected to fall by 2%. If inflation actually fell further this could further reduce the savings ratio and increase consumers' expenditure. Government expenditure on goods and services in current prices is planned to rise by less than inflation between 1981-82 and 1982-83. The Treasury already forecast investment to rise by 2½% between 1981 and 1982, partly reflecting the hope that private housebuilding will recover from its present low level.⁴⁴ Finally, it surprised us that the Treasury forecasts assume 4-5% world trade growth (manufactures, weighted by UK share of markets) next year, more than double the rate they estimate for this year. Given the world recession and the deterioration in UK competitiveness in the last two years which the fall in the exchange rate has only partially offset, there seems little hope of a significant extra boost from export demand. Indeed we may not have seen the full effects of the rise of Sterling in 1980; from past experience the Treasury suggest that "effects on trade volumes, particularly exports, take some time to come through".⁴⁵

43. Appendix 4

44. Q 272

45. Evidence, p.1, para 4

38. The 4% increase in manufacturing output (stock adjusted) between 1981 and 1982 which the Treasury forecast will, if achieved, be welcome; this would, however, still leave it by the second half of 1982 6% below its level of the first half 1980 and 11% below its 1979 level.
39. On productivity, the Treasury suggest that, bearing in mind the need for a cautious interpretation of recent short run movements, it "has held up better than might be expected" but "It is still too early to say however whether this ... presages a sustained improvement in the future trend."⁴⁶ As far as productivity in the public sector is concerned, we were told that Government cannot set manning targets for the local authorities but did assume that there would be a substantial improvement in the efficiency of the National Health Service as a result of reductions in staff for the same output.⁴⁷

Comparison with other forecasts

40. The forecasts provided for the Committee by the Economist Intelligence Unit, the London Business School, the National Institute of Economic and Social Research and that of Phillips and Drew set out in the Annex to the Report show that there is no major disagreement with the Treasury. All forecasts predict a small GDP increase between 1981 and 1982 (the LBS predicts a rather larger increase than the others); the main source of increased GDP is the end of de-stocking although much of this is reflected in increased imports; inflation remains in double figures at the end of 1982; and UK unemployment (seasonally adjusted and excluding school leavers) is forecast to be between 2.8 and 3.0 million in the fourth quarter of 1982.

46. HC(1981-82)28-i, p.7

47: Q 202

Risks and uncertainties

41. Although the various forecasting institutions are in closer agreement than they have been in the recent past it should be stressed that there is still a margin of error surrounding their results, particularly as a result of external factors. The Treasury's forecast at this time of year for GDP growth between the current year and the next has been subject in the past to an average error of 1½ per cent of GDP.⁴⁸ Within this margin of error GDP could rise at twice the rate the Treasury are forecasting or, alternatively, it could actually fall.
42. The uncertainties of forecasting are made larger this year by the lack of information about the UK's recent trade performance and by the world situation. Export prospects may be seriously damaged by recessions in Europe and the United States on the one hand, while changes in US interest rates would have significant effects on UK interest rates and the exchange rate. We have gained no idea of what variations of strategy, if any, the Chancellor might adopt if external forces behave very differently from their assumed course.

The medium term

43. The upswing which is forecast for 1982 is weak, with GDP growing much more slowly than in similar stages of previous economic cycles.⁴⁹ Moreover, of the 1% forecast increase in GDP between 1981 and 1982 between a quarter and a half is a result of higher North Sea oil and gas output.⁵⁰ The end of de-stocking, which more than accounts for the GDP increase between 1981 and 1982, is a short term influence. We have not seen any firm evidence of factors leading to a sustained level of growth in the medium term which would significantly reduce unemployment.

48. 'Economic Prospects for 1982', Table 1.

49. Q 257

50. Q 281

E - RESTATEMENT OF THE STRATEGY

45. In our Second Report of Session 1979-80, on the Budget and the Government's Expenditure Plans 1980-81 to 1983-84, we commented on the launching of the Medium Term Financial Strategy welcoming in particular the bringing together of expenditure and revenue plans for a four-year period.⁵¹ We saw the introduction of the Strategy as a method of establishing disciplines, and the announcement of targets for various important constituents of the national economy (e.g. the financing of the nationalised industries) as a significant method of verifying progress towards achieving those declared targets. At the same time, we expressed reservations and anxieties about certain of the targets and the feasibility of realising them at that time. In our Third Report of Session 1980-81 (on Monetary Policy) we made further comment on the concept underlying the Strategy, describing it as "a bold experiment".⁵²
46. In view of the emphasis which the Government originally accorded to the Strategy and to certain particular targets, notably those for the money supply and the Public Sector Borrowing Requirement, it is a surprise to the Committee to find a lesser emphasis being currently given to these items. The evidence we have taken in the course of the present enquiry indicates a marked lack of certainty in relation to these targets, which is in strong contrast to the position of eighteen months ago. This makes it difficult for the Committee to measure and assess the position which the economy has now reached, and must throw doubt on the underlying Strategy as it was promulgated at the time of the Budget in 1980. We therefore believe that the time has come for a major re-statement of the Strategy, so that Parliament and public may be fully informed of the economic objectives which the Government now have set.

51. HC(1979-80)584, p.vii, para 3

52. HC(1980-81)163-I, p.xcvi, para 11.26

ANNEX

1. The Table overleaf compares the latest Treasury forecast with forecasts prepared for the Committee by the Economist Intelligence Unit (using the Treasury model), the London Business School and the National Institute of Economic and Social Research and Phillips and Drew's latest forecast.

2. Three of the forecasting teams submitting forecasts to the Committee supplied two forecasts. One - the basic forecast - was based on their own assumptions about the likely development of the world economy and UK economic policy. The other was based on a set of assumptions common to all three teams. These common assumptions were agreed among the forecasters (Mr Paul Ormerod from the Economist Intelligence Unit, Dr Bill Robinson from the London Business School and Mr Brian Henry from the National Institute of Economic and Social Research) and were essentially compromises between their individual assumptions. The forecasters argue that the estimates based on their own individual assumptions are their best guesses of how the economy is likely to develop. The LBS base forecast used in this exercise does not fully reflect latest developments and is felt by them to be probably over optimistic.

3. The Treasury and Phillips and Drew forecasts include the impact of the latest measures announced by the Chancellor. The other forecasts do not. (The common assumptions forecasts, though, assume a path for public expenditure similar to that now being planned as well as a similar view of future tax policy to that lying behind the Treasury forecast.)

4. Some of the salient points that arise are:-

(i) with the partial exception of the LBS, all forecasts predict slow economic growth.

(ii) all forecasters see stockbuilding as being the main source of increased demand, although much of this is dissipated in higher imports.

(iii) inflation is unlikely to fall into single figures by the last quarter of 1982.

(iv) unemployment (UK, seasonally adjusted and excluding school leavers) is likely to be only marginally below 3 million by the 4th quarter of 1982.

5. A note to this Annex discusses the common assumptions forecasts in some more detail.

COMPARISONS OF FORECASTS

	NIESR		LBS		EIU		Phillips & Drew Treasury	
	A	B	A	B	A	B		
A. Output and expenditure at 1975 prices. Per cent changes between 1981 and 1982								
(i) GDP (Factor cost)	0.6	0.6	2.3	2.0	0.5	0.5	1.0	1.0
(ii) Consumers' expenditure	-0.3	-0.2	1.0	0.6	-0.5	-1.0	0.0	0.2
(iii) General Government current expenditure on goods & services	0.5	-0.9	0.4*	-0.6*	0.5	0.5	0.5	1.0
(iv) Fixed investment	-1.9	-1.3	1.2	0.6	-2.0	-1.5	1.8	-1.2
(v) Exports of goods and services	3.3	4.5	1.9	1.8	1.0	1.5	2.5	3.9
(vi) Imports of goods and services	6.7	7.6	9.8	8.6	7.0	7.5	8.5	5.4
(vii) Change in stock building (as per cent of level of GDP)	2.0	2.0	2.7	2.7	2.0	2.0	2.5	2.1
B. Balance of payments on current account £billion								
1982: First half	1.4	2.0	0.5	0.75	0.0	0.0	} 3.0 }	1.8
Second half	0.6	2.4	-0.5	-	0.0	0.0		
C. Public Sector Borrowing Requirement £billion								
Financial year 1981/2	11.3	11.0	10.3	10.5	12.5	12.5	10.5	
1982/3	12.0	11.0	9.0	8.5	10.5	10.5	n.a.	11.0
D. Retail price index Per cent change								
4th Quarter 1981 to 4th Quarter 1982	11.2	10.0	10.4**	11.0**	11.5	11.5	10.0	9.9
E. Money Supply (£M3) per cent change								
March 1982 to March 1983	15.5	9.5	14.9	12.3	3.0***	8.0***	n.a.	9.0
F. Unemployment, UK., excluding school leavers, 4th Quarter 1982, millions	2.9	3.0	2.8	2.8	2.8	2.8	****	2.9

n.a. not available

Common Assumption Forecast

Basic Forecast. /That of the NIESR is taken from their November Review, the LBS base was done for the Committee, and the EIU's is their October Includes Nationalised Industry Investment Consumer Price Index forecast./

* April 1982 to March 1983 at annual rate

** Government Actuary's assumption; GB excluding school leavers, average.

Note to the AnnexCommon Assumption Forecasts

1. Three major forecasting teams (the Economist Intelligence Unit, the London Business School, and the National Institute of Economic and Social Research) have in the past provided the Committee with forecasts of the economy. Such forecasts have been used to outline possible developments in the economy. They embody the forecasters' best guesses of where the economy is going.

2. Each of the forecasting teams usually produces a different forecast. Differences arise from
 - (i) differing views of how the economy works, embodied in the structure and coefficients of the model
 - (ii) differing assumptions about future UK economic policy
 - (iii) differing assumptions about economic developments outside the UK
 - (iv) differing assumptions about recent past events the statistical record of which is incomplete or provisional
 - (v) differing choice of residuals or judgemental adjustments to model forecasts.

A common assumptions forecast should eliminate (ii), (iii) and (iv), concentrating attention on how the economy works and judgemental adjustments, which may be made to support views on how the economy works. A necessary condition for differences in views as to how the economy works to be small is that common assumption forecasts should be similar. Their dissimilarities help to indicate where, in the assumed scenario, there are important differences in view on how the economy works.

3. The Table in the Annex details the salient results from the forecasting teams using both common assumptions and individuals', preferred assumptions. The forecasters point out that their common assumptions forecasts were not constructed with as much concern for detail as their normal forecasting exercises are and must be seen as being somewhat rough and ready. The Tables overleaf present the differences

between basic forecasts and common assumption forecasts. The general picture is that using common assumptions increases the differences between forecasts. This can be interpreted as showing that basic model differences are greater than the basic forecasts suggests.

4. Another interpretation is possible. In constructing a forecast forecasters often adjust the results their models produce. Such adjustments essentially over-ride the economic views embodied in the model and the empirical evidence on which the model is based. For example, the model may predict that a 10% fall in the exchange rate will raise import prices by 5% after one year. The forecasting team may feel that this effect is say too big in the circumstances envisaged by the forecast overall, and reduce it. To an extent this kind of adjustment is absent from the common assumption forecasts. The greater divergence of the forecasts may therefore indicate that forecasters in adjusting these results from their models tend to produce forecasts that converge.

5. This exercise in producing common assumptions forecasts is very much a first step down this particular path of inter-model comparisons. Moreover, only the most rudimentary analysis of the results has been presented here. It is hoped that a more detailed examination of the results will be included in and contribute to, a similar exercise now being undertaken by Professor Artis for the Bank of England. The more thorough comparison of models requires examination of systematic sets of 'ready reckoners' prepared on comparable assumptions on different economic models, with any differences that arise traced back to the underlying theory, structure and estimation of the models themselves, their component sectors and individual equations. The Committee wish to encourage the Social Science Research Council and the forecasting teams, including the Treasury, to make provision for such work, and consider it of direct relevance to the work of the Committee.

Comparison of Base and Common Assumption Forecasts

(i) % increase in GDP at 1975 prices between 1982 & 1981

	Base Forecast	Difference from average of base forecasts	Common Assumptions Forecast	Difference from average of common assumptions forecasts
NIESR	0.6	-0.4	0.6	-0.5
LBS	2.0	+1.0	2.3	+1.2
EIU	0.5	-0.5	0.5	-0.6
Average	1.0		1.1	
Difference between highest and lowest forecast	1.5		1.8	

(ii) % increase in Consumption at 1975 prices between 1982 & 1981

NIESR	-0.2	0.0	-0.3	-0.4
LBS	0.6	+0.8	1.0	+0.9
EIU	-1.0	-0.8	-0.5	-0.6
Average	-0.2		0.1	
Difference between highest and lowest forecast	1.6		1.5	

(iii) % increase in Fixed Investment at 1975 prices between 1982 & 1981

NIESR	-1.3	-0.6	-1.9	-1.0
LBS	0.6	+1.3	1.2	+2.1
EIU	-1.5	-0.8	-2.0	-1.1
Average	-0.7		-0.9	
Difference between highest and lowest forecast	2.1		3.2	

(iv) % increase in Exports of Goods and Services at 1975 prices between 1982 & 1981

NIESR	4.5	+1.9	3.3	+1.2
LBS	1.8	-0.8	1.9	-0.2
EIU	1.5	-1.1	1.0	-1.1
Average	2.6		2.1	
Difference between highest and lowest forecast	3.0		2.3	

(v) % increase in Imports of Goods and Services at 1975 prices between 1982 & 1981

	Base Forecast	Difference from Average of Base Forecasts	Common Assumptions Forecast	Difference from average of common assumptions forecasts
NIESR	7.6	-0.3	6.7	-1.1
LBS	8.6	+0.7	9.8	+2.0
EIU	7.5	-0.4	7.0	-0.8
Average	7.9		7.8	
Difference between highest and lowest forecast	1.1		3.1	

(vi) Change in stockbuilding 1982 on 1981 as % of GDP

NIESR	2.0	-0.2	2.0	-0.2
LBS	2.7	+0.5	2.7	+0.5
EIU	2.0	-0.2	2.0	-0.2
Average	2.2		2.2	
Difference between highest and lowest forecast	0.7		0.7	

(vii) Balance of Payments, Current account 1982, £ billion

NIESR	4.4	+2.7	2.0	+1.3
LBS	0.8	-0.9	0.0	-0.7
EIU	0.0	-1.7	0.0	-0.7
Average	1.7		0.7	
Difference between highest and lowest forecast	4.4		2.0	

(viii) PSBR, 1982/83, £ billion

NIESR	11.0	+1.0	12.0	+1.5
LBS	8.5	-1.5	9.0	-1.5
EIU	10.5	+0.5	10.5	0.0
Average	10.0		10.5	
Difference between highest and lowest forecast	2.5		3.0	

(ix) RPI % change 4th quarter 1981 to 4th quarter 1982

	Base Forecast	Difference from average of Base Forecasts	Common Assumptions Forecast	Difference from average of common assumptions forecasts
NIESR	10.0	-0.8	11.2	+0.2
LBS	11.0	+0.2	10.4	-0.6
EIU	11.5	+0.7	11.5	+0.5
Average	10.8		11.0	
Difference between highest and lowest forecast	1.5		1.1	

(x) £M3, % change March 1982 to March 1983

NIESR	9.5	-0.4	15.5	+4.4
LBS	12.3	+2.4	14.9	+3.8
EIU	8.0	-1.9	3.0	-8.1
Average	9.9		11.1	
Difference between highest and lowest forecast	4.3		12.5	

(xi) UK Unemployment, excluding school leavers, 4th quarter 1982, millions

NIESR	3.0	+0.1	2.9	+0.1
LBS	2.8	-0.1	2.8	0.0
EIU	2.8	-0.1	2.8	0.0
Average	2.9		2.8	
Difference between highest and lowest forecast	0.2		0.1	

Assumptions used in Base and 'Common Assumptions' Forecasts

	Per cent changes			
	Base forecasts			Common assumptions forecasts
	NIESR	EIU	LBS	
North Sea Output 1981 Q3/1982 Q4	22.5	11.0	9.1	10.4
World Oil price 1981 Q2/1982 Q4	7.0	4.8	5.7	5.3
\$/£ rate 1981 Q2/1982 Q4	-9.0	-8.7	-18.8	-13.5
Effective Exchange Rate 1981 Q2/1982 Q4	-9.3	-5.1	-17.3	-11.2
World Interest Rates (percentage points) 1981 Q4/1982 Q4	-2.0	-3.5	-4.7	-4.0
World Export Prices (dollars) 1981 Q2/1982 Q4	10.0	13.5	5.5	9.3
World Trade in manufactures 1981 Q2/1982 Q4	6.5	5.1	5.1	5.1
UK short-term interest rates (levels) 1982 Average	15.5	12.6	15.7	14.1
General Government current expenditure on goods & services 1982/1981	-0.9	0.5	-0.6*	0.5

*includes nationalised industry
industry investment

Tax assumptions

(a) Base forecasts:

NIESR: Tax rates and allowances indexed at 1981/2 levels

EIU: " " " " " " " " " " " "

LBS: income tax held at constant proportion of personal incomes, indirect taxation held at constant proportion of consumption, national insurance surcharge reduced from 1982/3

(b) Common Assumptions Forecasts:

Tax rates and allowances indexed at 1981/2 levels



Econ Policy JFH

cc: Cabinet
CWO
CWO, H/W
Co
Mr Kydd

10 DOWNING STREET

From the Private Secretary

17 December 1981

Dear John

Shortly after Christmas, the Prime Minister will be giving a number of interviews in the course of which she will be asked to look back over 1981 and to look ahead at the prospects for 1982.

In preparation for interviews of this kind we always find it most helpful to have brief notes from Departments covering issues within their fields. I should therefore be most grateful if you, and those to whom this letter is copied, could let me have, by noon on Wednesday 23 December, notes covering:

BF

- (1) the main Departmental activities and achievements in 1981.
- (2) outlook for 1982.
- (3) major issues outstanding at the end of the year and not covered under 1 and 2 above.

It is most helpful for these notes to be kept as concise as possible. I should be grateful if they could be kept to a maximum of two sides. If Departments feel a need to explain any points in more detail, this can be done in separate background notes, although I hope that there will be few cases where this proves necessary.

I am sending copies of this letter to the Private Secretaries to members of the Cabinet and, for information, to Murdo Maclean (Chief Whip's Office), Michael Pownall (Chief Whip's Office, House of Lords) and David Wright (Cabinet Office).

Yours ever
Mike Pattison

John Halliday, Esq.,
Home Office.

58

Prime Minister.

1.

I think it would help CONFIDENTIAL
to send over a letter on the lines of the attached draft.
If you agree, I will clear the draft with the home
secretary and then send it round.

MR WHITMORE

tbl
23xii

Liswellant.

Speed

no

PRESENTATION - WHERE WE ARE FAILING

We discussed this problem on Friday and I promised you a note which you may care to put to the Prime Minister for comment and approval of the action I suggest. This minute reflects comments made to me by politicians and political journalists but is based essentially on my experience of different Governments since 1967.

Overall Assessment

This Government is widely felt to be one of the least "political" we have had for years. Certainly it does not spend much time agonising over presentation. I cannot think of another Government I have served which, for example, would have come as clean over its public expenditure decisions in the middle of miners' pay negotiations.

This Government is more concerned with getting the right decisions - i.e. decisions which it perceives to be right - than with how they are received. That means that presentation has a relatively low priority.

It has found it possible to maintain this stance for a combination of reasons:

- its strong majority in Parliament;
- the phenomenal disarray in the Parliamentary Labour Party;
- the broad acceptance in the Conservative Parliamentary Party of the overall strategy and policies; and
- on the whole, a good relationship with the media.

But now the Government has lost a number of by-elections; the SDP is riding high and far higher than anyone (including the Liberals) expected; the Conservative Parliamentary Party is tetchy, nervous, anxious for signs of hope and success and rebellious; and the Government has latterly run into trouble on a number of issues.

Presentation is therefore of increasing importance and this is reflected in the tendency - par for the course in all Governments in mid-term - to lay the blame for failures at the door of presentation.

There is no doubt that presentation could be improved. But the Government must face the fact that it is its own worst presentational enemy. It is no longer possible for the Government to present its policies on its own terms. Invariably the worst possible light is put upon them before they have been formally announced by malicious leaking. A more cohesive Government would work wonders for presentation.

← Thus the problem we now face is not whether the Government can improve its standing with the public by better presentation, but whether it has the will to do so.

Solving the problem

Any proposals for improving presentation must take account of the fact that the Government is a house divided.

They must also face up to the reality that what really counts is substance and not veneer. You can't make a silk purse out of a sow's ear.

We must also accept that all Governments go through bad patches. We had one 12 months ago when we ran into all sorts of embarrassing problems over Written Answers when Mr Foot wanted Oral Statements, not to mention the appalling mess (in the context of the public expenditure decisions) over the effect on employers of increased National Insurance contributions.

We have latterly been through another series:

- Rates Bill/referenda (a policy failure);
- Juggernauts (a clear case of the right policy ineffectively sold);

- Inner cities (a classic example of Government failing to put over its decisions in the best possible light); and
- Public expenditure (a text book example of the Government's failure to decide how to present its policy).

We learned from the 1980 presentational errors. For example, this time we watched the effect on employer National Insurance contributions like a hawk. Can we now learn from the 1981 mistakes? And, more important, can we devise some rules which will generally safeguard the Government's presentation?

Proposals

The Heath Government tried to cope with the problem by insisting that each Cabinet paper contained a passage headed 'Presentation', under which Ministers were supposed briefly to set out the problems and how they proposed to cope with them. I do not believe this worked.

The proposals and procedures suggested below - and especially Point 2 - are likely to have more practical effect. They assume that it is generally recognised that officials will be less than effective in their presentational efforts if Ministers are displaying their divisions to the world.

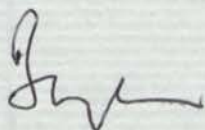
Having said that, it is possible to ensure better presentation if the following basic rules are observed:

- 1 - Departments should, wherever possible, give No. 10 Private and Press Offices and the Lord President's Office 48 hours in which to comment on draft statements; the maximum amount of time for comment is the essential point. Central Departments operating at a distance from policy detail have a potentially invaluable presentational commentary to make.

- 2 - Draft statements should be submitted with background papers which identify the major points of political attack (from all quarters) and how those attacks may be repulsed. This is not making work. In each Department I have worked in I have made it my responsibility to pose the awkward questions on all policy developments and to ensure that satisfactory answers were available before and not after presentation. We did it here in No. 10 to some effect on the dismantling of the CSD. This should be standard Departmental practice.
- 3 - Departments should identify as a matter of course announcements of policy developments, measures, initiatives and Answers which are politically sensitive; ensure that positive and defensive briefing is prepared; and alert their Press Offices in good time to operate effectively - i.e. bring them into the process of identifying sensitive issues and how they might best be presented.
- 4 - As one aspect of 3 above, Departments should identify as a matter of course and priority good news and ensure that they and their Press Offices put it over with vigour; I am sorry to say that day in and day out No. 10 Press Office has to drag good news out of Departments and, having dragged it out, has to spur them to sell it hard.

Summary

Nothing can be achieved unless Ministers and officials accept that presentation is essential to the Government's success. If that is accepted, the next requirement is for Ministers to recognise that presentation will be more rather than less effective if they row together. But whether they row together or not there are ways in which the Government's act can be better presented and these are set out in the attached Dear Private Secretary letter for your signature.



B. INGHAM
16 December 1981

Draft Dear Private Secretary letter

The Prime Minister is anxious, as I am sure is the Government, to improve the presentation of its policies. I am therefore writing, ^{on his instructions, / Home produce} to suggest ways in which this might be achieved. ~~(subject of course to Ministers being able to present their policies, measures and initiatives in the way they would choose rather than in a manner conditioned by unauthorised disclosure)~~

The Prime Minister can see how President's letter like to have the opportunity
~~If we are to treat presentation seriously, Departments should give No. 10 Private and Press Offices and the Lord President's Office the maximum amount of time to comment on Parliamentary statements, initiatives or sensitive Answers. I suggest that~~

~~48 hours advance notice should be the working rule.~~ *But to do this they need time, and Departments should accordingly aim to get drafts to the No 10 Private and Press Offices and to the Lord President's Office early on the morning of the day before the announcement.*

Second, Departments should ensure that details of each ~~statements, initiative and Answers~~ ^{are} should be sent to No. 10 and the Lord President, ^{with background notes which identify the points of political attack and how those attacks can be met.} It is ~~absolutely~~ ^{essential} that before any Department ~~goes public~~ ^{the lines of attack should have been anticipated and a means of securing the most positive presentation should have been devised.}

- and at a more routine level -

are likely to ^{are likely to} ~~Third, Departments should as a matter of course identify~~ ^{problems and opportunities} and ensure that their press offices (and No. 10 Press Office) are put in the best position to meet the problems and ~~exploit the opportunities.~~ ^{For maximum effect, guidance should reach No. 10 Press Office by 10.45 am and 3.45 pm each day.} *if No. 10 learn about a Departmental problem for the first time through a press enquiry, we are not well placed to handle it to the Government's advantage.*

Finally, it goes without saying that Departments should pay particular attention to items of good news and ensure that they are put over with vigour. ^{The Prime Minister is ever willing to lend a hand in this both at Question Time and in speeches (or on more informal occasions).} She also wants ^{her Press Office to be given} ~~positive bullets to fire by Departments.~~ ^{Departments to give}

I should be grateful if you could ensure that the above points are

I am sure I can count on you to act on this prescription for improving the presentation of Government policy.

Some currently in mind in your Department. If there is one aspect of them I would single out for particular mention, it is the importance of giving departmental Press Officers and the No 10 Press Office as much notice of proposed announcements as possible: good PTO

presentations needs time for preparation.

I am sending copies of this letter to the Public Secretary to the members of the Council, ^{and} to the High Com, ~~to the High Com~~ and to Sir Robert Amstrong.

[The following text is extremely faint and largely illegible, appearing to be a series of lines and fragments of handwriting, possibly bleed-through or a very light scan of a document.]

Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in The National Archives.

HC. First Report from Treasury and
Civil Service Committee, Session 1981-82
Government's Economic Policy: Autumn Review,
16 December 1981

Signed OWayland Date 16 August 2012

PREM Records Team



Prime Minister

(4)

H. M. TREASURY

Summary below

Parliament Street, London SW1P 3AG, Press Office: 01-233-3415

Telex 262405

MUS 18/12

PLEASE NOTE EMBARGO

NOT FOR PUBLICATION,
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TUESDAY, 15 DECEMBER 1981

14 December 1981

ECONOMIC PROGRESS REPORT : DECEMBER 1981

The December issue of Economic Progress Report will be published at 3.30pm tomorrow, Tuesday, 15 December. It contains the following articles:

Public expenditure in 1982-83 (pages 1-4)

This article give the main points of the Chancellor of the Exchequer's statement on 2 December, with some additional explanation and tables.

National insurance : changes in contribution rates (pages 4-5)

Some further details on the proposed changes in national insurance contributions from next April.

Rate support grant proposals (page 4)

The three main objectives of the Government's approach, announced by the Secretary of State for the Environment on 2 December.

Public and private sector earnings (pages 5-6)

A table and chart, drawn from the latest New Earnings Survey, show some broad comparisons in movements in earnings of public sector and private sector employees since 1970, giving central government, local government and public corporations separately and combined. In all cases the relative position of public sector earnings peaked in 1975-76, and in all cases the recent relative position of the public sector is better than in the early 1970s.

The Monthly Economic Assessment can be found on pages 7 and 8.

The index to articles in Economic Progress Report during 1981 will be published next month. The Industry Act forecast, "Economic Prospects for 1982", is published as a supplement to the December issue.

PRESS OFFICE

HM TREASURY

PARLIAMENT STREET

LONDON SW1P 3AG

01-233 3415

188/81

Economic Progress Report



Published by the Treasury

No. 140 December 1981

Public expenditure in 1982-83

The Chancellor of the Exchequer, Sir Geoffrey Howe, made a statement to the House of Commons on 2 December 1981 about government decisions on public expenditure in 1982-83 and on the future pattern of national insurance contributions for next year, on the basis of the Government Actuary's report. This article includes the main points of the Chancellor's statement and some further details of the public expenditure and national insurance decisions.

As required by the 1975 Industry Act, the Chancellor also announced publication of the forecast of economic prospects for 1982. The full text of the forecast can be found in a supplement to this issue of *Economic Progress Report*.

'Eighteen months ago,' the Chancellor said, 'the annual increase in the retail prices index (RPI) was 22 per cent and a year ago 15 per cent. It is now about 12 per cent. Over the next year we expect a further reduction to about 10 per cent. Output is expected to rise by about one per cent, and manufacturing output rather more rapidly. The outlook, in short, is for gradual recovery.'

Planning in cash

'As I told the House in my Budget statement,' the Chancellor continued, 'we are no longer planning public expenditure in volume terms but in cash.** The plans next year, which appeared in the last White Paper in volume terms, had therefore to be revalued in cash. On this basis the starting point for discussions about 1982-83 was a cash total of £110 billion.' (See table 1.)

'The net result of the decisions which I am announcing today will be to raise that figure by almost £5 billion, to bring the planning total for next year to about £115 bil-

lion. The exact total for next year will depend upon decisions which cannot be taken yet about the appropriate provision for certain demand-determined programmes and for the contingency reserve.'

The decisions for 1982-83

The main public expenditure decisions which have been taken for 1982-83 are shown in tables 1-3. They are in cash†. They will be set out in full, along with the planning figures for 1983-84 and 1984-85, in the next public expenditure White Paper to be published at the time of the Budget.

Starting point

The Government's earlier plans for expenditure in 1982-83, set out in the last public expenditure White Paper (Cmnd 8175) were expressed in '1980 survey prices': that is, broadly, the prices ruling in the autumn of 1979. To establish a starting point for this year's survey just concluded, those last White Paper plans were revalued to express the plans in cash.

For this revaluation, a general factor of nine per cent was used for the increase in prices other than public services pay between 1981-82 and 1982-83, and for public services pay a factor of four per cent from the next settlement dates. Adjustments were also used to allow for certain changes which do not affect the PSBR, notably additional external finance for the British Gas Corporation to allow for the gas levy, and for certain minor classification changes. This produced a total of £110 billion, as shown in table 1.

Decisions

It has been decided that the cash to be made available for programmes in 1982-83 should be as shown in table 2 on page 2.

The proposed external financing limits for the nationalised industries in 1982-83 are listed in table 3 on page 4.

Planning total

For programmes which depend on economic assumptions, such as the level of unemployment (the main such programmes are marked with an asterisk in table 2), the revised figures for individual programmes have been constructed on the basis of the economic assumptions used in the last White Paper. New assumptions for the next White Paper will be decided nearer the time of publication, and an appropriate adjustment made to those programmes. The size of the contingency reserve and the provision for asset sales will also be determined later. These decisions will determine the exact size of the planning total to be included in the next White Paper.

In the meantime, a single global allowance has been made for the effects of these adjustments, for the contingency reserve, and for asset sales. This results in an estimate of the planning total of about £115 billion.

†In a few cases, expenditure is on an 'accruals basis'.

Table 1
The survey's starting point

	1981-82 £ bn	1982-83 £ bn
1 Cmnd 8175 at 1980 survey prices	79.5*	77.9
2 (1) revalued to cash	104½*†	109½†
3 Adjustments for PSBR—neutral changes	½	½
4 Starting point for the survey	105	110

*Including Budget changes

†Including minor classification changes etc.

**See *Economic Progress Report*, November 1981, page 1.

'At the time of the Budget we expected cash expenditure in 1982-83 to grow more slowly than we now envisage. We now think it appropriate to increase the planned provision for certain programmes to reflect changed circumstances.'

'It is too early to judge with precision what these changes,' (including changes in national insurance contributions), 'will mean for next year's public sector borrowing requirement (PSBR),' the Chancellor said. 'On the basis of the conventional assumptions set out in the Industry Act forecast there is no present reason to depart from the projections published at the time of the last Budget. I shall, of course, have to take all the relevant factors into account when the time comes for framing next year's Budget.'

Some main changes

The Chancellor went on to outline some of the main changes. Increases in programmes — whether on account of policy or of changed demands — amounted to about £6 billion. But offsetting reductions in previous plans of over £1 billion had been made. These restricted the net increase to the figure of £5 billion already mentioned. (For details of programme changes, see table 2.)

The administrative costs of central government were not far short of 10 per cent of total public expenditure. 'We are determined,' the Chancellor said, 'to reduce that proportion and maintain the drive for more efficient management throughout the public sector.'

'Our spending plans provide broadly for increases of four per cent in the total sums available for the pay of public servants from next settlement dates. The provision for administrative costs will be further reduced by the impact of a general reduction of at least two per cent in all cash-limited expenditure.'

'This will involve economies in the cost of maintenance and improvement of government buildings as well as in manpower and ancillary services. And we shall continue to reduce civil service numbers so as to maintain progress towards our aim to have 102,000 fewer staff in post in April 1984 than when this Government came into office.'

Consultations on housing

The Chancellor said that the Secretaries of State for the Environment and for Wales were about to undertake consultations with the local authority associations on the increase in local housing income, including rents, to be assumed for grant and subsidy purposes.

'Subject to those consultations,' he said, 'and to the contribution of our successful policy for increasing council house sales, we hope to be able to maintain activity on public housing construction and improvement at approximately the same level as this year.'

There would be some reductions in the cash provision for some other capital programmes, including those for water services, motorways and trunk roads, and certain local authority services. There had, however, been a substantial fall in tender prices. Because of this, there should be no significant impact on the published plans for water services, motorways and trunk roads.

'Our cash provision' the Chancellor continued, 'will again allow continued growth in the National Health Service (NHS). More of the cost of the health services will be financed by contributions and charges. We will be increasing the Health Service contribution (from the National Insurance Fund) by 0.1 per cent' (providing additional revenue for the NHS of £104 million in 1982-83).

The full present range of exemptions from charging remained unchanged. Two out of every three prescrip-

tions would continue to be provided free of charge. Where a charge was payable, it would be raised to £1.30. There would also be increases in charges for dental and ophthalmic services.

The increase in student grants for the next academic year would be 4 per cent, in line with the pay increases broadly envisaged for employees in the public services. The parental contribution scale would remain unchanged, but the minimum award would be kept at the present cash level.

Table 2 Public expenditure plans, by Department

	1981-82		1982-83
	White Paper† £m	White Paper† £m	Revised programme £m
1 Departments (excluding nationalised industries' external finance):			
Ministry of Defence	12,270	13,624	14,103
Foreign & Commonwealth Office (including Overseas Development Administration)	1,556	1,575	1,565
European Community Intervention Board for Agricultural Produce	460	501	587
Ministry of Agriculture, Fisheries and Food	530	593	664
Forestry Commission	962	976	1,031
Department of Industry	59	64	62
Department of Energy	1,970	1,460	1,393
Department of Trade	354	385	387
Export Credits Guarantee Department	287	302	292
Department of Employment	4	89	115*
Department of Transport	2,320	1,911	2,688
DOE — Housing	2,880	3,036	3,166
DOE — Property Services Agency	4,125	3,869	3,871*
DOE — Other environment services	439	453	444
Home Office	3,546	3,669	3,661
Department of Education & Science	3,263	3,529	3,639
Office of Arts & Libraries	11,315	11,667	12,216
DHSS — Health	475	500	532
DHSS — Personal social services	10,793	11,613	11,650
DHSS — Social security	1,657	1,788	1,970
Scotland	27,575	30,197	29,900*
Wales	5,621	5,855	5,956
Northern Ireland	2,240	2,326	2,375
Other Departments	3,223	3,419	3,510
	2,907	3,111	3,121
2 Nationalised industries' total external finance	2,924	1,470	2,770
3 Total programmes (rounded)	103,750	107,980	111,670
4 Contingency reserve	2,500	2,850	
5 Special sales of assets †	-230	-180	3,300 (provisional)
6 General allowance for underspend	-1,000	-700	
7 Planning total (rounded)	105,000	110,000	115,000 (provisional)

†Plans in White Paper (Cmnd 8175) revalued and adjusted for Budget changes (1981-82 only) certain changes not affecting the PSBR, and minor classification changes.

*Subject to adjustment for revised economic assumption (see box on page 1).

†To be determined later. For the present, includes allowance for effect on programmes of possible revised economic assumptions (see box on page 1).

Social security

The Chancellor then turned to national insurance and other social security payments. 'These benefits will be uprated in line with the forecast movement in prices from November 1981 to November 1982,' he said. 'As is customary, the announcement of the forecast of the movement of prices and the consequent changes in benefit rates will be made next spring.'

The increase in the RPI to November 1981 would probably be some two per cent higher than the 10 per cent increase allowed for when calculating this year's uprating. For retirement pensions, and other long-term benefits, the shortfall would be made good in the November 1982 uprating. 'We shall thus continue to fulfil our pledge to retirement pensioners that they will be fully protected against inflation,' the Chancellor said. 'In the case of the short-term benefits, however, next year's increase will be equal to the expected increase in the RPI over the next 12 months.'

'All in all, we are planning to spend very substantial extra sums of money next year on social security. The great bulk of this is on pensions, which alone will cost the National Insurance Fund nearly £1.5 billion more next year than this. Expenditure on other benefits and outgoings is also expected to increase, in part due to a further small rise in unemployment — an assumption which is reflected in the Government Actuary's report.'

'These increases, together with the slower rate of growth in contribution income, would mean that if we took no action on contributions, there would be substantial deficits in the National Insurance and Redundancy Funds. Those deficits must be financed. In addition, as I have said, we have decided to propose an increase of 0.1 per cent in the allocation to the NHS. The taxpayers' contribution to the National Insurance Fund — the so-called Treasury supplement — will at the same time be reduced by 1½ per cent.'

In view of the burdens of national insurance on employers, the Government thought it right that the greater

Assumptions used by the Government Actuary

The effect of the national insurance changes and the assumptions which underlie them are set out in the report of the Government Actuary (Cmnd 8443) published on 3 December. These assumptions are:

1. That the number of unemployed people, excluding school-leavers, will average 2,600,000 in 1981/2 and 2,900,000 in 1982/3; and that, in addition, the number of unemployed school-leavers and adult students or people whose employment has temporarily stopped will average 220,000 in 1981/2 and 225,000 in 1982/3.
2. That average earnings in the tax year 1981/2 will be 11.3 per cent higher than in the tax year 1980/81; and that the average in the tax year 1982/3 will be 7.5 per cent higher than in 1981/2.
3. That there will be a benefit uprating of 10 per cent in November 1982 in line with the expected movement of prices plus, in the case of long-term benefits, a further 2 per cent to make good the expected shortfall in the November 1981 uprating. (N.B. As the Chancellor said, the actual uprating in benefit rates will be announced next spring, in line with the then forecast movement in prices.)

part of the increase in contributions should come from employees. It was, moreover, right that those in work should shoulder these additional costs.

'We therefore propose that the rate of contributions for employees should be raised by one per cent from the beginning of April next: it would then be 8.75 per cent of relevant earnings. There will be some increase for the self-employed. The percentage rate for employers will not be changed.'

The lower earnings limit, which sets the starting point of the contributions, would be increased to £29.50 per week, in line with the single rate retirement pension. The upper earnings limit, which sets the ceiling up to which payments are made, proportionate to income, would be increased to £220 per week, within the normal criteria.

It would be appreciated that, although the percentage rates charged to employers would not be changed, the cash amount which they paid in national insurance contributions and national insurance surcharge would rise in

Table A NIC AND NIS PAYMENTS, 1982-83

Total payments in 1982-83 by employers and employees in national insurance contributions and national insurance surcharge

	NATIONAL INSURANCE CONTRIBUTIONS		NI SURCHARGE		Total employees' & employers' contributions & NIS	Total employers' contributions & NIS
	Employees	Employers	Total employees & employers	Employers		
Contributions in 1981-82*	6,756	9,011	15,767	3,791	19,558	12,802
1982-83 increase from increased earnings etc†	542	512	1,054	225	1,279	737
Sub-total	7,298	9,523	16,821	4,016	20,837	13,539
1982-83 increase from changes in earnings limits	105	140	245	47	292	187
1982-83 increase from increased rates (1%)‡	992	—	992	—	992	—
Total contributions in 1982-83	8,395	9,663	18,058	4,063	22,121	13,726
Total increase in 1982-83	1,639	652	2,291	272	2,563	924

* Including NHS and, for employers, redundancy and maternity funds.

†Includes population and employment changes and delayed effects of April 1981 changes.

‡These result from class 1 contributions. A further £20 million should be added for class 2, 3 and 4 contributions (self-employed and voluntary) to give the total of £1,012 million as the increase in income attributable to the change in rates.

line with any increase in the wages and salaries which they paid, and also as a result of the increase in the upper earnings limit. The amount which employees paid in contributions would be similarly affected, as well as by changes in their contribution rates. (See tables A and B on pages 3 and 5.)

The increase in contribution rates, as well as the decision to exempt employers from it, both in respect of the Redundancy Fund and in respect of national insurance, would require legislation.

Higher spending: four main areas

The Chancellor then turned to other areas where spending next year was to rise. The increases had been concentrated in four main areas — local government, nationalised industries, defence and employment measures.

'Local authorities are likely to overspend substantially this year,' the Chancellor said. 'We recognise that it would not be practicable to eliminate this overspend in a single year. We therefore propose to allow an increase in the programmes for local authority current expenditure in 1982-83 of some £1,350 million. This will provide authorities with a reasonable target. They will still be required to make substantial economies.'

The Secretary of State for the Environment proposed to provide a level of grant support for local authorities in England of 56 per cent. Ministers would be consulting local authorities about this and about commensurate provision in Scotland and Wales.

The nationalised industries' total bids for increased external finance amounted to about £2½ billion. This would have been in addition to the nearly £1½ billion already provided in the plans. 'We have decided to allow them about half their new bids, some £1,300 million in total,' the Chancellor said. 'Nevertheless, if, as the Government and the House very clearly expect, they continue their drive to contain current costs, both by increasing efficiency and by making moderate pay settlements, they should be able to maintain their aggregate capital investment programme at much the same level as was envisaged in the plans published last March, a level of 15 per cent higher in real terms than in 1980-81.' (For details of EFLs, see table 3.)

National insurance: changes in contribution rates

The Secretary of State for Social Services, Mr. Norman Fowler, gave these further details of the proposed changes, on 2 December. All changes would be made next April.

Employees and employers

The Class 1 employee contribution rate (not contracted out) is increased from 7.75 per cent to 8.75 per cent. Of this increase, 0.25 per cent is on account of the reduction in the Treasury supplement, 0.1 per cent for the NHS, 0.35 per cent for the Redundancy Fund and 0.3 per cent to keep the National Insurance Fund in broad balance. The same increases are being made in the employee contracted-out rate. The reduced contribution payable by opted-out married women and widows is increased from 2.75 per cent to 3.2 per cent. There will be no increase in the contribution rate for employers, which will continue at 10 per cent (not contracted out) plus 0.2 per cent for the Redundancy and Maternity Pay Funds and 3.5 per cent national insurance surcharge, although employers' contributions will be affected by the new upper earnings limit.

These contributions are payable on all earnings up to an upper limit provided that the earnings reach a lower limit. In line with the requirements of the Social Security Pensions Act 1975, the

Table 3
Nationalised industry external financing limits (EFLs)¹

	1982-83 Proposed provision
National Coal Board	1,026
Electricity Supply Industry (England & Wales)	-319
British Gas Corporation	-2 ²
British National Oil Corporation ³	-85
British Steel Corporation	350 ⁴
British Telecom	340 ⁵
Post Office and National Girobank	-25
British Shipbuilders	125 ⁶
British Airways	-9
British Airports Authority	48
British Railways Board	950
British Transport Docks Board	-7
National Freight Company Ltd	(na) ⁶
National Bus Company	71
British Waterways Board	40
North of Scotland Hydro-Electric Board	47
South of Scotland Electricity Board	198
Scottish Transport Group	21
Total	2,770

¹Included in line 2 of table 2.

²Estimated effects of gas levy payments on BGC's cash flow of £430 million have been taken into account in setting BGC's EFL for 1982-83.

³As in previous years, the figure for BNOC is a forecast and does not represent a limit.

⁴Provisional: to be determined after consideration of the industry's corporate plan.

⁵The Government have indicated that they will increase British Telecom's EFL if agreement is reached on a bond for 1982-83.

⁶The Government intend to sell all the shares in the National Freight Company Limited during 1981-82, and, in view of this, no figure for the company has been included.

'In order to enable us to carry through the policies set out in the June defence White Paper we are increasing the provision for defence next year by a further £480 million. This includes the cost of carrying forward the 1981 armed forces pay award.'

Improvements to the various special employment programmes had been announced by the Prime Minister on 27 July. These added some £650 million to public expenditure next year. The Secretary of State for Employment would be making an announcement on further training measures in due course. In all, nearly £800 million would be added to the employment programme next year, already planned at nearly £2 billion. A substantial proportion of this additional spending would go to help the young unemployed.

lower earnings limit will be increased to £29.50 a week, just below the new basic retirement pension, and the upper earnings limit will be increased to £220 a week. The present limits are £27 and £200 a week respectively.

The self-employed

The flat-rate Class 2 contribution will be raised from £3.40 a week to £3.75 a week. This increase is accounted for entirely by inflation, in particular the movement of earnings and benefit rates. I have thought it right not to make additions to the Class 2 rate for the NHS allocation or to compensate for the reduction in the Treasury supplement. In reaching this decision, I have suspended for this year the application of the formula for calculating the Class 2 contribution which has been used since 1978. I do so in recognition of the important role which the self-employed, and in particular small businesses, must play in the regeneration of our economy: the need to keep to a minimum the burdens of the self-employed — especially those with lower profits, who may have a Class 2 liability only — has therefore been foremost in my mind.

The annual limit of earnings below which a self-employed person may apply for exception from liability for Class 2 con-

tributions will be raised from £1,475 to £1,600.

The weekly Class 2 contribution rate for share fishermen (who are eligible for unemployment benefit) will go up from 5.15 a week to 5.85.

The rate of Class 4 contributions payable on profits will be increased from 5.75 per cent to 6 per cent (0.1 per cent for the NHS, 0.15 per cent on account of the reduced Treasury supplement), and the limits of annual profits between which Class 4 contributions are paid will be raised from £3,150 and £10,000 to £3,450 and £11,000. The new Class 4 rates also represent a slight modification of the usual formula for calculating self-employed contributions, which would have given a rate of 6.1 per cent. I felt, however, that it was right to shield the self-employed from the full effects of the reduction in the Treasury supplement.

Voluntary contributions

The rate of the Class 3 (voluntary) contributions will be increased from £3.30 to £3.65 a week.'

Effect of all the changes

The total effect of the changes can be seen in table A on page 3, and some implications for employed people, not contracted out of the state pension scheme, and for their employers in table B. For those with earnings or profits between the lower and upper limits, Class 1 or Class 4 contributions will rise automatically with earnings or profits. Inflation increases will therefore affect only the flat-rate contributions and Class 1 and Class 4 contributions on earnings and profits above the old upper limits.

For someone earning £150 a week (about the average for men for September 1981), and not contracted out, the Class 1 contribution would rise by £1.50 a week. For the self-employed person with profits of this amount (£7,800), the combined Class 2 and Class 4 contribution would rise by 23p a week. The maximum increase in the total Class 1 contribution (employer and employee jointly) would be £6.49 a week, of which the employer would pay £2.24, on account of inflation. The employee would pay £1.55 for inflation and £2.20 because of the increase in the rate. For the self-employed, the maximum increase would be

Table B
CHANGES IN WEEKLY CONTRIBUTIONS
For employees and employers (Class 1), not contracted out

Weekly earnings	1981/82 weekly contribution	Changes on account of inflation*	Other changes	1982/83 weekly contribution
£	£	£	£	£
Employed earner				
27.00	2.09	-2.09	—	Nil
29.50	2.29	—	+0.29	2.58
60.00	4.65	—	+0.60	5.25
100.00	7.75	—	+1.00	8.75
150.00**	11.62	—	+1.50	13.12
200.00	15.50	—	+2.00	17.50
220.00	15.50	+1.55	+2.20	19.25
Employer†				
27.00	3.70	-3.70	—	Nil
29.50	4.04	—	—	4.04
60.00	8.22	—	—	8.22
100.00	13.70	—	—	13.70
150.00**	20.55	—	—	20.55
200.00	27.40	—	—	27.40
220.00	27.40	+2.74	—	30.14
Total				
27.00	5.79	-5.79	—	Nil
29.50	6.33	—	+0.29	6.62
60.00	12.87	—	+0.60	13.47
100.00	21.45	—	+1.00	22.45
150.00**	32.17	—	+1.50	33.67
200.00	42.90	—	+2.00	44.90
220.00	42.90	+4.29	+2.20	49.39

*ie changes in lower and upper earnings limits

†Includes national insurance surcharge (3.5 per cent) and Redundancy and Maternity Pay Fund allocation (0.2 per cent)

**Approximate average weekly earnings of all full-time male workers at September 1981.

£1.49 a week, 77p due to the higher profits limit and 72p due to the increase in rates.

Rate support grant proposals

The Secretary of State for the Environment, Mr Michael Heseltine, made this statement in London on 2 December:

'In the current year, local government has budgetted to overspend the Government's targets by almost £1½ billion in cash terms. That is the position the Government have to start from in deciding their approach for next year. There are three main objectives.

'First, we need to exert the maximum pressure to continue the downward trend of current expenditure. That is an essential part of the Government's economic strategy.

'Second, we must recognise the fact that very large numbers of authorities have achieved, or are well on the way to achieving, their targets this year. For those authorities which have achieved their volume targets to date and spend below their grant related expenditures (GREs), I have limited the reduction in their expenditure target to a maximum of one per cent in real terms for next year.

'And third, we must look to the high spending authorities to bear the heaviest share of any reductions. Nevertheless, I recognise that there is a limit to the reductions that individual authorities can make in a single year. Accordingly, I have assumed a maximum reduction of seven per cent in real terms for any authority's target from its original or revised budget, whichever is the lower.

'My proposals rest on a number of assumptions:

- authorities which have increased their budgets this year will be expected to eliminate the increase and then make a further reduction;
- the Government's announced cash factors apply: four per cent and nine per cent for pay and price increases respectively in the public sector; and
- authorities increase rents by £2.50 per week on average.

'I am proposing that no authority should have its GRE reduced because of an assessed surplus on its housing revenue account. But I shall be exploring with the local authority associations how to secure that any potential surplus is so applied for housing purposes as to meet our public expenditure objectives.

'I intend to reinforce the pressures of the block grant system in two ways. First, I propose a reduction in the rate of Exchequer grant from 59.1 per cent to 56 per cent. Second, I propose to publish expenditure targets for individual authorities, and to abate grant for authorities spending above GRE who exceed their target next year.

'I shall discuss these proposals next week with the local authority associations. I intend to publish before Christmas more detailed proposals for authorities' GREs and targets, and an indication of the proposed poundage schedules for the calculation of grant.'

Public and private sector earnings

Public and private sector earnings can be broadly compared over a period of years on the basis of the New Earnings Survey (NES), compiled by the Department of Employment since 1970. The NES is based on a one per cent sample of earnings throughout the economy in April each year. Results from the 1981 NES are now being published, and figures for the public and private sector appeared in the October issue of the *Employment Gazette* of the Department of Employment. The relevant figures, together with those for earlier years, are set out in the table. To facilitate comparison, actual public sector earnings are shown as percentages of the corresponding private sector figures, for manual employees, non-manual employees or both as appropriate.

Basis of the figures

The figures relate to men working full-time. The corresponding information on women's earnings is not included because moves to equal pay in the private sector during the period increased the growth of women's earnings in the private sector relative to those in the public sector. The figures relate to gross earnings, and do not take account of pension arrangements, fringe benefits or other conditions of service. Relative average earnings in different sectors and changes in those relativities will reflect differences and changes in the structure of employment, as well as differences in rates of pay for similar work. (Such structural differences account for the fact that totals and sub-totals can be higher — or lower — than either of the component figures for manual and non-manual employees.) The comparisons are not, therefore, definitive, but, nevertheless, give a useful indication of trends.

Main trends

The charts set out the main trends indicated by the figures*. Each chart shows comparative earnings of manual employees, non-manual employees and both combined. They cover respectively central government (civil service and National Health Service but not the armed forces, which are not covered in the NES), local government, public corporations (mainly nationalised industries), and the total public sector.

In all cases the recent position of the public sector can be seen to be better than in the first few years of the 1970s. This is especially true of manual workers, where relative improvements of around 10 per cent have been recorded. The improvement for non-manual workers is smaller, but still of the order of 5 per cent. Comparable information is not available for earlier periods. But the figures which exist suggest that relativities between the public and private sectors were fairly stable in the 1950s and 1960s.

In all cases a peak was reached in the years 1975 and 1976. Thereafter, the relative level fell back uniformly (allowing for the discontinuity for central and local government manual employees between 1977 and 1978 — see footnote 3 to the table) to a low point in 1979, in most cases close to the original level. Since then, however, the previous peak levels have been almost regained, reflecting large comparability awards and other factors.

*The charts incorporate the adjustments for the timing of the 1981 civil service settlement given in footnote 4, and show the discontinuity for central and local government manual employees between 1977 and 1978 which is mentioned in footnote 3.

PUBLIC AND PRIVATE SECTOR EARNINGS¹ 1970-80

Public sector earnings as a percentage of private sector earnings for manual and non-manual employees

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
a. Public Sector (b+c+d)												
Manual	93.4	94.3	96.7	96.1	97.3	106.2	104.5	102.4	100.9	100.0	103.9	106.8
Non-manual	102.3	101.3	104.4	100.8	103.5	107.5	112.1	107.6	101.0	99.0	102.0	106.3
TOTAL	100.0	100.3	103.6	100.7	102.7	109.0	110.5	107.2	103.4	101.5	105.3	108.4 ⁴
b. Central Government²												
Manual ³	81	86	84	79	83	91	91	91	88	84	95	95
Non-manual	103	102	103	96	105	104	113	109	102	100	108	104 ⁴
TOTAL	102	105	105	98	106	108	114	112	104	100	111	108
c. Local Government												
Manual ³	78	81	80	80	81	89	88	84	86	84	91	91
Non-manual	102	101	104	103	103	109	113	107	100	97	98	106
TOTAL	102	104	107	105	105	112	115	111	102	99	102	108
d. Public Corporations												
Manual	102	101	105	104	105	115	113	111	109	108	111	115
Non-manual	99	100	102	100	102	109	110	108	102	102	103	108
TOTAL	98	97	100	100	101	110	109	107	104	104	105	109

Source: *Employment Gazette* December 1977 and *New Earnings Survey* each year 1978-81

(1) Comparisons have been made in terms of the average gross weekly earnings of men aged 21 and over (working full-time) whose pay during the survey period was not affected by absence. Manual and non-manual group earnings have been related to the appropriate private sector group.

(2) Includes NHS.

(3) The figures for central government, local government and public corporations are calculated on a rather different basis in the periods 1970-77 and 1978-1981. The different bases of calculation have no effect on the figures for the public sector as a whole, and a significant effect only on the figures for manual employees in central government and local authorities: results on both bases for 1977 suggest that the figures in the 1970-77 basis may have under-stated the level of earnings for those workers by 2½ per cent and 4½ per cent respectively.

(4) If rough adjustments are made for:

(i) the 1981 non-industrial civil service award which was too late to be included in the 1981 NES;

(ii) the effect of the civil service strike (which had a greater effect on the lower grades than on the higher grades and so raised the average earnings of those whose pay was not affected by absence);

the central government figure for non-manual employees would be 107 and the total public sector figure would be 108.8.

Monthly Economic Assessment

Prepared by the Treasury on the basis of statistics† available up to 3 December.

- There are signs that activity may now be increasing: total output has risen, destocking has moderated, and hours worked have increased. Unemployment continues to rise, although less rapidly.
- Sterling has strengthened slightly.
- UK interest rates fell in November, but the trend of bank lending — particularly to the personal sector — remains strong.
- The current account remains in surplus, exports have held up well, and imports have risen substantially from their exceptionally low levels early in the year.

Financial developments

In the banking month of October sterling M3 increased by 1.7 per cent, bringing recorded growth over the first eight months of this target period to 12½ per cent. This figure remains considerably distorted upwards by the effects of the civil service dispute and its aftermath; but by the end of the February 1981-April 1982 target period, when most of these distortions will have been unwound, the annual rate may be somewhat above the top of the target range. It is clear that the pace of bank lending is very strong, particularly to the personal sector and, within that sector, in connection with house purchase.

Interest rates* generally fell during the first part of November. On 9 November clearing bank base rates were cut by ½ per cent to 15 per cent. But on 16 November the Bank of England intervened in the money market by discount window lending in order to discourage too rapid a decline in rates. Over the month as a whole, three-month interbank rates fell by ¼ per cent to around 15 per cent, short-term gilt yields fell by around 1½ per cent to 15¾ per cent, and long-term gilt yields fell by around 1 per cent to 15 per cent. On 3 December the clearing banks cut their base rates by another ½ per cent, to 14½ per cent.

Government borrowing figures have been severely distorted by the effect of the civil service dispute on receipts of tax and

† All figures are seasonally adjusted unless marked *.

national insurance. So far as can be judged at this stage, the underlying central government borrowing requirement (CGBR) is broadly consistent with the Budget forecast of £11½ billion. In the first seven months of the 1981-82 financial year, the CGBR* was £9¼ billion, about half of which was due to the civil service dispute. This compares with a CGBR* of £8 billion in the same period last year.

Since the end of September US three-month interest rates have fallen by about 5 percentage points, compared with a fall in UK three-month rates of about 2 percentage points over the same period. This, together with a slight weakening of the US dollar, has helped to strengthen sterling. During November sterling rose from an opening level of \$1.89 (89.3 effective) to \$1.96 (91.8 effective) at the end of the month.

Inflation

The rate of price inflation, as measured by the 12-monthly increase in the retail prices index* (RPI) in October was 11.7 per cent. The increase in the mortgage rate with effect from 1 November will raise the RPI by nearly ½ per cent in November, with a little more to come through later.

The recent stabilisation of sterling has halted the rise in the cost of imported raw materials and fuels. As a consequence, manufacturers' input prices*, after rising at an annual rate in excess of 20 per cent for nearly a year, rose by less than ½ per

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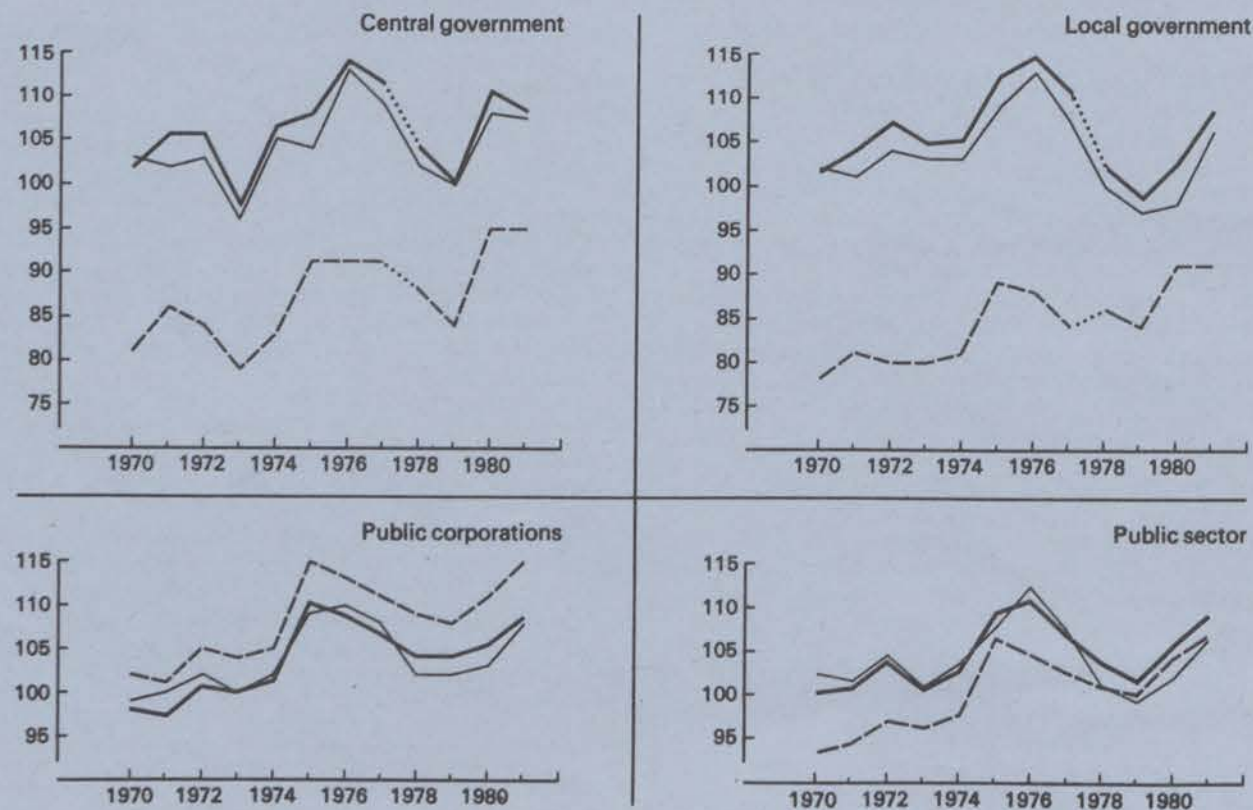
The index of main articles published during 1981 will be included in the January 1982 issue.

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PUBLIC SECTOR PAY (as % of private sector pay*)

--- Manual employees
— Non-manual employees
— Total



* See text and footnotes to table

RUNNING THE CIVIL SERVICE

It was announced by the Prime Minister on 12 November that the Civil Service Department was to be abolished and its functions divided between a new Management and Personnel Office (MPO) and the Treasury. The change took administrative effect from 16 November. The Prime Minister remains Minister for the Civil Service, assisted by Baroness Young (Chancellor of the Duchy of Lancaster).

The new MPO, working alongside the Cabinet Office, is now responsible for management systems and organisation, personnel management, recruitment and training.

The Treasury is now responsible for the control of civil service manpower, pay and superannuation, the Central Computer and Telecommunications Agency, and the Civil Service Catering Organisation.

Mr Barney Hayhoe is now a Minister of State in the Treasury, and also answers in the House of Commons on civil service matters covered by the MPO. Lady Young answers in the House of Lords on the whole range of civil service matters, including those covered by the Treasury. Mr John Bruce-Gardyne, formerly a Minister of State, Treasury, has assumed the title of Economic Secretary, Treasury.

cent in September and were stable in October. In contrast, **manufacturers' unit wage and salary costs** were stable during the first half of the year; but have risen since June. Manufacturers' unit wage and salary costs rose by 5¼ per cent in the year to August. Excluding the food, drink and tobacco industries — where selling prices include increases in excise duties, and therefore overstate the net-of-duty prices actually received — **manufacturers' output prices** rose by 9½ per cent in the year to October.

The moderate increases in unit wage costs (due to lower pay settlements in the previous pay round and a recovery in productivity), together with sterling's depreciation, have alleviated the intensity of the squeeze on profit margins and competitiveness. (See last month's assessment for a discussion of business surveys.) It is estimated that competitiveness may have improved by over 10 per cent since the early part of the year.

Average **earnings** of employees in Great Britain rose by 9.4 per cent in the year to September, but allowing for temporary factors such as back-pay, the underlying rate of increase was about 11 per cent. The opening months of the wage round contain relatively few settlements, so it is too early to assess any change from the previous pay round's level of settlements.

Economic activity

Third-quarter statistics strengthen the view, now clearly shown by the CSO's cyclical indicators, that the low point of the recession was probably reached in the second quarter of 1981, and that activity is now making a modest recovery.

The preliminary third-quarter estimate of the **output** measure of GDP — usually regarded as the best indicator of short-term movements in activity — shows a rise of ¼ per cent over its second quarter level. The recovery in manufacturing output, up by about 2 per cent over the second quarter, was partially offset by some further decline in the service and construction sectors.

Preliminary estimates show a substantial reduction in the rate of **destocking** by manufacturers and distributors (see table 1).

Table 1

Change in stocks held by manufacturers and distributors

	<i>Em, 1975 prices, seasonally adjusted</i>						
	1980				1981		
1979	Q1	Q2	Q3	Q4	Q1	Q2	Q3
740	-430	-220	-390	-840	-410	-560	-170

The turnaround in stocks since 1979 has been the major contractionary influence on expenditure during the downswing in activity. As manufacturers and distributors held nearly four fifths of total stocks at the end of 1980, the third-quarter mates imply a significant addition to expenditure, although good part of this may have been met by higher imports.

Investment by the manufacturing, distributive and service industries (which accounts for about half of total fixed investment) is estimated to have remained broadly unchanged during the third quarter, at the same level as in the first half of the year.

In contrast with other components of domestic demand, consumers' expenditure in the third quarter is estimated to have declined by about ½ per cent compared with the second quarter. Retail sales have shown an uneven and erratic monthly pattern, but have been broadly flat over the last half year.

The CBI's **monthly trends enquiry** (covering manufacturing) shows some further improvement in orders.

Labour market developments

The recovery in manufacturing output since the spring has been clearly reflected in a stabilisation, and more recently an improvement, in most labour demand indicators, although many indicators remain low by historic standards. Table 2 shows recent movements in hours worked in manufacturing.

Table 2

Hours worked by operatives in manufacturing industry (GB) 1981

	<i>seasonally adjusted</i>									
	J	F	M	A	M	J	J	A	S	
Short time* (million hours)	8.5	8.0	6.8	5.7	4.5	3.6	2.6	2.4	2.2	
Overtime (million hours)	8.9	8.4	8.0	8.8	8.5	9.1	8.8	10.4	10.2	
Average hours worked (1962=100)	88.3	88.1	88.4	89.3	89.7	90.3	90.6	91.4	91.7	
Total hours worked (1962=100)	58.3	57.9	57.8	57.8	57.6	57.5	57.4	57.9	58.1	

Average hours worked have been picking up for much of this year as short time was sharply reduced and, more recently, overtime increased. Manufacturing employment continues to decline but at a much reduced rate in recent months. The decline was 25,000 per month in August and September, compared with nearly 50,000 earlier in the year, and 80,000 in the second half of last year. **Total hours worked** stabilised around the middle of the year with some small increase during the third quarter.

Complete figures for third-quarter employment levels other than in industry are not yet available. Unusually, this cycle has seen some reduction — some 3 per cent in the 18 months to mid-1981 — in service sector employment.

Unemployment continues to rise, but at less than half the rate of a year ago. Seasonally-adjusted adult unemployment stood at 2¾ million (11.4 per cent) in November.

Both the level and the flows of **vacancies** show some improvement since the middle of the year.

Balance of payments

Two months' figures — September and October — are now available. They remain extremely difficult to interpret, given the absence of complete information since February, normal monthly variability, and changed documentation procedures for exports in October.

At a little over £300 million, October's **current account** surplus, while higher than September's, was substantially below the levels recorded at the turn of the year (about £800 million per month between November and February).

Since early 1981 **export** volumes have held up well against a background of weak world demand and earlier losses in competitiveness. Business opinion surveys have this year been showing an improving prospect for exports, with the expectation of increased orders and deliveries. **Import** volumes have risen by about a fifth from the very low levels of early 1981. This rapid rise is thought to reflect a much slower reduction in stock levels and the recovery in manufacturing output.

Economic prospects for 1982



The Industry Act (1975) requires the Government to publish economic forecasts twice yearly. This supplement reviews economic developments so far this year and outlines the prospects for 1982.

Summary

In the world economy, attempts to contain the inflationary impulses from the second major oil shock of the decade are restraining activity in many industrialised countries. The United Kingdom, with particularly deep-seated problems of high inflation and low productivity growth, is making painful adjustments — through lower wage settlements and higher unemployment — in a highly competitive environment.

The rise in sterling was one of the causes of the rapid fall in inflation which began in mid-1980. The fall in the exchange rate earlier this year has interrupted progress, but slower increases in pay together with productivity improvements point to further falls in cost and price inflation in the course of 1982.

After the fall in output in 1980 and the first half of 1981, there are signs that recovery began in the summer of this year. Further growth of output is forecast for 1982.

Recent economic developments

A year ago, and at the time of the 1981 Budget, government forecasts showed UK output levelling out and then recovering slowly by the end of 1981, while inflation was expected to fall substantially from its 1980 level. These expectations have been broadly fulfilled.

The world economy

Nineteen-eighty was a year of very slow growth in the world economy, with unemployment rising and inflation high. This year has seen the maintenance of generally tight monetary and fiscal policies, including very high nominal and real interest rates, and while inflation (the rise of consumer prices in the major economies) has come down from 12 per cent in 1980 to about 10 per cent in 1981, this has been accompanied by depressed output in many countries, and by substantial increases in unemployment. As usual at this stage of the economic cycle, commodity prices have weakened relative to prices of manufactures and contributed to the increasing deficits of many developing countries. The volume of world trade may now be rising slowly. The table shows how recent years compared to earlier periods in world economic development.

Annual percentage changes

	1964 to 1973	1973 to 1979	1980	1981 (partly forecast)
GNP in 7 major countries	5	3	1	1
Consumer prices	4½	9½	12	10
World trade in manufacturing (weighted by the pattern of UK markets)	10	5½	5	2

The UK economy

The exchange rate in September/October was 13 per cent below the average for the first quarter of 1981 and at about the same level as in mid-1979. Import prices, measured by average values in sterling terms, rose 7 per cent between the first quarter of 1981 and the September/October level — a modest rise in relation to exchange rate and overseas price movements, reflecting both weak commodity prices and a reduction in margins on imported manufactured goods. Higher import prices have three main effects — directly on prices in the UK, indirectly through the higher costs of UK producers, and through the lessening of the downward pressures on the prices of all goods and services sold in the UK in competition with imports. Partly in consequence, there has been no further fall in the rate of inflation in recent months.

Companies' inability to pass on higher costs into prices, together with the fall in activity, contributed to a large fall in the level of wage settlements. The underlying increase in average earnings in the year to September, at about 11 per cent, was broadly comparable to the average of other countries, after years in which the increase had been well above that of most other countries. These movements, together with the changes in the exchange rate, imply that competitiveness, as measured by relative unit labour costs, has improved over 10 per cent this year; but it remains 35-40 per cent worse than in 1975, a deterioration mainly attributable to the higher rate of increase in UK labour costs relative to the UK's competitors.

There has been a modest recovery in company profits, which are estimated to have risen in aggregate 8 per cent between the second half of 1980 and the first half of 1981. Non-North Sea profits of industrial and commercial companies have, however, remained broadly flat since mid-1980; and the rate of return on capital remains very low, having fallen from 9 per cent in 1970 to 3 per cent in 1980. With companies cutting their expenditure, above all

on stocks (destocking by industrial and commercial companies in 1980 and the first half of 1981 amounted to £6 billion), they succeeded in moving from a position of heavy overall borrowing in 1979 and early 1980 to a net repayment of debt in early 1981. Over the three years to 1980, the personal sector's real disposable income increased by 17 per cent. But by mid-1981 the shift of real income towards consumers and away from companies was being reversed.

After the rapid fall in activity during 1980, especially in manufacturing, there was a much smaller fall in the early part of 1981. Preliminary estimates for the third quarter suggest a 2 per cent increase in manufacturing output (stock-adjusted) with a particularly strong rise in chemical production, and a rise in the total output of the economy. A recovery in activity has been suggested over the past year by the responses to the output question in the regular surveys undertaken by the Confederation of British Industry:

Balance of ups over downs

Percentages	Trend in output volume over next four months	Present stocks of finished goods too high	Volume of new orders over next four months	New export orders over next four months	
					1980 July
	-41	36	-47	-35	
	-31	33	-32	-17	
	-16	31	-17	-10	
	-4	26	-2	1	
	1	20	+4	9	
	0	17	+2	11	

The second column suggests that, as the level of stocks has been substantially reduced and expectations of output recovery strengthened, the desire to reduce stocks has steadily declined. The third quarter estimates of stockbuilding are consistent with this. The last column indicates an improvement in export orders, a trend also evident in the Department of Industry's series for export orders in engineering. But the rises in interest rates in September and October, reflected in a lower level of business optimism in some recent surveys, suggest a cautious interpretation.

The early stages of a recovery in industrial output have been accompanied, as usual, by a sharp fall in short-time, and a recovery in overtime, with average hours worked increasing by about 3 per cent in manufacturing between the end of 1980 and the summer of 1981 — and by a continuing, though much slower, rise in unemployment. In manufacturing, there has been little change in total hours worked since the beginning of this year — the rise in average hours offsetting the fall in employment. Productivity has been better than would have been expected on the basis of past experience; output per man-hour in manufacturing rose 7 per cent between the fourth quarter of 1980 and the third quarter of 1981.

Over the twelve months to the banking month of October, M1 grew by a little under 10 per cent, the wide measure of private sector liquidity, PSL2, by 13 per cent, and £M3 by over 15 per cent. The Civil Service dispute has served to raise the growth of most, if not all, monetary aggregates this year, with probably the greatest impact on £M3. The public sector borrowing requirement (PSBR) for the year as a whole appears to be in line with the Budget forecast of £10½ billion. The growth in bank lending, especially to the personal sector, has been very rapid so far this year: to some extent this reflects a move by the banks into the housing market. Other factors influencing the demand for money in 1981-82 include the rise in nominal incomes, at around 10 per cent. The recorded figures for the

Table 1: Economic prospects for 1982

	Percentage changes		Average errors* from forecasts, relevant for 1982 per cent
	1980 to 1981	1981 to 1982	
A. Output and expenditure at constant 1975 prices			
Gross domestic product (at factor cost)	-2	1	1½
Consumers' expenditure	0	0	1½
General government expenditure on consumption and investment	-2	0	1½
Other fixed investment	-2½	2½	3
Exports of goods and services	-5½	2½	3½
Change in rate of stockbuilding as a percentage of GDP	-½	2½	1
Imports of goods and services	-4½	8½	2½
B. Balance of payments on current account			
	1981	1982	
	£ billion	£ billion	£ billion
	6½	3½	2½
C. Retail prices index			
	Percentage changes		per cent
	4th quarter 1980 to 4th quarter 1981	4th quarter 1981 to 4th quarter 1982	
	12	10	3

*The errors relate to the average differences (on either side of the central figure) between forecast and outturn. The method of calculating these errors has been explained in earlier publications on government forecasts, notably in November 1978 (see *Economic Progress Report Supplement* or *Economic Trends* No 301, November 1978, and *Economic Progress Report*, June 1981). The calculations for the constant price variables are now derived from internal forecasts made during the period June 1965 to October 1979. For the current balance and the retail prices index, forecasts made between June 1970 and October 1979 are used. The errors relate to the figures after adjustment for the effects of major changes in fiscal policy, where excluded from the forecasts. Quarterly forecasts are grouped so as to be comparable with the changes between calendar years as shown. Thus for forecasts of constant price variables and the current account made in quarter 0 the errors relate to the forecast period (quarters 1 to 4) compared with the base year (quarters -3 to 0). For the retail prices index the margin relates to the percentage change between quarter 0 and quarter 4.

Table 2. Constant price forecasts of expenditure, imports and gross domestic product
£ million at 1975 prices, seasonally adjusted

	Consumers' expenditure	General government expenditure on goods and services			Other fixed investment	Exports of goods and services	Change in stocks	Total final expenditure	Less imports of goods and services	Less adjustment to factor cost	Plus statistical adjustment	GDP at factor cost	GDP index 1975 = 100
		Final consumption	Fixed investment	Total									
1979	71,400	23,850	3,350	27,200	17,550	33,050	1,500	150,700	35,300	12,400	650	103,650	109.9
1980	71,450	24,450	2,950	27,400	17,850	33,300	-2,000	148,000	34,150	12,450	-50	101,350	107.5
1981	71,650	24,450	2,300	26,750	17,400	31,450	-2,300	144,950	32,750	12,100	-950	99,150	105.2
1982	71,700	24,550	2,200	26,750	17,850	32,200	300	148,800	35,600	12,400	-600	100,200	106.4
1980 First half	35,800	12,150	1,550	13,700	9,050	16,950	-500	75,000	17,800	6,200	300	51,300	108.8
Second half	35,650	12,300	1,400	13,700	8,800	16,350	-1,500	73,000	16,350	6,250	-350	50,050	106.2
1981 First half	35,900	12,200	1,200	13,400	8,550	15,700	-1,800	71,750	15,700	6,100	-500	49,450	105.0
Second half	35,750	12,250	1,100	13,350	8,850	15,750	-500	73,200	17,050	6,000	-450	49,700	105.5
1982 First half	35,850	12,250	1,100	13,350	8,900	15,950	100	74,150	17,650	6,200	-350	49,950	106.1
Second half	35,850	12,300	1,100	13,400	8,950	16,250	200	74,650	17,950	6,200	-250	50,250	106.7
Annual percentage changes													
1979 to 1980	0	2½	-12	½	1½	1	-2	-3½	½			-2	
1980 to 1981	0	0	-21½	-2	-2½	-5½	-2	-4	-3			-2	
1981 to 1982	0	½	-5	0	2½	2½	2½	8½	2½			1	

Notes:

- GDP figures in the table are based on 'compromise' estimates of gross domestic product.
- Figures in £ million are rounded to £50 million. Percentage changes are calculated from unrounded levels and then rounded to ½ per cent. The GDP index in the final column is calculated from unrounded numbers.
- Data on exports and imports for the first half of 1981 are based on very incomplete information.

February 1981 to April 1982 target period, which will be raised by the strike and by the banks' gain in market share, may be somewhat above the top of the target range, though interpretation of recent movements has been made very difficult by the distortions arising from the effects of the Civil Service dispute.

Economic prospects

Assumptions

This forecast takes full account of the decisions on public expenditure and on employees' national insurance contribution rates announced by the Chancellor on 2 December. A conventional assumption is made that income tax thresholds and allowances and the rates of specific duties will be raised by 12 per cent in the 1982 Budget, in line with the expected rate of increase in the retail prices index (RPI) over the year to the fourth quarter of 1981.

Interest rates are, in practice, determined by a number of factors, set out in the 1981 Budget statement. These include all the monetary aggregates and the exchange rate. This forecast is constructed on the assumption that the growth of £M3 in 1982-83 will be at the top end of the 5-9 per cent range set out in the medium-term financial strategy (MTFS) last March, and that the exchange rate will remain constant, against a weighted average of other currencies, at the level in November 1981.

The world economy and UK trade

Output in the main industrial countries may recover over the next year. But the upswing is likely to be no more than moderate by past standards — perhaps 1½-2 per cent — and unemployment is liable to increase further in many countries. The nature of the forecast recovery reflects the slow progress in reducing inflation against a background of firm policies.

There has been little, if any, rise in overall world trade in 1981. In 1982, the modest recovery in output, the growth in OPEC markets and the usual tendency for trade in manufactures to rise faster than trade in total, suggest that world trade in manufactures (weighted by the UK share of markets) could expand by 4-5 per cent.

Judgments about the course of UK trade in 1981 have been obscured by the Civil Service dispute and the September and October trade figures are extremely difficult to interpret. Export volumes have held up well since the early part of the year, in difficult circumstances. The rise in import volumes in September/October is consistent with a much reduced rate of destocking, and with a rise in output, in the second half of 1981.

Over the next year, the volume of exports can be expected to rise, as foreshadowed in recent surveys. As output rises next year, with stocks no longer being reduced, further rises in import volumes are in prospect. The current account of the balance of payments should continue to run a sizeable surplus into 1982 though at a lower rate than in late 1980 and early 1981 when the import level was exceptionally low.

Inflation

The rate of inflation is inevitably being affected by the turnaround in sterling that took place earlier this year, though there is tentative evidence from the latest trade figures that some of the impact is falling on importers' margins. Once this has finished feeding through into final prices, however, and provided there is a continued slowdown in the rise in domestic unit costs, a further fall in the inflation rate is in prospect: over the year to the fourth quarter of 1982, the RPI is forecast to rise 10 per cent.

Profit margins — as measured by the movement of prices over actual costs — should continue to improve over the next year. With the exchange rate lower than at the start of 1981, and firms continuing to make productivity gains,

they should be able to retain higher profits. Nonetheless, an exchange rate still high in real terms by comparison with the period before 1980 will continue to limit firms' ability both to raise prices and to incur higher costs. The competitive pressures in the private sector, and the influence of cash constraints in the public services, should combine to bring about another substantial fall in the level of wage settlements and earnings growth, over the next year. The share of company profits, net of North Sea oil, in total domestic incomes should show a considerable recovery in 1982.

Domestic demand and activity

After an increase of 17 per cent between 1977 and 1980, the personal sector's real income after tax is now lower, by over 3 per cent in the second half of 1981, than a year earlier, as a result of the fall in wage settlements relative to prices, and the rises earlier this year in taxation and national insurance contribution rates. A further fall in real income after tax is forecast, but the level of personal consumption may remain steady with a continuing fall in the saving ratio influenced partly by the further decline in inflation.

The company sector's real income after tax should show some recovery over the next year, after the sharp fall during 1980, as a result of some improvement in profit margins from the low levels reached in 1980 and early 1981. This recovery in income, together with a better prospect for demand, should ease the financial pressures on companies to reduce stocks. Indeed, there should be a small increase in stocks next year (see table 2).

In the second half of 1980 and the first half of 1981 companies' sales were being met, in part, from running down stocks as well as from current production. By 1982, on this forecast, all sales will be met from current production, and none — in aggregate — from destocking. The stock/output ratio in manufacturing had fallen back sharply by the third quarter of 1981: this forecast implies a stock/output ratio in 1982 close to the average for the period 1975-79.

Fixed investment, outside general government, should also see some recovery in 1982 after a fall up to the first half of 1981. In industry, a moderate recovery was suggested for both manufacturing and distribution by the Department of Industry's May survey of investment intentions. Private housing starts are higher than a year ago, and there may be some rise in investment — which is measured by sales — over the next year.

In total, domestic demand is forecast to recover by over 1½ per cent between the second halves of 1981 and 1982. With imports again tending to rise faster than exports, the prospect for domestic output, consistent with the rise predicted for profitability, is one of moderate recovery, which will help to limit the rise in unemployment. Manufacturing output, which fell particularly sharply in relation to total output up to the end of 1980, may now recover rather more sharply than total output. The table below sets out half-yearly paths for total output, and for manufacturing output:

Prospects for output

1975 = 100

	1980		1981		1982	
	I	II	I	II	I	II
GDP	109	106	105	105½	106	106½
Manufacturing output (stock-adjusted)	99	90½	87½	90½	92	93

These forecasts are close to those published in November 1980 and in March 1981.

Government borrowing

In the first half of 1981-82 the PSBR was £9½ billion, seasonally adjusted. The best estimate is that, in the absence of the Civil Service dispute, it would have been about half this figure, and much smaller than in the first half of the previous financial year. The trends in revenue and the PSBR this year are being obscured by the effects of the dispute, but it seems that the PSBR for the year as a whole may turn out near to the budget estimate of £10½ billion, or 4 per cent of gross domestic product (GDP) at current market prices. This represents a substantial fall from nearly 6 per cent in 1980-81.

Next financial year, 1982-83, the public expenditure planning total is expected to be about £115 billion. On the basis of the *conventional* assumptions that thresholds, allowances and specific duties are raised in line with inflation, general government receipts should rise faster than expenditure next year, against the background of money GDP forecast to rise 11 per cent. On this basis, and on the assumptions already stated, decisions on public expenditure point to a PSBR next year broadly in line with the projections published at the time of the last Budget. But experience shows that estimates of the PSBR are liable to substantial margins of error.

Risks and uncertainties

The summary table includes averages of past errors from internal Treasury forecasts over the last ten to fifteen years. The particular average shown in the table is the average absolute error. An analysis of errors in the first six Industry Act Forecasts was published in the *Economic Progress Report* for June 1981.

On this occasion, and because of the absence of trade statistics for much of 1981 because of the Civil Service dispute, the forecast of the balance of payments is subject to a larger margin of error than usual. The current account balance is the difference between inflows and outflows each of which approach £100 billion. The distortions of recent borrowing and money supply figures also make interpretations more hazardous than usual.

✓
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PS/Secretary of State for Employment
PS/Paymaster General
and officials in HMT, Revenue Departments and
other Departments in Whitehall

TREASURY WEEKLY ECONOMIC BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 7 December, are sidelined.

M M Deyes

M M DEYES

R.A

EB Division
HM Treasury
01-233-3364

R I G ALLEN
14 December 1981

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A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

Main objectives are to achieve, over a period, a sustained improvement in the economy through reduction of inflation and promotion of enterprise and initiative. Reduction of inflation requires strict adherence to firm monetary and fiscal policies. Improvement of supply side depends on restoration of flexible and competitive market economy and better incentives.

2. Place of 2 December announcements in economic strategy?

Decisions were taken within Government's broad priorities of: need to reduce inflation, control public expenditure, and pursue responsible financial policies.

3. Relative importance given to inflation and unemployment?

Government is equally concerned about both. These are complementary not competitive objectives; unemployment will not be reduced by relaxing struggle against inflation.

4. MTFS no longer plausible?

Not so. Government remain determined to maintain downward pressure on monetary variables so as to keep up progress in reducing inflation. (Will need to judge appropriate fiscal stance in Budget.)

5. Expectations for next year disappointing?

[Industry Act Forecast, published 2 December: details at B2]

No. Further falls in inflation in prospect. A rise in output instead of a fall. Good export prospects and current balance will remain in surplus. Admittedly a gradual undramatic recovery, but UK operating in difficult economic environment. Prospects for unemployment very uncertain and depend on a number of factors. [IF PRESSED on unemployment prospects: IAF broadly consistent with assumptions in Government Actuary Report that unemployment in 1982-83 will be 300,000 higher than in 1981-82. But if things go well - pay settlements, recovery in world trade - then reasonable to hope for fall in unemployment before end 1982-83.]

6. Announcements reflationary/deflationary?

Neither. Announcements have to be seen in context of overall fiscal and monetary policies. On conventional assumptions set out in the IAF, figures point to a PSBR next year broadly in

line with 1981 Budget projections. Further announcements only one half of picture. Cannot anticipate at this stage decisions on tax etc which fall to be taken at Budget time.

7. Effect of higher NIC, rent, health charges, on wages? inflation?

[Announcements increase RPI by 0.6 per cent (mainly higher council rents) and TPI by 1½-2 per cent (reflecting also higher NICs) from next April.]

Growing evidence of greater realism in pay bargaining. Pay bargainers unlikely to look at NIC and other changes in isolation from circumstances of their own industry - as well as wider economic factors. Prospects for inflation depend on developments in pay, import prices, interest rates and the financial position of companies. These all taken into account in IAF.

8. Government has failed to check public spending?

No. Have made positive decision to increase spending in some areas but remain determined to stick to plans once set. This year, cash limits are generally holding; determined to set (and keep to) tight but realistic limits next year. [See also E2-3 and 17.]

9. Tax increases necessary?

Cannot foreshadow Budget. Undoubtedly, higher public spending makes prospects for PSBR, interest rates and burden of taxation next year more difficult. But, as rhF said in his ^{2 December} statement, on conventional assumptions figures point to a PSBR next year broadly in line with projections published at time of Budget. Final assessment must await Budget next year. Will need to assess appropriate fiscal stance in light of circumstances at time, including monetary prospects and outlook for inflation.

10. Distributional effects of 2 December statement

NIC increases will take a larger proportion of net income from the better paid, up to the earnings limit. Council rent increases will not be flat-rate because of rebate system: lower-paid get more rebate. Pensions and unemployment and other benefits are planned to increase by more than the expected rise in earnings, implying a redistribution from the working population to the unemployed and elderly.

11. Government has failed to allow accommodation to the recession?

On the contrary. Have been flexible within the limits of prudence over the levels of public spending and borrowing. But experience shows that attempts to "buy" jobs only temporarily beneficial. Repercussions weaken economy and worsen job prospects in longer run.

12. Failure to control monetary growth?

Judged by results rather than precise numbers, strategy successful. Growth of money GDP fallen sharply. Inflation rate halved. Some good features in monetary picture -outturn for PSBR in 1981-82 should be close to forecast; funding programme on track. [Nevertheless, bank lending disturbingly high, particularly personal lending.]

13. Why are high interest rates needed?

Current level of interest rates has reflected developments overseas and strength of bank lending. Although sterling has recently firmed, high level of bank lending continues. However it should be noted that bank base rates have come down by 1½ per cent since September.

14. Government should change course?

(a) Moderate reflation the answer?

[Alternative reflationary packages continue to proliferate: eg NIESR suggested £5 billion in their November Review; £6.8 billion reflationary package proposed by Hopkin/Miller/Reddaway]

Government recognise need to respond flexibility to economic situation, within framework of overall strategy. But no question of abandoning that strategy. Cannot throw away gains made so far by return to discredited policies. Fallacy that we could "spend our way out of recession" (i.e borrow much more) without seeing resurgence of inflation and undermining financial markets, and, as a consequence, interest rates rising further and faster. Even large reflationary packages yield relatively small benefits
eg NIESR £ 5 billion package would reduce unemployment by only 150 - 300, 000 after 5 years .

(b) Reintroduce exchange controls and join EMS?

EMS is not a panacea. But Government does fully support EMS as an important step in monetary co-operation and closer integration in the European Community. Have stated that UK will participate in the EMS exchange rate mechanism when conditions appropriate both for the system and ourselves. Question is kept under constant review.

(c) More capital spending in public sector?

Projects must be economically sound. Not all capital spending virtuous nor all current spending bad. Cost of public sector investment in terms higher borrowing pushing up interest rates could outweigh immediate boost to jobs.

B ECONOMIC ACTIVITY AND PROSPECTS

1. Is recession over?

The fall in output now over. GDP output rising - preliminary figures for Q3 up $\frac{1}{4}$ per cent on Q2. Manufacturing and construction output increased by 2 per cent and $2\frac{1}{2}$ per cent respectively in same period. Q3 figures for manufacturers' and distributors' stocks show rate of destocking reduced by about two-thirds compared with H1 1981. October industrial production figures continue to show improvement - manufacturing output up $2\frac{1}{4}$ per cent from low point (H1 1981). New Industry Act forecast sees continuation of recovery in output.

IF ASKED about decline in CSO's longer leading indicator: Too early to judge significance; recall that temporary weakening occurred in last cycle.

[NOTE: November cyclical indicators to be released 17 December. DOI Investment Intentions survey due out also 17 December.]

2. Government assessment of prospects

[New Industry Act forecast (2 December) assessed recovery to have begun.

	Increase in 1982 per cent
GDP	1
Manufacturing output	4
Exports	$2\frac{1}{2}$
Investment	$2\frac{1}{2}$

End to destocking. Consumers' expenditure and Government expenditure flat.]

Industry Act forecast sees prospect of some recovery. (Last two Government assessments of economy were broadly correct.) Exports and investment up. Resumption of decline in inflation. Further progress depends on continued moderation in domestic costs and restoration of competitiveness.

3. Outside forecasts

[GDP profile in major forecasts released since June:

	H2 1981 on H1 1981	H1 1982 on H1 1981	per cent
LBS (Nov)	$\frac{1}{3}$	1	
CBI (Nov)	0	$\frac{2}{3}$	
Phillips & Drew (Dec)	0	$\frac{3}{4}$	
OECD (July)	$-\frac{1}{3}$	0	
(IAF - for comparison)	$\frac{1}{2}$	1	

November NIESR Review contains only annual data, but commentary suggests low point reached in H1 1981, with prospect of some recovery.]

Recent major independent forecasts assess that low point in activity was reached in first half of year, with prospect of some recovery in the coming year.

4. Higher interest rates will abort recovery? Business confidence weakened?

Understand concern over interest rates, but it is absolutely essential to contain inflation. Inflation is inimical to sustainable recovery. Interest rates only one of factors affecting industry. Other costs, particularly labour costs, more important for improved profitability and competitiveness.

5. Recession worse than in the 1930s?

Any such comparisons must of course be subject to a statistical health warning. It is true that the fall in output is comparable to the 1930s, but structure of the economy and society is much changed.

C LABOUR

1. Unemployment continues to rise?

[November total count was 2,954,000 (12.2 per cent) - second consecutive month showing slight decrease. Seasonally adjusted excluding school leavers figure was 2,764,000 (11.4 per cent)]

Unemployment rising much less rapidly. Increase in recent months less than half those at end of last year [44,000 per month in 3 months to November 1981 compared with 115,000 per month in Q4 1980]. Also should note within manufacturing short time working sharply cut -(down $\frac{1}{2}$ from January level), overtime showing signs of picking up and fall in employment much less. Result is that total hours worked have stabilised and now show signs of some pick up. Vacancies improving too.

2. Employment continues to fall?

[Total employment fell further $\frac{1}{2}$ million in Q2 1981, much the same as in Q1. Total decline since mid-1979 1.7 million or $7\frac{1}{2}$ per cent.]

Decline in manufacturing employment showing signs of further marked slackening in August and September (25,000 compared with about 50,000 per month earlier in year), and 80,000 per month in H2 1980.

3. Government forecasts for unemployment

[Government Actuary's Report published 2 December uses working assumption of an average level of 2.6 million unemployed in Great Britain (excluding school leavers) in 1981-82 and 2.9 million in 1982-83. (222,000 school leavers and adult students in 1981-82, 225,000 in 1982-83).]

Like previous administrations Government does not publish forecasts of unemployment, though some Government publications, eg Government Actuary's Report, contain working assumptions. Government is concerned about unemployment. Scale of special employment measures (SEMs) adequate evidence of this. Prospects depend on further progress on productivity and competitiveness. [See 4 below for independent forecasts.]

IF PRESSED on whether unemployment will "peak next year". [Headline to report in The Times 8 December of Mr T Burn's evidence to TCSC.] Mr Burns referred to unemployment assumption given to Government Actuary; said it was not far from Treasury assessments, GA figures consistent with the prospect of some fall in total unemployment before the end of 1982-83. They do not however necessarily imply this. If things go well - lower pay settlements, recovery in world trade - then reasonable to hope for fall in unemployment before end 1982-83.

4. Independent forecasts?

[Consensus is for medium term rise in "narrow definition" unemployment, reaching about 3 million in Q4 1982.]

History shows unemployment forecasts to be very uncertain (this is a major reason why Government does not publish one). This is reflected in range especially for beyond next year.

5. Unemployment higher than in other countries?

[OECD standardised data show UK Q1 1981 at 10½ per cent compared with OECD average of 6½ per cent.]

Unemployment has been rising sharply in major industrialised countries, given weakness of world economy. In our case we are suffering the cumulative effects of lost competitiveness and low productivity and implications of inflationary pay settlements in 1978-79 and 1979-80 pay rounds. This is why the rise in UK unemployment has been higher than in most other countries, and points to the need to improve productivity and competitiveness.

6. What is the cost to the Exchequer of the unemployed?

[MSC estimate £438 million per 100,000 additional registered, private sector unemployment; (figure of £450 million estimated by Institute of Fiscal Studies); when "grossed up" gives £12½ billion for total unemployment. Treasury's internal revision of figure published in February Economic Progress Report not published so far - further article likely in EPR in near future.]

All such calculations depend critically on and are sensitive to exact assumptions adopted eg composition (especially whether public or private sector workers), previous earnings, and benefit entitlement of the additional unemployed. As explained in detail in Treasury's Economic Progress Report for February 1981, cannot gross up estimates by naive arithmetic to give cost of total unemployed - or of resources available for costlessly reducing unemployment. [IF PRESSED: No economy has zero unemployment: Moreover, any major change in policy would have implications for inflation, thereby affecting estimates by changing earnings, prices, taxes and benefits.]

7. Spend money on new jobs rather than unemployment benefit?

Cannot switch employment on and off like a tap. But Government doing a great deal to help. Special employment and training measures currently cover almost 700,000 people at a cost of over £1,100 million this year. Not easy to assess just how many being kept off unemployment register by SEMs, but Department of Employment estimate at around 345,000.

8. Should spend more, especially for young people?

Next year, Government is planning to spend £2.7 billion on employment programme, special employment and training measures. Of this, £0.8 million on YOP and other programmes for young people. In addition, estimated expenditure on redundancy payments has risen by £135 million. The total also includes provision for the further training measures to be announced by the Secretary of State for Employment.

9. Need to improve training at all levels?

Agree. Aim must be both to help individual and strengthen economy by having a better trained workforce. Government has fully endorsed objectives of MSC's New Training Initiative. We shall be making a statement before the turn of the year about role which Government and others can play.

10. Unemployment as bad as in the 1930s?

Comparisons extremely difficult to make. Maximum recorded unemployment in 1930s was just under 3 million; but the labour force has grown by about $\frac{1}{3}$ since, so unemployment rates in the 1930s almost certainly higher than now. One also needs to bear in mind changed social conditions and protection given by the welfare state.

D TAXATION

1. Burden of taxation

[Total taxation in 1978-79 was 35 per cent of GDP (at market prices), 36½ per cent in 1979-80, 38 per cent 1980-81. It is forecast to be 40 per cent in 1981-82.]

This has inevitably increased during a time when national production has not been growing. But, for the vast majority, real personal disposable income is still higher than for most of the period when the Labour Party was in Government. Recent OECD report showed that the Government's total 'take' (by way of taxation and national insurance contribution) as percentage of GDP is less than in many other industrial countries - UK eleventh in OECD rankings, behind most other EC countries, including France and W Germany. [NB: HMG's position is that national insurance contributions are not a tax].

2. What are implications of 2 December announcements for 1982 Budget?

Cannot anticipate Budget decisions which will be taken in light of circumstances at the time. In spite of higher projected level of public expenditure, as rhF the Chancellor said in his statement, we have no reason to depart from the projections for the PSBR published at the time of the last Budget. Other factors will also be important, including monetary targets and outlook for pay and inflation.

3. Government policy has harmed incentives?

Marginal rates of income tax for most taxpayers lower than when the Government came to power. Basic rate still 3p below rate inherited from Labour.

4. Reduce National Insurance Surcharge?

Well aware of view of many in industry that a reduction in NIS would be greatest help. But could not prejudge Budget judgment both on whether could afford tax relief on that scale and on whether a reduction in NIS should have priority. But position of employers was taken into account in decision to load increase in National Insurance contribution on to employees.

5. NIS burden in fact increased?

True that as in previous years increase in earnings limits for NICs will also apply automatically to NIS. But increase in upper earnings limits is expected to add only £47 million (in 1982-83) to NIS burden (which is expected to total £3.8 billion this year). Major part (£225 million) of increase expected in NIS burden in 1982-83 will arise solely from increase in earnings. Total NIS/NIC burden on employers likely to fall in real terms in 1982-83 - for second year running.

6. Heavy fuel oil duty

Costs involved mean that it would not be in the national interest to go beyond the Budget decision not to increase the duty in heavy fuel oil. Terms of North Sea gas contracts a commercial matter for the British Gas Corporation.

7. Revenue shortfall in alcohol and tobacco duties due to Budget increases?

[Stockbrokers' comments widely reported 1 December. Detailed briefing was provided to PM 2 December.]

Revenue estimates complex, and open to wide margin of error under normal statistical conventions, given that yield from duties is over £6000 million. Outsiders' estimates contain internal inconsistencies. Budget increases did no more than restore real value of duties to mid-1970's position - when allowance made for inflation.

8. Progress with examining corporation tax structure?

[Promise to re-examine corporation tax structure in 1980 Budget Speech]

It is hoped to produce the Green Paper on corporation tax this winter.

9. Progress so far on tax reform/simplification?

[As in CST's speech 18 November]

Substantial progress has already been made in improving incentives and simplifying the tax system, eg switch from direct to indirect taxes in 1979, correction of worst features of Capital Transfer Tax, improvement in Capital Gains Tax and Development Land Tax regimes, introduction of Business Start Up scheme etc. But reform of the tax system must be pursued within a financially responsible framework.

10. North Sea fiscal regime?

See R3.

E PUBLIC EXPENDITURE AND FINANCE

[The Chancellor announced main decisions for public spending 1982-83 on 2 December. Main increases on programmes are for local authority current expenditure (£1.3 billion), employment measures (£0.8 billion), defence (£0.5 billion) and finance for the nationalised industries (£1.3 billion). Increases will be offset in part by general reduction in most cash limited expenditure and by specific cuts - including increases in prescription charge and other health charges. Planning total for next year will be in the region of £115 billion against £110 billion for the White Paper revalued.]

1. Further announcements?/Questions on later years?

Full details will be in the White Paper to be published at the time of the Budget.

2. 1981-82: Overspending?

[Outturn for the current year is expected to be in the region of £107 billion against £104½ billion in the last White Paper.]

Spending is expected to be higher in 1981-82 than was planned in the last White Paper. The major reason for this is the present level of spending by local authorities. But too early to be certain about likely outturn because civil service dispute has affected monitoring, and changes in circumstances could well lead to a higher or lower total than the £107 billion we now provisionally expect.

3. Plans for next year unrealistic, given likely overspending this year?

No. Realism, particularly in respect of local authorities and nationalised industries, is one reason why our plans for next year are higher than in last White Paper (revalued).

4. Are plans for 1982-83 reflationary or deflationary?

As my rhF the Chief Secretary said during the debate on 8 December, the changes are neither reflationary or deflationary.

5. Fall in real terms?

We have increased cash provision for next year. In real terms this means that spending next year will be broadly at level planned for this year. Expect public expenditure will fall as proportion of GDP, which is what really matters.

6. Failure to cut spending?

Our decisions to increase spending next year reflect a flexible but prudent response to changed circumstances. The increases we have decided were however offset in part by reductions elsewhere.

7. Implications for tax and monetary policy?

A matter for the Budget. But a high level of spending does mean taxation higher than it would otherwise be. The alternative would be more borrowing and higher inflation and interest rates.

8. Increase spending during recession?

It is not the Government's intention to try to spend its way out the recession. That would only lead to more inflation and higher interest rates and taxes. But we are responding, within the limits of prudence, to the needs of current circumstances.

9. Increase spending on worthwhile infrastructure projects?

Our first concern must be with realistic public expenditure levels. Within these, our aim is to encourage worthwhile capital projects wherever possible. The 2 per cent cut in cash-limited programmes reflects in part a reduction in administrative costs, in most cases of 2 per cent or more. But as my rhF the Chief Secretary said during the debate on 3 December, social security spending is the only other area of major possible attack if we seek savings in current expenditure to make room for capital expenditure.

10. Public capital investment in 1982-83 cut by £500 million compared with 1981-82?

[Claimed by The Times in leader by 8 December.]

As my rhF the Chief Secretary said during the debate on 8 December the figure mentioned in The Times is not accurate. As far as the nationalised industries are concerned, so long as they restrain their current costs the extra cash provision we have given them should allow them to maintain their investment next year at broadly the same level in real terms as this year - and that is in real terms 15 per cent up on the 1980-81 level. Other public capital expenditure will be a little lower in cash next year compared with this but keen tendering will mean the programmes should be carried out as planned.

11. Number of cash limits breached last year?

In aggregate, central government voted cash limits in 1980-81 were underspent by just over 1 per cent. There were 6 individual breaches of cash limits (4 on central government and 2 on local authorities) compared with 13 in 1979-80, and amounts involved were marginal. A full statement of provisional outturn of spending compared with cash limits in 1980-81 was published as a White Paper (Cmnd 8437) on 4 December.

12. Position on 1981-82 cash limits?

Provisional outturn figures for first half year were published with Winter Supplementary Estimates in Financial Secretary to the Treasury's note on 4 December. Central government cash limited expenditure overall is on course. For a number of individual cash limits expenditure was well in excess of profile for first half year. In many cases the excess is due to a shift on timing of expenditure and/or receipts; in other cases there have been cash limit increases. In remaining cases position is being discussed with relevant departments to ensure that corrective action, if necessary, can be taken in good time.

13. Cut public sector pay bill?

We have limited the provision for public service pay increases next year to 4 per cent. Administrative costs of central government are not far short of 10 per cent of total public expenditure. We are determined to reduce that proportion, and to maintain the drive for more efficient management throughout the public sector. Only one third of current expenditure is on wages and salaries and much of that is for nurses, teachers, members of armed forces, police and so on.

14. Cut staff numbers in public services?

Numbers in public service have already fallen since we took office. Civil Service has been reduced by over 7 per cent to 679,800. This is the smallest for over 14 years and we are well on target to achieve our aim of having 102,000 fewer staff in post in April 1984 than when Government came into office; this will be smallest Civil Service since the war. Local authority manpower has been reduced by nearly 70,000 (over 3 per cent).

15. Moves to cash planning announced in Budget mean that Plowden system is being abandoned?

Government does recognise case for medium term planning. But it must be planning in relation to the availability of finance as well as in relation to prospective resources. Illusion to suppose there can be unconditional commitment to forward plans for services.

16. Ratio of public spending to GDP is getting back to the peak levels of the mid 1970's?

The ratios in 1980-81 (44½ per cent) and 1981-82 (45 per cent forecast) remain below the level of 1974-75 and 1975-76 (46½ per cent in both years). The large rise from 41½ per cent in 1979-80 is partly because of the "relative price effect" and partly because the volume of expenditure rose at a time when real GDP has fallen.

LOCAL GOVERNMENT

17. Spending plans for 1982-83? Too tough? Too weak?

We have accepted that it will not be practicable for local authorities to eliminate all their present overspending in a single year. We have therefore increased plans by £1.35 billion. As a result targets will be both reasonable and realistic. But this does not mean we have conceded defeat. Substantial economies will still be required as plans allow only about 2 per cent more cash spending than latest budgets for this year. Pressure to curb overspending through RSG system and otherwise will be maintained.

18. Cut in RSG percentage will mean large rate increases?

Not at all. Must look at combined effect of increase of £1.35 million in plans and RSG percentage. If local authorities budget to spend in line with Government's plans, rate increases should be very low. Where they are high, it is because local authorities have chosen to overspend. [IF PRESSED for a figure: Predictions of average rate increases are very unwise as any average figure rapidly becomes a minimum. Impossible to give a meaningful figure because of enormous variation in local authorities' spending intentions.]

19. Increased burden on industry?

Very conscious of harmful effect of large rate increases. But remedy lies with local authorities. Realism of Government's plans means that there is no need for high rate increases.

20. Scotland and Wales?

Plans have also been increased. Rate increases will be very moderate if local authorities budget in line with Government's plans.

21. Rates: alternatives?

[A Green Paper on alternatives to domestic rates is expected to be published on Wednesday 16 December. New proposals to prevent supplementary rates may also be announced the same day. FT 14 December offers preview of contents of Green Paper.]

We shall be publishing a Green Paper later this week.

F SOCIAL SECURITY

[Note: 2nd Reading of Social Security Bill on 16 December]

1. Increase in employees' national insurance contributions?

[Chancellor and Social Services Secretary announced on 2 December 1 per cent increase in employees' national insurance contribution from 7.75 per cent to 8.75 per cent to be made from April 1982, as part of review of National Insurance Contributions. Increase will help increase TPI from April - J4. Bill to implement this published on Thursday 3 December].

An increase in contributions was necessary to pay for increased benefit expenditure (notably retirement pensions), increased redundancy payments and to maintain expenditure on the health service. Relative share of these costs met by employers has increased in recent years; we considered it essential to avoid placing this additional burden on them. Employers will still be bearing a higher proportion of the burden than they did ten years ago.

2. What about Treasury Supplement?

[Bill also provides for a 1½ per cent reduction in the Treasury Supplement - from 14.5 per cent to 13 per cent].

Treasury Supplement represents only one part of cost of benefit expenditure met by the general taxpayer. If all such expenditure taken into account, general taxpayer still be funding as high a proportion of benefit expenditure next year as this year - and substantially more than a few years ago. Not, therefore, unreasonable for contributors, rather than general taxpayer, to meet these extra costs.

3. Burden on employers?

We have avoided making any increase in employers' rate of contributions. Some increase in cash burden is, however, inevitable simply because of higher earnings. In addition, upper earnings limit has been raised by £20 to £220 - which adds a relatively small additional cash burden. Cash payments to increase by around 7 per cent, that is, slightly less than our estimate of the movement between 1981-82 and 1982-83 in earnings (7.5 per cent) and substantially less than the movement in prices (10 per cent).

4. Balance on the Fund?

We are budgeting for a very small deficit (£9 million) this year. The accumulated balance in the National Insurance Fund is of order of £5 billion. This may seem large as a proportion of expenditure; it has, however, been falling, and now represents about 13 weeks benefit expenditure - as compared with 25 to 30 weeks ten years ago. A balance of some weeks

expenditure is necessary to cope with emergencies such as flu epidemics and industrial disputes.

5. Restoration of shortfall on unemployment benefit, etc?

As my rhF the Chief Secretary said in the House last Tuesday, the decision on the level of benefits in November 1982 is announced at the time of the Budget, when account can be taken of the latest forecast of price inflation. In reaching our decision we shall of course take into account everything hon Members said during the debate last Tuesday. They will no doubt continue to give their views.

G PUBLIC SECTOR BORROWING

1. PSBR in 1981-82

[Industry Act forecast published 2 December shows PSBR in 1981-82 was £10.2 billion; PSBR in April - September was £10 billion]

The Civil Service dispute has greatly affected the PSBR so far this year, but the underlying PSBR looks to be in line with the Budget forecast of £10½ billion.

2. Effect of civil service dispute on CGBR?/Revenue still outstanding?

[CGBR April-November was £9.4 billion.]

The shortfall of net revenue outstanding at the end of November from the start of the dispute was about £4 billion, of which around £3 billion related to the current financial year. Interest costs so far on the additional borrowing caused by the dispute are around £350 to 400 million.

3. Will the Government be able to collect all delayed revenue this financial year?

Some revenue is expected to be outstanding at the end of March.

4. Public expenditure likely to overrun this year?

[On 2 December, Chancellor referred to £107 billion - £2 billion above Budget time plans.]

It is too early to be certain what the outturn for the current year will be. The local authorities are, admittedly, spending above the Government's plans. We are taking measures to deal with that but these measures cannot be effective this year. Expenditure which is under the Government's direct control is running broadly according to plan in total.

5. Recession means that PSBR should be higher, not lower?

In my rhF's Budget statement earlier this year he explained that this year's PSBR would be larger on account of the recession. But experience shows that attempts to buy jobs with reflation simply fuel inflation and quickly have to be reversed. Our policies are designed to cut inflation and secure a sustainable improvement in output and employment.

6. What are implications for next year's PSBR of 2 December statement?

No decisions have yet been made on 1982-83 PSBR. Must await Budget. But on conventional assumption, set out in Industry Act Forecast, figures point to a PSBR next year broadly in line with 1981 Budget projections. [IF PRESSED: This means PSBR is expected to decline as proportion of GDP (even before taking account of revenue delayed by civil service dispute).]

H MONETARY AND FINANCIAL POLICY

1. Why has Bank of England appeared to brake the fall in UK interest rates when rates overseas, particularly in US, have fallen rapidly?

[US 1-month rates have fallen about 5½ per cent over past two months, but have firmed slightly in past few days; UK rates ^{fell} by 2 per cent over same period.]

Of course we want to see lower rates. But must proceed cautiously if we are not to let up in the fight against inflation. Clearing banks have already reduced base rates by 1½ per cent from their peak. But wrong to think that rates could safely drop much further in near future without potentially dangerous consequences for inflation.

2. Why so much emphasis on cutting PSBR if efforts undermined so easily by high overseas rates and rapid pace of bank lending?

Interest rate decisions must take account of all potential risks of inflation. If we had not reined back the PSBR, interest rates would be still higher.

3. The death knell for the recovery?

Agree that higher interest rates will increase difficulties of industry. But companies' financial position generally much stronger than a year ago. No purpose served by allowing higher inflation, whether due to falling exchange rate or credit-financed consumer spending.

4. Two tier system of interest rates?

Not practicable in highly sophisticated financial market like UK's. Very difficult to prevent money borrowed at lower rate being on-lent at higher. A lower rate for specified borrowers would require extra Government subsidy which would push up borrowing or require cross-subsidisation by the banks. In either case the level of interest rates to other borrowers would be increased.

5. Will there be an overshoot of money supply?

[£M3 increased by ½ per cent in banking November, bringing recorded increase in first nine months of target period to 13 per cent. Position remains seriously distorted by effect of civil service dispute and aftermath. Advice below is based on Industry Act forecast.]

Recorded figure for target period as a whole may be somewhat above top of target range. But too early to say by how much. Interpretation of recent figures very difficult because of civil service strike distortions. Some good features in monetary picture: 1981-82 PSBR should be close to forecast; funding programme is on track. But bank lending is disturbingly high, particularly personal lending.

6. When will the strike distortions be eliminated?

Distortion will continue for some months yet. The distortion to the CGBR was reduced by over £1 billion in (calendar) November. In eight months ending November the effect of strike was to add around £3½ billion to the CGBR.

7. Status of MTFFS if money supply overshoots for second year running?

MTFFS remains basic framework of Government's economic policy. But as Chancellor said in Budget speech, also take account of other monetary indicators as well as sterling M3. Will continue to maintain steady but not excessive downward pressure on monetary aggregate.

8. But increase in bank lending not inflationary: house prices stagnant, retail sales flat or falling?

Very hard to distinguish upward pressure on prices due to bank lending from downward pressure due to other factors, especially falling real personal disposable incomes. Effect of higher bank lending will not be felt on prices immediately, but only with a lag.

9. Ceilings on non-priority bank lending?

In UK's complex financial system, ways would be found of by-passing credit controls. Any improvement to money figures would prove to be cosmetic. Would create distortions and inhibit competition between banks.

J PRICES AND EARNINGS

1. Inflation has increased under this Government?

Considerable progress has been made in bringing down inflation from a peak of 21.9 per cent in May 1980 to 11.7 per cent in October.

2. Inflation back on a rising trend?

[Year-on year rate of inflation rose to 11.7 per cent in October compared with 11.4 per cent in September and lowest recent level of 10.9 per cent in July. Effect of mortgage interest increases estimated at around $\frac{1}{2}$ per cent on RPI in November, some $\frac{2}{3}$ per cent in December.]

Progress on inflation has been affected by the fall in the exchange rate, and the rise in the mortgage interest rate will affect the RPI. We expect further progress in reducing inflation, but the timing is of necessity uncertain.

3. Industry Act forecast (12 per cent by Q4 1981; 10 per cent Q4 1982)

Progress in reducing inflation has been hindered by fall in exchange rate, and by higher mortgage interest rates. Government is confident that downward trend in inflation will be resumed.

4. Effect of 2 December measures on RPI/TPI?

[Measures include 1 per cent increase in employees' NIC, higher prescription charges, and council house rents.]

Effect of measures on RPI will be roughly 0.6 per cent from April 1982 [reflecting mainly increase in council house rents; higher prescription charges will have negligible effect]. Effect on TPI will be $1\frac{1}{2}$ -2 per cent from April 1982 [reflecting also higher NICs.]

5. Nationalised industry prices

Nationalised industry price rises have been due in substantial part to the ending of the previous Government's policy of artificial and distortionary price restraint. The rate of nationalised industry price rises is now coming more closely into line with the RPI.

6. TPI

The fact that the TPI has been increasing faster than the RPI ($3\frac{1}{2}$ per cent faster over the year to October) reflects the measures which have been taken to restrain Government borrowing, which is essential if inflation is to be controlled.

7. A 4 per cent pay policy?

The 4 per cent factor announced on 15 September [for calculations in Public Expenditure Survey] is not a pay norm. It is a broad measure of what the Government thinks reasonable and can be afforded as a general allowance for increases in pay, at this stage of fixing the programme from which the public service wage bill has to be met.

8. Does the 4 per cent apply to the Civil Service?

The 4 per cent factor does not imply that all public service pay increases will or should be 4 per cent. Some may be more; some less. [IF PRESSED: In response to enquiries from the civil service unions, they have been told that the assurance they were given earlier in the year about next year's pay negotiations are unaffected by the announcement of the 4 per cent factor.]

9. Public sector ignoring 4 per cent policy?

[Firemen have now settled at 10.1 per cent; NUM have rejected revised offer worth 9.3 per cent on basic rates [NOT FOR QUOTATION: 7.4 per cent on earnings]; water manuals considering offer worth 8.8 per cent on earnings; LA manuals considering offer reported as worth 6.3-7.8 per cent on basic rates]

Pay negotiations in local government and the nationalised industries are a matter for the parties concerned, as are the financial consequences of any settlements reached. The Government has continually stressed importance of restraining current costs, including unit labour costs.

[NOTE: Not enough settlements yet in this pay round in private sector to comment on trend here]

10. Government aiming to cut living standards?

Government seeking to create conditions for sustained improvements in living standards. This requires creation of more competitive and profitable industrial sector. Means that less of increase in nominal incomes should be absorbed by higher pay. The lower the level of settlements, the greater the headroom for output and employment to expand.

11. Average earnings index

[Drop in year on year growth from 12.8 per cent in August to 9.4 per cent in September may attract attention, though (unpublished) underlying increase unchanged at 11 per cent]

I very much welcome the sharp reduction in pay settlements which has been achieved over the past year. Further moderation in settlements can only be helpful in maintaining jobs and getting inflation down.

12. Comparison of TPI and index shows that real take-home pay has fallen over the past year

Yes. But follows growth of $17\frac{1}{2}$ per cent in personal living standards in three years 1977-80.

13. Layard's wage inflation tax?

Like any other attempt to rely on incomes policy, Layard's proposal (picked up by SDP) would entail all the familiar problems of setting norms and interfering with market forces. Experience gives no encouragement to the idea that incomes policies can be made to work on a permanent basis. They always succumb to the distortions they create.

14. Index-linked pensions and the Scott Report?

We are considering question of index-linking of public service and other public sector pensions, including the question of contributions made by public servants for their pensions. Changes in these arrangements could produce further savings in due course.

K BALANCE OF PAYMENTS

1. Balance of payments in third quarter 1981

[Figures for invisibles and capital transactions published 9 December]

The capital account outflow in Q3 was much smaller than earlier in the year. Portfolio investment abroad (estimated at £1.3 billion in Q1) was only £0.6 billion in Q3. Total surplus on invisibles was £303 million.

2. What is happening to the trade account?

November figures are not yet available. September and October trade figures show a small surplus; this is probably the best guide.

3. Trade figures for October

The October figures show that the current account continues in surplus. Exports have performed much better than many people expected and held up well. Imports have recovered from the depressed level at the start of 1981. This is consistent with a slowdown in destocking and recovery in output.

4. Trends in exports

Export figures for September/October very uncertain: but appear to have held up well under difficult circumstances, despite sluggish world trade and earlier losses of competitiveness. Export orders for British engineering industries show a 40 per cent increase since the summer.

5. Trends in imports

The increase in import volumes in October confirms recent evidence of slowdown in destocking, and recovery in output. Import volumes are 16 per cent higher than in the first four months of 1981 but are only 1 per cent higher than in 1980.

6. Trends in invisibles

Invisible earnings continue in substantial surplus and are likely to rise to about £200 million a month in the fourth quarter of 1981 due to budget refunds from the EC.

7. Capital flows

The net capital outflow in 1981 Q3 was about £0.7 billion compared with £1.9 billion in 1981 Q2. These capital flows represent overseas investment which will provide a valuable source of overseas income in future years. There is no evidence that outflows deprive UK firms of capital to invest.

L FOREIGN EXCHANGE, RESERVES AND IMF

1. Sterling still too high?

[Since July sterling has remained broadly stable against the dollar but has depreciated against the Deutschmark due to a slacker oil market and improved German current account. Recent "lows" have been \$1.77 on 14 September, DM4.07 on 20 October. Rates at noon on 11 December were \$1.8810; DM4.241 and an effective rate of 89.69. Reserves at end November stood at \$23.5 billion, compared with \$23.2 billion at end October]

Our policy is to allow the rate to be determined primarily by the balance of market forces. The effective exchange rate is only slightly higher than when the Government took office. Manipulating the rate is no answer to problems in the real economy.

2. Has the Bank intervened to support the rate?

The Bank intervene to smooth excessive fluctuations and preserve orderly markets. They do not seek to maintain any particular rate.

3. Does the Government have an exchange rate target?

No. As my rhF the Chancellor told the TCSC in July 1980, it is very difficult to make judgments about the 'right' level for the exchange rate or to resist strong market trends That continues to be the Governments' view. However, the Government is not indifferent to exchange market developments: account is taken of the level and movement in the exchange rate when taking decisions on interest rates.

4. Sterling should join the EMS?

[See M13]

5. Exchange rate and competitiveness?

I welcome the improvement in UK cost competitiveness of perhaps 10 per cent so far this year. This is partly due to a decline in the exchange rate; more importantly because there are signs that our domestic unit labour costs are now growing more slowly than those of our major competitors.

6. Debt repayments

We have made substantial progress with our plans to reduce the burden of external debt substantially during this Parliament. We have now pre-paid the \$2.5 billion Eurodollar loan and are continuing with other scheduled repayments. By end of 1981, total official external debt will be reduced to around \$14 billion, compared with over \$22 billion when the Government took office.

M EUROPEAN MATTERS

[Note: Meeting of Finance Council scheduled for 14 December business to discuss draft annual Community report.]

MEMBERSHIP OF EUROPEAN COMMUNITY

1. Follow-up to European Council?

Further work concentrating on four issues - problems arising from Community milk surplus; support measures for Mediterranean agriculture; limiting spending on agriculture; and the Budget problem. Foreign Ministers to meet and report back to Heads of Government.

2. Net UK contribution to community too high?

A lot lower than it would have been without the refund agreement of 30 May last year.

3. Lower Commission estimates of net contributions in respect of 1980 and 1981?

We are examining the new Commission estimates. If our adjusted net contribution in respect of 1980 and 1981 turns out to be lower than expected, that is very satisfactory, because the 30 May Agreement left us paying a large net contribution even though we are one of the poorer Member States. The problem of 1982 and later years remains to be solved.

4. Budget refunds reduced if net contribution less than originally estimated?

The UK is clear that the minimum net refunds payable under the 30 May agreement are 175 million ecus (European Currency Units) for 1980 and 1410 million ecus for 1981.

5. Do supplementary measures grants lead to additionality?

There is additionality in that refunds enable public expenditure in the regions and elsewhere to be higher than would otherwise have been possible.

6. Policy for CAP reform

Key measures are price restraint, curbs on surplus production and strict control of the growth of guarantee expenditure.

7. Costs of CAP to UK consumers

My rhF, the Minister of Agriculture, has dealt with a number of questions on this. Costs to consumers of the CAP as such depend on nature of alternative support system that is envisaged. Arrangements leading to a reduction in the cost of food to the consumer could well involve increased costs to taxpayers.

EUROPEAN MONETARY SYSTEM

8. What is the current attitude of the UK Government?

We fully support the EMS, and acknowledge the contribution which it has made to stability in the exchange markets. However, we do not yet feel able to join the exchange rate mechanism. We must wait until conditions are right for the system and for ourselves.

N INDUSTRY

1. Recent increases in interest rates - damaging for industry and investment?

(Each 1 per cent in interest rates raises interest payments on industry's borrowing by around £250 million.)

Government believes best way it can help industry and promote investment is to create a climate in which business can flourish. Essential to get rate of inflation down so as to create a stable environment for business decision-taking. Recent rise in interest rates must be seen in context of priority attached to reducing inflation and need to control growth in money supply underlying the MTFs. (See brief H).

2. Prospects for industry - recovery?

Encouraging evidence that fall in output has now come to an end. Too early to talk about recovery: but index of manufacturing output rose 1½ per cent in the third quarter with chemicals and engineering performing particularly well.

3. Company sector finances improved?

[Gross Trading Profits of industrial and commercial companies (ICCs) other than North Sea activities net of stock appreciation were around £3¼ billion in Q2 1981 for third successive quarter. Borrowing requirement of ICCs has improved over last year, and financial deficit turned into surplus. DOI's latest survey of company liquidity (published 4 December) shows further marked improvement in third quarter (particularly in manufacturing) bringing liquidity ratio back to 1979 Q3 level. NB figures difficult to interpret, however, particularly because of uncertain impact of CS dispute].

Figures mildly encouraging (but not wildly so). Company financial position is in any case confused by effects of civil service dispute. After adjustment for stock appreciation and excluding North Sea, ICC profits have stabilised since mid-1980. Improvement in financial position partly reflects destocking and action to reduce overmanning.

4. Industries' claim that 2 December package adds £600 million to employers' costs?

[Higher NIC £200 million; higher rates £400 million.]

In real terms burden of NIC/NIS on employer's likely to fall in 1982-83, for second year in succession. And company sector now in rather stronger financial position than a year ago, partly through Government policies to switch fiscal burden.

SMALL FIRMS

5. Government help for small firms

Over 70 measures taken which help important small firms sector: in particular the Business Start-Up Scheme, the pilot Loan Guarantee Scheme, the Venture Capital Scheme, and reduction in the burden of small firms' corporation tax.

6. Response to Loan Guarantee Scheme?

Scheme has got off to very good start. We have already issued more than 1500 guarantees - well over half to new businesses. Total lending under scheme is already over £52 million. Substantial demand for loans has led the Government to double this year's lending limit under the scheme. Ten new banks were admitted to the Scheme in November: a total of twenty-seven financial institutions are now participating.

ENTERPRISE ZONES

7. Progress with setting up Enterprise Zones?

Excellent progress being made. Ten of the eleven zones are already in operation. We expect the final zone - Isle of Dogs - to come into operation early next year.

8. Response from private sector?

Initial response has been very encouraging. Many new firms are setting up in the zones, existing firms are expanding their activities and vacant land has been brought into use. Too early to assess success of zones.

P NATIONALISED INDUSTRIES

EXTERNAL FINANCING LIMITS

1. EFLs for 1982-83?

Despite constraints on public expenditure as a whole, Government has recognised the problems faced by the industries in a period of recession and has increased provision for 1982-83 by £1.3 billion cash. This is larger than the increase in any individual Departmental programme.

2. Pay assumptions?

Government does not set a uniform pay assumption for the industries. But industries' own assumptions have been discussed, and external financing limits have been set on assumption that reasonable settlements will be reached. Moderate pay settlements - and restraint of current costs generally - essential if investment programmes to be maintained and prices to consumers kept down.

3. Government simply forcing financing burden on to the consumer, ie through higher prices?

Some further price rises have been assumed in reaching decision on EFLs as in previous years. Should be possible to avoid large real increases experienced in 1980-81, but this will require continuing effort to keep down current costs, particularly pay.

4. Why not give British Telecom more?

The £340 million EFL is still relatively large, particularly for a profitable industry. Ministers will be looking to British Telecom, as to others, to make a substantial contribution through reduced costs. There could be a higher figure if the bond proves feasible.

5. Government still cutting back the industries savagely?

Not so. The industries made very large original bids for additional external finance in 1982-83, totalling about £2.5 billion, in their medium-term financial plans presented to the Government in early summer. This would have brought their total external finance to around £4 billion. The agreed increase of £1.3 billion is roughly halfway between the industries' original bids and the White Paper figure.

INVESTMENT

6. Current year?

Last Public Expenditure White Paper showed nationalised industry planned investment 15 per cent higher in real terms this year than a year ago. Quantity of investment frustrated by tight EFLs is less than often implied. TSSC report published in August estimated in range of £250-500 million this year.

7. Future years?

Investment approvals for the years 1982-83, 1983-84 and 1984-85 have yet to be settled. They will be communicated to the industries in due course and will be published in the forthcoming Public Expenditure White Paper.

8. But announced EFLs for 1982-83 will make it hard for the industries to keep up their investment?

The industries should be able, in total, to maintain broadly the same level of investment in 1982-83 as planned in the last White Paper, despite lower revenue, with higher investment in important industrial priorities, eg telecommunications. This will enable the 15 per cent real increase over the 1980-81 level, which was included in the 1981-82 plans to be sustained. These plans, in turn, represented the highest real level of investment in the industries since 1975-76.

9. Take nationalised industry investment out of the PSBR?

Since nationalised industries are part of the public sector, their borrowing - for whatever purpose - must by definition form part of the public sector borrowing requirement. The real problem of pressure on resources cannot be solved by changing statistical definitions.

10. Private finance for NI investment?

(The NEDC Working Party's study of nationalised industry investment was discussed at the Council's 5 October meeting; agreed that there should be a review of progress to be completed by June 1982]

We have indicated our willingness to consider new financing proposals, most recently in the context of the review carried out by the NEDC Working Party. But direct market finance can only be justified if there is a genuine element of performance-related risk for the investor, in order to improve incentives to management efficiency, and if new forms of saving are tapped, so as to avoid adverse monetary consequences. Market financing does not of itself reduce the PSBR, nor does it lessen the burden on financial markets.

11. Finance more nationalised industry investment by cutting current spending?

Yes. In particular, moderate pay settlements are essential. The ability to finance new investment in the nationalised industries is bound to diminish if excessive pay settlements are agreed.

12. But you cannot finance much investment by cutting current costs alone?

Not true. Each 1 per cent off wage costs would save about £¹²⁵ million per annum; and each 1 per cent off total costs saves £³⁰⁰ million this year.

NATIONALISED INDUSTRY PAY AND PRICES

13. Nationalised industries' prices have risen more rapidly than RPI?

True over last year or so, while adjustments from artificial and distortionary price restraints introduced by the Labour Government were working through the system. Unwelcome but inevitable: the only alternative is an increased burden on the taxpayer and a distortion of market forces.

14. What is happening now?

Nationalised industry price increases are falling relative to the RPI (14 per cent above in year to January, 3 per cent above in year to October). Fully expect them to come closer to RPI next few months.

15. And the future?

Better price performance depends on improvements in efficiency and control of current costs, particularly pay. We are determined to see those improvements brought about. Privatisation and increasing competition have an especially important role here.

PRIVATISATION

16. The Government simply selling valuable national assets to achieve PSBR target?

Of course, the cash is welcome, but the benefits run wider than that. Not only will the main financial benefit be that future borrowing of these undertakings will be outside the PSBR and no longer burden the taxpayer, but the organisations concerned will be made responsive to market forces and thus have greater incentives to improve efficiency.

17. Does the Government have more privatisation plans to announce?

Legislation already passed to enable public to hold equity stake in British Airways, British Transport Dock Board, subsidiaries of British Rail; and to dispose of some of British Telecom's peripheral activities. We shall be announcing further measures in due course.

R NORTH SEA AND UK ECONOMY

1. Benefits of North Sea should be used to strengthen the economy?

[Direct contribution of North Sea oil and gas to GNP is estimated to rise from 3 per cent in 1980 to about 5 per cent in 1984; expected contribution to Government revenues estimated at £3½ billion in 1980-81 and £6 billion in 1981-82 (at current prices). Less susceptible of measurement is boost given by North Sea to local employment and to industry in offshore equipment].

Yes. Government's strategy derives greatest possible long-term benefit from North Sea. Revenues ease task of controlling public borrowing. This will help to achieve a lower level of interest rates to the benefit of industry and the economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Only one-twentieth of total general government receipts in 1981-82.

2. Will HMG change North Sea fiscal regime in line with oil industry's proposals?

[Memoranda lodged with Treasury and D/Energy 22 October].

Recommend UKOOA (UK Offshore Operations Association) and BRINDEX for the hard work which they have put in. Obviously full study of their proposals is required. We shall look at their suggestions with an open mind, in close liaison with UKOOA and BRINDEX.

3. North Sea oil depletion policy?

Secretary of State for Energy announced in June that the Government would review in the Autumn the possibility of oil production cuts in 1982. We shall give the industry proper notice of our intentions.

4. Government revenues from the North Sea should be used to finance cheap energy for industry?

It would be inequitable and inefficient to use the benefits of North Sea oil to subsidise some users. The age of cheap energy is past. Energy prices should recognise the cost of marginal supply and reflect the competitive position of industrial fuels. Only then can consumers receive reliable signals on which to base their energy consumption and investment decisions.

5. North Sea revenues should be channelled into a special fund to finance new investment, particularly in energy?

North Sea revenues are already committed. Setting up a special fund would make no difference. More money would not magically become available. So the money for this

special fund would have to come from somewhere else - lower public expenditure, higher taxes or higher public borrowing.

6. North Sea oil bond?

Ministers concerned are currently finalising a decision on this.

S WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Governments' policies pushing world economy into recession?

[Output in OECD area grew modestly in first half 1981. Little information on Q3; but small rise in US and French GNP. Industrial production picture in Q3 mixed. Average unemployment rate rising.] [OECD believe output of member countries will have stayed flat in second half of this year, and will recover gradually in 1982. CONFIDENTIAL: NOT FOR USE This OECD forecast not yet published.]

No. Healthy growth only possible if anti-inflation policies persevered with. Some recovery of output expected next year. And unemployment should level off during the year.

2. OECD gloomier about world economic prospects?

[Draft report referred to in Sunday Times 15 November]

Latest OECD forecast is still being prepared. Most major forecasts, including the IMF's, expect modest growth next year. OECD forecasts unlikely to be markedly different.

3. Comment on latest NIESR Review forecast for industrial countries?

[Report published 26 November forecasts 'slow' economic growth and 'gradual' decline in inflation in industrial countries in 1982 and 1983.]

Interested to note that NIESR forecasts lower inflation and rising output in the industrial countries in next few years.

Anti-inflation policies not working?

[Year on year consumer price inflation in major countries around 10 per cent in September. Underlying rates increasing in US and France. OECD and IMF expect some decline next year.]

Takes time to squeeze inflation out of system. Year-on-year consumer price inflation in major economies down from peak of 13 per cent in April 1980 to around 10 per cent in September 1981. Further decline expected next year.

5. Governments' policies have failed or worsened situation?

No. Adjustment to second oil shock better than to first. Investment has performed better, impact on wages better contained and dependence on oil reduced. But these gains must be reinforced by continued firm policies.

6. Countries disagree over direction of policy?

No. Both Ottawa Summit and IMF Interim Committee agreed that a clear priority had to be given to firm policies to reduce inflation. They stressed importance of steady and careful

restraint on growth of monetary aggregates and emphasised need, in many countries, for reductions in size of budget deficits.

7. Other countries giving priority to unemployment rather than inflation?

No. All major countries agree that lasting reduction in unemployment can only be achieved when inflation brought down. France, an exception till October, is now acting to curb inflation. This best way to secure lower interest rates, encourage productive investment and achieve better rates of economic growth and employment.

8. Other governments not following such stern policies as UK?

[US, Canada and Germany have announced lower monetary targets for this year compared with last. Most major countries (US, Japan, Germany, Italy, Netherlands, Australia, Sweden) have recently announced measures to cut planned public spending. France has announced the deferral of FF15 billion (£1½ billion) of capital investment. Recent Canadian Budget will reduce deficit.]

Most governments persevering with firm policies to lay foundations of renewed non-inflationary growth. In particular, continuing with their efforts to control monetary growth, offset effects of recession on budget balances, and keep public spending in check.

9. US are pursuing mad policies and care nothing for their impact on rest of world?

US authorities have widespread international support in their battle against inflation. Sound \$ is in everyone's best interests. Concern is over monetary/fiscal mix - a problem all countries familiar with.

10. Deeper than expected US recession will kill recovery in other countries?

Some fall of output in the US may be inevitable before inflationary expectations are reduced. In everyone's interests that US inflation should come down. A sustainable recovery will then be possible.

11. Recent comments by US Budget Director have undermined confidence?

[Press reports of Dr Stockman's description of Budget spending cuts as "hastily prepared and enacted" and tax cuts "Trojan horse" favouring the rich, while casting doubt on "Supply side" policies].

I note that Dr Stockman has apologised for his "careless ramblings to a reporter".

12. Recent international interest rate developments?

True that international interest rates have been high over last year, but glad to see some easing of US prime rates - down to 16 per cent from peak of 21½ per cent; also German rates declining.

13. Prospects for international interest rates?

Always difficult to forecast interest rates with certainty, but firm policies should over a period bring lasting reduction in both inflation and interest rates.

PRESENT SITUATION

Most recent major outside forecasts (NIESR, P&D, CBI, LBS, Industry Act Forecast (IAF)) assess recession's trough was reached in H1 1981, with some recovery in year to H2 1982 (in range $\frac{1}{2}$ - $2\frac{1}{4}$ per cent). Item are more pessimistic, seeing output fall a further 2 per cent in 1982, recovery thereafter. Unemployment (UK adult sa) forecast to increase to around 3 million by end 1982. (IAF does not assess unemployment prospects). Most major forecasters see year-on-year inflation in range 11-12 $\frac{1}{2}$ per cent for Q4 1981, falling to 9-11 per cent in Q4 1982. Item and St James are more pessimistic; forecasting range of 13-15 per cent. Item see a sharp drop, well into single figures in 1983. The IAF which sees inflation falling to 10 per cent in 1982 Q4, lies at the centre of the range.

GDP output estimate rose $\frac{1}{2}$ per cent in Q3 1981 the first rise for 7 quarters. In the 3 months to October 1981 industrial output and manufacturing output both rose $1\frac{1}{2}$ per cent.

Consumers' expenditure fell by $\frac{1}{2}$ per cent in Q3 1981 returning to the level of Q3 1980.

Retail sales in the 3 months to November 1981 were unchanged. In September and October

Volume of visible exports was 4 per cent above the average in January and February.

Volume of visible imports rose 21 per cent on the same comparison. Manufacturing investment (excluding assets leased from the service sector) fell $4\frac{1}{2}$ per cent in Q3 1981.

Distributive and service industry investment (including shipping and leasing) was virtually unchanged in Q3 1981. DI investment intentions survey (conducted in April/May) suggests a fall in manufacturing investment after allowing for leasing of 11 to 14 per cent in 1981 with some recovery in 1982; distributive and service industries investment (including shipping) expected to rise by less than 5 per cent in both 1981 and 1982. Manufacturers', wholesalers' and retail stocks dropped by £0.2 bn (at 1975 prices) in Q3 1981 compared with destocking of £1.0 bn in H1 1981 and £1.9 bn in 1980 as a whole.

Unemployment (UK, seasonally adjusted excl. school-leavers) was 2,764,000 (11.4 per cent) at November count, up 36,000 on October. Vacancies rose slightly to 104,000 in November.

Wholesale input prices (fuel and materials) fell $\frac{1}{2}$ per cent in November; the year on year increase fell to $16\frac{1}{2}$ per cent. Wholesale output prices rose $\frac{1}{2}$ per cent and remain 11 per cent above a year ago. Year-on-year RPI increase was 11.7 per cent in October. Year-on-year increase in average earnings was 9.4 per cent in September. RPDI fell by $2\frac{1}{2}$ per cent in Q2 1981 after a $1\frac{1}{2}$ per cent fall in the previous quarter and a 17.5 per cent rise over the 3 years 1977 to 1980. The savings ratio fell 2 per cent to $12\frac{1}{2}$ per cent in Q2 1981.

PSBR £9.5 bn in the first half of 1981/82 and CGBR in April to November - £9.4 bn; but both distorted upwards by the civil service dispute. Underlying PSBR believed in line with Budget forecast (£10½ bn).

Sterling M3 estimated to have increased by ½ per cent in banking November.

Visible trade showed an estimated surplus of £13 million in September and £116 million in October compared with an average monthly surplus of £368 million over the period July 1980 to February 1981. Invisibles surplus in first ten months of 1981 estimated at £2.4 billion. Reserves at end-November \$23.5 bn. At the close on 11 December the sterling exchange rate was \$1.8805 and the effective rate was 89.8.



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PRESS INFORMATION

DIRECTORS CALL FOR A 'WORKERS CHARTER' TO SPREAD BENEFITS OF RECOVERY

Britain needs a 'Workers Charter' of new Government policies designed to give all workers a real share in the coming economic recovery, the Institute of Directors said today.

Walter Goldsmith, IOD Director-General, called for a programme of joint action by Government and employers to link all workers directly with the results of economic upturn and shift economic power back into the hands of the individual.

"In the next two years the Government must emphasise not 'unparalleled austerity' but policies to ensure that the rewards of the sacrifices that have been made are transferred directly into the pay packets of workers and their spending power as customers", Mr Goldsmith told a meeting of businessmen in London.

"Businessmen do not want Mrs Thatcher to change course. What they do, desperately, want to see is the entrenchment of the capitalist system in our society. To achieve a closer connection between individual workers and growing economic success, a new range of policies is required that will challenge in its radicalism both long-established prescriptions and the spurious solutions that are widely offered today"

Among the components of the 'Workers Charter', Mr Goldsmith urged measures to enable workers:

To share in the financial rewards of successful enterprise

- through employers' undertaking not to hold down artificially the pay of workers who have achieved gains in productivity leading to profitability

- through cash incentives to civil servants to introduce more efficient and cost-effective working practices

- through luring moonlighting workers out of the black economy by generous new tax reliefs for those starting small businesses or becoming self-employed

EXTRACT OF A SPEECH BY WALTER GOLDSMITH, DIRECTOR GENERAL OF THE
INSTITUTE OF DIRECTORS
TO A BUSINESSMEN'S LUNCH IN LONDON
THURSDAY 10 DECEMBER 1981

You have invited me to speak to you at a time which is critical for the future economic policies of Mrs. Thatcher's Government, and for that reason critical also for the longer term economic, social and political development of British society.

The policies which are pursued now and implemented over the next two years will settle the balance of the great interests in the economy: they will determine the future shape of the public and the private sectors and their rate of growth.

In our economy some key indicators have consistently pointed upwards and others have now begun to mark the onset of a significant recovery. Export performance and balance of payments have been consistently good. Productivity is now set to rise at about 11% this year. The decline in manufacturing output has been halted and reversed. The level of sterling has settled within a band which would appear to satisfy all but the most extreme advocates of devaluation.

But what many businessmen see to be a significant threat to long-term social stability posed by high unemployment levels remains unsolved; real standards of living are likely to decline in the immediate future as lower wage levels confront continuing high price inflation in the cost of public utility services and the costs, in both charges and subsidisation through taxation, of notoriously unproductive uncompetitive and monopolistic nationalised industries.

We must face the reality that many in Britain are deeply unsettled by both the pace and the effects of the economic

changes that have taken place since 1979. In 2½ years the Government has attempted to put into reverse the accretion of power in the hands of the controllers of nationalised industry, local authorities and the trade union movement which occurred between 1970 and 1976.

The high water marks, with the consequences of which we wrestle today, are the reorganisation of British Leyland and British Steel, the Heath-Walker reorganisation of local government, and Michael Foot's Trades Union and Labour Relations Acts of 1974 and 1976.

To begin to put into reverse the centralisation of power in the hands of these institutions is a major achievement of the present Government. It may be dismissed easily with a facile phrase about one government reversing the policies of its predecessor in a game of swings and roundabouts. But to businessmen who believe in free enterprise it is a success of the most spectacular kind.

A WORKER CHARTER

But now we must turn our attention to the next two years.

Waiting in the wings are those who wish to return to the old ways, who wish to strengthen and renew bureaucratic power with themselves at the pinnacle; and those who seek the transformation to a full-blooded socialist society which amounts to a declaration of war on the free enterprise system.

Making the choice will be Britain's employees: those for whom your businesses are responsible, and their families and dependants.

And where Mrs. Thatcher's government has suffered its most disturbing failure is in its inability to present its policies in a manner which links employees directly to the results of economic upturn.

Nor has it pursued with sufficient radicalism policies geared to make a fundamental and irreversible transfer of ownership of resources in society from the state to the individual worker.

That is why the Institute of Directors is calling today for a second wave of Thatcher policies to share out the rewards of economic recovery.

Norman Tebbit's proposed legislation on trade union reform will restore the balance of industrial power between employers and trade union movement. Now is the time to go further with broader measures to strengthen the rights of individual workers against collectivist power blocs.

In the next two years the Government must emphasise not 'unparalleled austerity' but policies to ensure that the rewards of the sacrifices that have been made are transferred directly to the pay packets of workers and the spending power of customers.

What Britain must see is a Workers Charter in which joint action by Government and by employers will strengthen the vested interest of employees in the free enterprise system by carrying through a decentralisation of wealth and power; and in particular from a sagging public sector to an expanded private sector in which every worker could share.

Businessmen do not want Mrs. Thatcher to change course. What they desperately want to see is the entrenchment of the capitalist system in society. To achieve this closer connection between individual workers and economic success, a new range of policies is required that will challenge in its radicalism both long established preconceptions and the spurious solutions widely offered today.

New policies in bringing ownership to the people. In taxation. In profit-sharing, and share-ownership and asset formation. In wages. In reversing an alarming failure of education and training policy. Giving new incentives for the ownership of property in all forms. Boosting small businesses by more radical measures than those yet employed.

We must not shield the British workforce from domestic and international change but strengthen workers' capability to cope with change from a stronger individual position.

To pursue this Workers Charter would not amount to a U-turn for Mrs. Thatcher's government. It would rather amount to the implementation of the policies the Government was elected to pursue, with overwhelming business and electoral support.

But it would challenge an entrenched bureaucracy in national and local government which has grown fat on the existing way of doing things.

Civil Service Incentives

If the scale of public sector economic activity is to be reduced by a shift of wealth into the hands of individuals it is now a high priority that the vested interest of public officials in the expansion of their empires be countered.

Already, measurement of labour turnover - which alone can identify the non-cash benefits of public sector employment - is being built in to civil service pay determination arrangements.

Now it is time to go further. Civil servants should be given a tangible personal financial interest in the contraction of departmental activity.

It is a rare industrial concern that does not operate a suggestion scheme with cash rewards for the introduction of more efficient and productive working methods. Let us now introduce a Civil Service equivalent: cash rewards for Departmental staff securing cost savings through the better employment of available personnel and cash resources.

Pay and promotion patterns should also reflect these factors.

Let the Comptroller and Auditor-General, with the aid of his professional staff and the assistance of external consultants for specific investigations, now assume a clear role with the responsibility to the House of Commons of monitoring a new regime of civil service economy in which it pays officials

personally to secure the contraction, rather than the expansion, of their administrative establishment.

It is difficult to imagine that the most elementary incentive or monitoring scheme would not, for example, have called an early halt to the empire building of the Manpower Services Commission which has established an unenviable record for profligacy in the setting of Job Centres in expensive High Street locations - 672 by the end of 1980, planned to increase to 1,020 by 1983-4. They work in a system whereby an unemployed worker may often be under the suzerainty of no fewer than three public bodies simply to register as unemployed and collect benefits: the Department of Employment Unemployment Benefit Office at one town centre site, the Department of Health and Social Security in another and the Manpower Services Commission in the third and most affluent.

It is time, too that civil servants at comparatively junior levels were involved more closely in the organisation of their work. Questioned in a significant survey of job satisfaction undertaken by Hugh Livingstone and Roy Wilkie of the University of Strathclyde, higher executive staff showed that dissatisfaction with pay levels was outstripped by over 7 to 1 by dissatisfaction in 'job content'. Significant numbers of civil servants felt underused, or without any sense of challenge; that they were performing a job of no use to anyone; or a general lack of responsibility.

As the authors said, "Our figures almost point too clearly in the direction indicated by the popular and over-simplified view of the nature of work in public bureaucracies".

Civil servants at these level deserve a better deal, a management system more clearly linked to curtailment of functions and greater cost-efficiency of operation.

Wage Levels

But worker perception of pay levels is becoming a significant problem in the private sector of the economy.

It is becoming clear that there is a danger that general calls for wage restraint, especially those involving the use of norms or coded phrases to suggest pay norms, are being overstressed by Government ministers and some business spokesmen.

Of course, I do not deny for a moment the general and demonstrable reality that wage levels have been far greater than accurate measures of productivity and profitability would justify. Wage inflation in the public sector continued at 30% in 1980.

But workers in the private sector are in many cases now beginning to suspect that the effect of a general pay clampdown will be to penalise the efficient and productive. Let us therefore make it quite clear, Government and employers alike, that workers in businesses where productivity and profitability have improved deserve higher pay packets to reward their achievement.

To do otherwise is shortsighted: employers who artificially seek to hold down pay will suffer low employee morale, worsening industrial relations, and skill shortages as employees move to more progressive employers.

Already there are signs, monitored this month by Incomes Data Services, that "very low norms sought by the Government and the CBI are not being followed at company level".

And there is renewed emphasis on productivity bonuses on top or low basic rate increases.

So let us give a clear message to our employees that performance and success will be properly rewarded. Good communication cannot be fostered by talking pay down against improved results.

Britain is a low pay society. We must move rapidly to high performance, high productivity and higher pay rewards.

Incentives to Workers

In many cases the most acceptable means of rewarding improved performance resulting in increased profits will be through cash bonus or incentive schemes.

A Workers Charter will mean employers in companies of all sizes re-examining pay arrangements to consider the introduction of these well-tried and self-policing systems.

Existing profit-share legislation, although fostering a welcome rise in the number of companies operating profit-sharing schemes - the consultants Copeman Paterson have estimated that by 1984 around half the country's quoted companies will have such schemes - artificially limits their effectiveness.

First, the legislation does not provide tax concessions for cash bonuses on employee shares. But a survey by the Industrial Participation Association has shown that over 70% of employees received the bonus in cash. 10% of their employees on average took the shares option.

So a Workers Charter would involve legislation broadening the scope of employee share schemes to give tax relief for shares in businesses outside those employing an individual worker.

Cash bonuses from existing share schemes should be tax-free when used to purchase more shares in other companies. We also need, as has been urged by the Centre for Policy Studies, measures to eliminate stamp duty and simplify transfer arrangements for small parcels of shares.

We want to see individual employees able to buy and transfer shares with the minimum of formality, the maximum tax advantage and the fewest difficulties.

A new system to encourage the use of bearer share certificates would be worth careful consideration. The administrative burden on company registrars would be significantly reduced by this boost to individual share ownership.

Then many private companies wish to reward employees without diluting share ownership. Companies should be permitted to issue employee bonds which would be treated for tax purposes in the same way as shares but would enable control to remain with the company.

It is a false conception of the wishes of workforces to seek to confer statutory powers of co-determination of company policy upon them or - in Britain - upon their representatives in the trades union movement who have signally failed in national terms adequately to reflect their wishes. That is why a true Workers Charter would reject the EEC's 5th, 9th and Vredeling Directives which seek to monopolise bargaining power in industry in the hands of representatives of collectivist bureaucracy.

This does not mean that workers are not fully entitled to have relevant details of company performance communicated to them; to be consulted about changes affecting their own work: to be involved in a wide field of work, extending beyond an individual's own task, where they have a contribution to offer; and where appropriate to individual financial participation in a company's success.

The Institute has called upon its members to introduce formal consultative and communicative procedures in all companies of over 100 employees.

Far more relevant to the British scene, is a dramatic expansion in employee share ownership. A House of Lords Select Committee on asset formation found that only 3.8% of the whole population own shares directly. This is a scandalously low figure.

And the scale of the problem is illustrated more dramatically still, when the same committee found that by January 1981 only 145,000 of a total working population of 24 million employees were covered by employee share schemes.

The need is primarily to increase ownership directly by individuals - not just through pension funds or unit trusts. The French Loi Monory has been examined in Britain time and again. In innumerable submissions to the Treasury the advantages of a simple tax rebate to those who purchase shares in British companies has been stressed. The French experience suggests that the Monory measure led to share purchase by about 400,000 taxpayers who were completely new to share investment. Between £400 and 440m of new funds came to the stock market through the measure.

It didn't stop the election of President Mitterand, but a very significant increase in new shares issues occurred in the first year of the scheme and French firms significantly increased their equity capital.

Workers must certainly not be led to place all their eggs in one basket, in the shares of their employing company, or into wild speculation with the family income. But Mrs. Thatcher and her Treasury ministers must now squarely confront the need to make much faster progress in employee share ownership.

Property Ownership

We must turn our attention, also, to wider questions of property ownership. Mr. Michael Heseltine is, in his inimitable and commendable way, beginning to deal with local authorities which appear to have gone slow on council house sales.

But meanwhile his Treasury colleagues have persisted in failing to amend thresholds of stamp duty on house purchase which have become punitive through property inflation.

It is now urgent, in the interests of property ownership and indeed job mobility that stamp duty thresholds be raised significantly. The Government must follow the lead given by private sector housebuilders who have recognised that stamp duty is a significant disincentive to wider home ownership.

At the same time more dramatic measures are needed to bolster the private rented market and help job mobility.

Let us in a Workers Charter end the fixing of rental levels by rent officers and rent tribunals for new rental agreements as the first move in a phased deregulation of the private rented housing sector.

Nationalised Industry Privatisation

It is no less urgent that the privatisation of nationalised industries proceeds more quickly in a more imaginative manner than has been the case to date.

Not only does the transfer of ownership of nationalised industries to free enterprise offer more secure long-term employment opportunities for workers whose future prospects as state employees are often slimmer than they may think. They are conditional upon the continuing stranglehold upon the taxpayer for subsidisation of their managements and trades unions, and on political whim.

But it tackles the reality that the influence of individual members of the working population is at its weakest when pitted against bodies which, in theory publicly owned, are in practice susceptible to the control neither of their sponsoring Departments, nor of Parliament or their customers.

A Workers Charter will reassert Parliamentary control of nationalised industries by strengthening the statutory powers of their controlling ministers over their board, by extending the role of the Comptroller and Auditor General to allow meaningful public and Parliamentary scrutiny of their financing, and by revamping the system of nationalised industry consumer councils which have failed overall to exercise a sufficiently independent and incisive role as the guardians of the public interest.

Not only are the measures announced by the Financial Secretary to the Treasury of Monopolies Commission examination of nationalised industries once every four years clearly inadequate as a means of supervision of nationalised industries. They have also succeeded in provoking a significant clash between Parliament and the Executive where members of the House of Commons are legitimately concerned at the ineffectual nature of public monitoring and supervision of nationalised industry finance.

In Britain today, what is everybody's is nobody's. We must give ownership back to the people.

So a Workers Charter for the nationalised industries would involve a parallel redoubling of the privatisation drive and a strengthening of the control mechanisms over industries remaining for the time being in the state sector.

In its failure to take up Samuel Brittan and Norman Riley's brave concept of giving North Sea Oil to the people through the distribution of North Sea Oil tax and royalty revenue direct to every UK taxpayer, the Government failed to take up a significant opportunity to move towards people's or workers capitalism.

But there is a need to pursue this line of thinking.

"Why should there not be a more general fund into which the revenues of all the nationalised industries are placed, and in which every citizen enjoys a stake?" asked Brittan and Riley in 1979, pointing out that it would be difficult to decide whether such a move should be termed denationalisation or more genuine public ownership.

It is time that Government looked into these challenging opportunities more carefully.

Let me give an example in the case of British Rail. That public sector organisation has just been bailed out to the tune of £110m for its losses in the last financial year, in addition to the extension of the already subsidised 'social railway'.

At the same time, BR is demanding an additional £5.67 bn of further subsidisation in a 10 year investment programme, its response to appeals from the Secretary of State for Transport to finance further investment internally has been to launch a political advertising campaign demanding more public money, and the fruits of privatisation to date extend to the sale of a mere three railway hotels to a consortium including itself and the railway unions.

Unless this rate of progress improves the Secretary of State should consider more radical measures to restore British Rail to effective public ownership. He could start setting in motion moves to transfer the assets of the British Rail Property Board, of about £700 - 800m, to the people through marketable share or bond certificates sent to every UK taxpayer and saleable through the Giro service at every Post Office, to private sector property and investment company buyers.

By such methods the assets of the British Rail Property Board, the British Gas Corporation, or any other limpets clinging obstinately to the public sector could be transferred to the stock market in a manner which brought home to every taxpayer his individual stake in their ownership.

Little or no published work has been conducted into the mechanics of transferring state industries through true public ownership to the market. But it is a central feature of any effective Workers Charter attempting to secure a wider dispersion of different kinds of property ownership.

Education and Training

The working population of this country has been scandalously ill-treated by our existing educational and vocational training systems.

That is the conclusion any businessman must reach, not merely by the evidence around him but also from a beautifully researched and written study by Mr. S.J. Prais of the National Institute of Economic and Social Research, a paper which has received far too little attention since it was published a fortnight ago.

Comparing, for the first time with the results of official household surveys, the vocational qualifications of the British and West German labour forces, Mr. Prais shows that the proportion of the workforce with intermediate qualifications - apprenticeship, City and Guilds, a full secretarial qualification - is double the British figure in West Germany.

60% of the German workforce falls into this qualified category - and only 30% in the British.

Two thirds of the British labour force have no vocational qualifications compared with a third in Germany, and this level of difference exists almost right across the two economies.

The Germans produce each year between two and three times as many qualified craftsmen as Britain in agriculture, (12,000 as opposed to 6,000) construction (35,000 compared with 14,000) and miscellaneous services such as catering, hairdressing etc (34,000 and 9,5000 respectively).

In its review of recent training legislation (Outlook on Training, 1980) the Manpower Services Commission had not been able even to put together statistics of the number of trainees reaching specified levels of competence.

This NIESR work suggests clearly what many businessmen have long suspected: that Britain's comprehensive education system and vocational training arrangements have signally failed to provide an adequate level of qualified workers in the crucial intermediate qualification area which tends to determine inter-industry variations in productivity levels.

As a part of a new Workers Charter, let us now open a fundamental re-examination of our secondary education and training systems and be prepared to admit that a new generation of specialised secondary technical schools or colleges may offer the most effective means of catching up with our European competitors.

The Government must face the need for an education voucher system to allow parents themselves to influence school curricula.

A lower school leaving age coupled with legislative encouragement of continuing part-time vocational training in the private sector could restore Britain's competitive position in education and training.

Taxation Policy

At base any new contract with Britain's workforce must depend upon the more efficient allocation of resources in society, the reduction of the tax burden upon the individual, and the restoration of individual consumer spending power as the most accurate determinant of profitable investment.

Measures to strengthen individual economic power will fall at the first hurdle unless the basic rate of income tax is reduced step by step to the Government's declared target of 25p in the pound.

The Institute of Directors, in its 1982 Budget submission, has demonstrated that the Chancellor has the flexibility to reduce basic rate income tax by 2p, to 28p; and to trim the rates of capital gains and capital transfer taxes to provide incentive for family businesses, in addition to a 2 percentage point cut in corporation tax.

More radical measures are required to bring home to individual workers the benefits and opportunities of small business activity - whether part-time or eventually full-time.

The Institute calls upon the Government to introduce a clear and unambiguous tax free starter for workers moving for first time into small business activity as a self-employed. A £5,000 tax free starter for the first few years of self-employment would reflect the reality that little tax is payable through the operation of the existing Schedule D system. Making the relief conditional upon prior registration with the Inland Revenue would lure thousands otherwise tempted into the black economy back into the real economy, where they would be free to advertise, to employ people and expand and develop their businesses without the attention of Mr. Ridley's new Inland Revenue anti-tax evasion squads.

Incentives of almost every kind now exists for those who make losses investing new small businesses, or for those who invest under the Business Opportunities Programme in other people's businesses.

We need to see now a Workers Charter in which employees who wish to do precisely what a Government is always urging upon them - to move into the self-employment sector - should have a clear individual tax advantage in doing so.

Employers have a responsibility, also. Many contracts of employment adopt a perhaps unduly restrictive approach to spare time economic activity by employees.

They encourage workers to play darts or drink in the evening, but not to take part in any sideline which might make a small profit pursuing a comparatively enjoyable leisure activity.

Employers should now consider relaxing the terms of employment which could preclude their workers from outside activity in spare time employment or self-employment, and concentrate more narrowly on areas where employees might compete with or otherwise damage the activities of their main employer.

Conclusion

Mrs. Thatcher's Government has reached a turning point in the way in which its relations will develop with the working population which elected it to power in 1979.

The siren voices are now at their loudest, urging ill-considered reflationary economic packages that would weaken rather than improve the economic position of the workers they are supposedly designed to assist. The public sector chieftains, accountable to no-one, are attempting to snatch back the power and the resources which they have seen begin to be returned to people. The manipulators of the trade union leadership similarly hope to grab back their corporate control of Britain's workforce, which has been so decisively rejected by working people themselves.

But, Mrs. Thatcher now has the opportunity to steal the clothes of her opponents. To put capitalism and free enterprise at the centre of the political stage. To fill the empty phrases of British political debate about decentralisation, participation and involvement with a new reality: a Workers Charter that pursues Government economic policy to its declared conclusion by making a fundamental and irreversible shift in economic power in society.

I am confident that she will have the courage to follow this route.

10 December 1981

NEDC Meeting

The Prime Minister was grateful for the Chancellor's minute of 4 December about the proposed meeting of the NEDC which she is to chair on Wednesday 3 February.

The Prime Minister is content with the agenda set out in the Chancellor's second paragraph.

MCS

Peter Jenkins, Esq.,
HM Treasury.

PJ

Covering CONFIDENTIAL

Ewan Pd

PPS/CHANCELLOR

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Mr Salveson (for transmission to No.10)
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PS/Secretary of State for Wales
PS/Lord Privy Seal
PS/Secretary of State for Industry
PS/Secretary of State for Social Services
PS/Secretary of State for Trade
PS/Secretary of State for Energy
PS/Secretary of State for Transport
PS/Chancellor of the Duchy of Lancaster
PS/Secretary of State for Employment
PS/Paymaster General
and officials in HMT, Revenue Departments and
other Departments in Whitehall

TREASURY WEEKLY ECONOMIC BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 30 November, are sidelined.

EB Division
HM Treasury
01-233-3364

for M M DEYES
127

R I G ALLEN
7 December 1981

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A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

Main objectives are to achieve, over a period, a sustained improvement in the economy through reduction of inflation and promotion of enterprise and initiative. Reduction of inflation requires strict adherence to firm monetary and fiscal policies. Improvement of supply side depends on restoration of flexible and competitive market economy and better incentives.

2. Place of 2 December announcements in economic strategy?

Decisions were taken within Government's broad priorities of: need to reduce inflation, control public expenditure, and pursue responsible financial policies.

3. Relative importance given to inflation and unemployment?

Government is equally concerned about both. These are complementary not competitive objectives; unemployment will not be reduced by relaxing struggle against inflation.

4. MTFS no longer plausible?

Not so. Government remain determined to maintain downward pressure on monetary variables so as to keep up progress in reducing inflation. (Will need to judge appropriate fiscal stance in Budget.)

5. Alan Budd's recantation

[Extensive interview with Max Wilkinson, FT 8 December]

Cannot answer for Professor Budd but he has stressed that he has not changed his mind about the Government's overall strategy. Mainly concerned that £M3 no longer can be relied on as a policy indications and that exchange rate should not have been allowed to appreciate in 1980. Government agree that particularly sharp changes in exchange rates can be damaging. And also agree that exchange rate is one factor taken into account in assessing monetary conditions.

6. Expectations for next year disappointing?

[Industry Act Forecast, published 2 December: details for B1]

No. Further falls in inflation in prospect. A rise in output instead of a fall. Good export prospects and current balance will remain in surplus. Admittedly a gradual undramatic recovery, but UK operating in difficult economic environment. Prospects for unemployment depend on a number of factors including competitiveness.

7. Announcements reflationary/deflationary?

Neither. Announcements have to be seen in context of overall fiscal and monetary policies. On conventional assumptions set out the IAF figures point to a PSBR next year broadly in line with 1981 Budget projections. Further decisions relating to 1982-83 and later years may fall to be taken at Budget time.

8. But higher NIC, rent, health charges, inflationary?

[Announcements increase RPI by 0.6 per cent (mainly higher Council rents) and TPI by 1½-2 per cent (reflecting also higher NICs) from next April.]

Irresponsible that those who clamour for increased public expenditure to shirk the realities of financing it.

9. Government has failed to check public spending?

No. Have made positive decision to increase spending in some areas but remain determined to stick to plans once set. This year, cash limits are generally holding; determined to set (and keep to) tight but realistic limits next year. [See also E1.]

10. Tax increases necessary?

Cannot foreshadow Budget. Undoubtedly, higher public spending makes prospects for PSBR, interest rates and burden of taxation next year more difficult. But, as rhF said in his statement, on conventional assumptions figures point to a PSBR next year broadly in line with projections published at time of Budget. Final assessment must await Budget next year. Will need to assess appropriate fiscal stance in light of circumstances at time, including monetary prospects and outlook for inflation.

11. Distributional effects of 2 December statement

NIC increases will take a larger proportion of net income from the better paid, up to the earnings limit. Council rent increases will not be flat-rate because of rebate system: lower-paid get more rebate. Pensions and unemployment and other benefits are planned to increase by more than the expected rise in earnings, implying a redistribution from the working population to the unemployed and elderly.

12. Government has failed to allow accommodation to the recession?

On the contrary. Have been flexible within the limits of prudence over the levels of public spending and borrowing. But experience shows that attempts to "buy" jobs only temporarily beneficial. Repercussions weaken economy and worsen job prospects in longer run.

13. Failure to control monetary growth?

Judged by results rather than precise numbers, strategy successful. Growth of money GDP fallen sharply. Inflation rate halved. Some good features in monetary picture -outturn for PSBR in 1981-82 should be close to forecast; funding programme on track. [Nevertheless, bank lending disturbingly high, particularly personal lending.]

14. Why are high interest rates needed?

Current level of interest rates has reflected developments overseas and strength of bank lending. Although sterling has recently firmed, high level of bank lending continues. However it should be noted that bank base rates have come down by 1½ per cent since September.

15. Government should change course?

(a) Moderate reflation the answer?

[Alternative reflationary packages continue to proliferate: eg NIESR suggested £5 billion in their November Review; £6.8 billion reflationary package proposed by Hopkin/Miller/Reddaway - separate briefing being prepared]

Government has shown willingness to adapt to recession by allowing higher PSBR than envisaged last year. Fallacy that we could "spend our way out of recession" (i.e borrow much more) without seeing resurgence of inflation and undermining financial markets, and, as a consequence, interest rates rising further and faster. Even large reflationary packages like those suggested by NIESR yield relatively small benefits in terms of higher output and lower unemployment.

(b) Reintroduce exchange controls and join EMS?

EMS is not a panacea. But Government does fully support EMS as an important step in monetary co-operation and closer integration in the European Community. Have stated that UK will participate in the EMS exchange rate mechanism when conditions appropriate both for the system and ourselves. Question is kept under constant review.

(c) More capital spending in public sector?

Projects must be economically sound. Not all capital spending virtuous nor all current spending bad. Cost of public sector investment in terms higher borrowing pushing up interest rates could outweigh immediate boost to jobs.

B ECONOMIC ACTIVITY AND PROSPECTS

1. Is recession over?

The fall in output now over. Preliminary GDP output figures for Q3 up $\frac{1}{4}$ per cent on Q2. Manufacturing output increased by $1\frac{1}{2}$ per cent in same period. Q3 figures for manufacturers' and distributors' stocks show rate of destocking reduced by about two-thirds compared with H1 1981. Some improvement in financial position of company sector (see N3). New Industry Act forecast sees resumption of growth.

IF ASKED about decline in CSO's longer leading indicator: Too early to judge significance; recall that temporary weakening occurred in last cycle.

2. Government assessment of prospects

[New Industry Act forecast (2 December) assessed recovery to have begun.

	Increase in 1982 per cent
GDP	1
Manufacturing output	4
Exports	$2\frac{1}{2}$
Investment	$2\frac{1}{2}$

End to destocking. Consumers' expenditure and Government expenditure flat.]

Industry Act forecast sees prospect of some recovery. (Last two Government assessments of economy were broadly correct.) Exports and investment up. Resumption of decline in inflation. Further progress depends on continued moderation in domestic costs and restoration of competitiveness.

3. Outside forecasts

[GDP profile in major forecasts released since June:

	H2 1981 on H1 1981	H1 1982 on H1 1981	per cent
LBS (Nov)	$\frac{1}{3}$	1	
CBI (Nov)	0	$\frac{2}{3}$	
Phillips & Drew (Dec)	0	$\frac{1}{4}$	
OECD (July)	$-\frac{1}{3}$	0	

November NIESR Review contains only annual data, but commentary suggests low point reached in H1 1981, with prospect of some recovery.]

Recent major independent forecasts assess that low point in activity was reached in first half of year, with prospect of some recovery in the coming year.

4. Higher interest rates will abort recovery? Business confidence weakened?

Understand concern over interest rates, but it is absolutely essential to contain inflation. Inflation is inimical to sustainable recovery. Interest rates only one of factors affecting industry. Other costs, particularly labour costs, more important for improved profitability and competitiveness.

5. Recession worse than in the 1930s?

Any such comparisons must of course be subject to a statistical health warning. It is true that the fall in output is comparable to the 1930s, but structure of the economy and society is much changed.

C LABOUR

1. Unemployment continues to rise?

[November total count was 2,954,000 (12.2 per cent) - second consecutive month showing slight decrease. Seasonally adjusted excluding school leavers figure was 2,764,000 (11.4 per cent)]

Unemployment rising much less rapidly. Increase in recent months less than half those at end of last year [44,000 per month in 3 months to November 1981 compared with 115,000 per month in Q4 1980]. Also should note within manufacturing short time working sharply cut -(down $\frac{1}{4}$ from January level), overtime showing signs of picking up and fall in employment much less. Result is that total hours worked have stabilised and now show signs of some pick up. Vacancies improving too.

2. Unemployment accelerating?

[Monthly increases in adult unemployment, seasonally adjusted, in 4 months July-October showed some acceleration, with successively 30,000; 44,000; 46,000; 56,000. November's 36,000 halts this.]

Recent months figures difficult to interpret [due to emergency procedures because of civil service dispute]. Reliability somewhat uncertain. November breaks any apparent trend. Remains the case that labour market indicators are much more favourable than at turn of year (see C1 above). IF PRESSED FURTHER: Unemployment forecasts and assessments always uncertain. What is essential is that all participants in the economy contribute to improved economic opportunities. Crucial to this is further moderation in pay settlements.

3. Employment continues to fall?

[Total employment fell further $\frac{1}{4}$ million in Q2 1981, much the same as in Q1. Total decline since mid-1979 1.7 million or $7\frac{1}{2}$ per cent.]

Decline in manufacturing employment showing signs of further marked slackening in August and September (25,000 compared with about 50,000 per month earlier in year), and 80,000 per month in H2 1980.

4. Government forecasts for unemployment

[Government Actuary's Report published 2 December uses working assumption of an average level of 2.6 million unemployed in Great Britain (excluding school leavers) in 1981-82 and 2.9 million in 1982-83. (222,000 school leavers and adult students in 1981-82, 225,000 in 1982-83).]

Like previous administrations Government does not publish forecasts of unemployment, though Government Actuary Reports etc contain working assumptions. Government is

concerned about unemployment. Scale of special employment measures (SEMs) adequate evidence of this. Prospects depend on further progress on productivity and competitiveness. [See 5 below for independent forecasts.]

5. Independent forecasts?

[Consensus is for medium term rise in "narrow definition" unemployment, reaching about 3 million in Q4 1982.]

History shows unemployment forecasts to be very uncertain (this is a major reason why Government does not publish one). This is reflected in range especially for beyond next year.

6. Unemployment higher than in other countries?

[OECD standardised data show UK Q1 1981 at 10½ per cent compared with OECD average of 6½ per cent.]

Unemployment has been rising sharply in major industrialised countries, given weakness of world economy. In our case we are suffering the cumulative effects of lost competitiveness and low productivity and implications of inflationary pay settlements in 1978-79 and 1979-80 pay rounds. This is why the rise in UK unemployment has been higher than in most other countries, and points to the need to improve productivity and competitiveness.

7. What is the cost to the Exchequer of the unemployed?

[MSC estimate £438 million per 100,000 additional registered, private sector unemployment (similar figure estimated by Institute of Fiscal Studies); when "grossed up" gives £12½ billion for total unemployment. This figure has received much attention eg FT front page 9 November.]

All such calculations depend critically on and are sensitive to exact assumptions adopted eg composition (especially whether public or private sector workers), previous earnings, and benefit entitlement of the additional unemployed. As explained in detail in Treasury's Economic Progress Report for February 1981, cannot gross up estimates by naive arithmetic to give cost of total unemployed - or of resources available for costlessly reducing unemployment. [IF PRESSED: No economy has zero unemployment: Moreover, any major change in policy would have implications for inflation, thereby affecting estimates by changing earnings, prices, taxes and benefits.]

10. Spend money on new jobs rather than unemployment benefit?

Cannot switch employment on and off like a tap. But Government doing a great deal to help. Special employment and training measures currently cover almost 700,000 people at a

cost of over £1,100 million this year. Not easy to assess just how many being kept off unemployment register by SEMs, but Department of Employment estimate at around 345,000.

11. Should spend more, especially for young people?

Next year, Government is planning to spend £2.7 billion on employment programme. Special employment and training measures are a major part of this programme. The increased provision for these measures announced in July totalled some £650 million. In addition, estimated expenditure on redundancy payments has risen by £135 million. The total also includes provision for the further training measures to be announced by the Secretary of State for Employment.

12. Need to improve training at all levels?

Agree. Aim must be both to help individual and strengthen economy by having a better trained workforce. Government has fully endorsed objectives of MSC's New Training Initiative. We shall be making a statement before the turn of the year about role which Government and others can play.

13. Unemployment as bad as in the 1930s?

Comparisons extremely difficult to make. Maximum recorded unemployment in 1930s was just under 3 million; but the labour force has grown by about $\frac{1}{3}$ since, so unemployment rates in the 1930s almost certainly higher than now. One also needs to bear in mind changed social conditions and protection given by the welfare state.

D TAXATION

1. Burden of taxation

[Total taxation in 1978-79 was 35 per cent of GDP (at market prices), 36½ per cent in 1979-80, 38 per cent 1980-81. It is forecast to be 40 per cent in 1981-82.]

This has inevitably increased during a time when national production has not been growing. But, for the vast majority, real personal disposable income is still higher than for most of the period when the Labour Party was in Government. Recent OECD report showed that the Government's total 'take' (by way of taxation and national insurance contribution) as percentage of GDP is less than in many other industrial countries - UK eleventh in OECD rankings, behind most other EC countries, including France and W Germany. [NB: HMG's position is that national insurance contributions are not a tax - compare F5].

2. What are implications of 2 December announcements for 1982 Budget?

Cannot anticipate Budget decisions which will be taken in light of circumstances at the time. In spite of higher projected level of public expenditure, as rhF the Chancellor said in his statement, we have no reason to depart from the projections for the PSBR published at the time of the last Budget. Other factors will also be important, including monetary targets and outlook for pay and inflation.

3. Government policy has harmed incentives?

Marginal rates of income tax for most taxpayers lower than when the Government came to power. Basic rate still 3p below rate inherited from Labour.

4. Reduce National Insurance Surcharge?

Well aware of view of many in industry that a reduction in NIS would be greatest help. But could not prejudge Budget judgment both on whether could afford tax relief on that scale and on whether a reduction in NIS should have priority. But position of employers was taken into account to load increase in National Insurance contribution on to employees.

5. NIS burden in fact increased?

True that as in previous years increase in earnings limits for NICs will also apply automatically to NIS. But increase in upper earnings limits is expected to add only £47 million (in 1982-83) to NIS burden (which is expected to total £3.8 billion this year). Major part (£225 million) of increase expected in NIS burden in 1982-83 will arise solely from increase in earnings.

6. Heavy fuel oil duty

Costs involved mean that it would not be in the national interest to go beyond the Budget decision not to increase the duty in heavy fuel oil. Terms of North Sea gas contracts a commercial matter for the British Gas Corporation.

7. Revenue shortfall in alcohol and tobacco duties due to Budget increases?

[Stockbrokers' comments widely reported 1 December. Detailed briefing was provided to pm 2 December.]

Revenue estimates complex, and open to wide margin of error under normal statistical conventions, given that yield from duties is over £6000 million. Outsiders' estimates contain internal inconsistencies. Budget increases did no more than restore real value of duties to mid-1970's position - when allowance made for inflation.

8. Progress with examining corporation tax structure?

[Promise to re-examine corporation tax structure in 1980 Budget Speech]

It is hoped to produce the Green Paper on corporation tax this winter.

9. Progress so far on tax reform/simplification?

[As in CST's speech 18 November]

Substantial progress has already been made in improving incentives and simplifying the tax system, eg switch from direct to indirect taxes in 1979, correction of worst features of Capital Transfer Tax, improvement in Capital Gains Tax and Development Land Tax regimes, introduction of Business Start Up scheme etc. But reform of the tax system must be pursued within a financially responsible framework.

10. North Sea fiscal regime?

See R3.

E PUBLIC EXPENDITURE AND FINANCE

[The Chancellor announced main decisions for public spending 1982-83 on 2 December. Main increases on programmes are for local authority current expenditure (£1.3 billion), employment measures (£0.8 billion), defence (£0.5 billion) and finance for the nationalised industries (£1.3 billion). Increases will be offset in part by general reduction in most cash limited expenditure and by specific cuts - including increases in prescription charge and other health charges. Planning total for next year will be in the region of £115 billion against £110 billion for the White Paper revalued.]

1. Further announcements?

Full details will be in the White Paper to be published at the time of the Budget.

2. 1981-82: Overspending?

[Outturn for the current year is expected to be in the region of £107 billion against £104½ billion in the last White Paper.]

Spending is expected to be higher in 1981-82 than was planned in the last White Paper. The major reason for this is the present level of spending by local authorities.

3. Fall in real terms?

We have increased cash provision for next year. In real terms this means that spending next year will be broadly at level planned for this year.

4. Failure to cut spending?

Necessary to take account of changing circumstances and the needs of programmes. The discussions of public expenditure this autumn have been about the extent to which it would be appropriate to increase spending and about the extent to which the increases we have agreed upon should be offset by reductions elsewhere so as to limit the overall increase in spending.

5. Implications for tax and monetary policy

A matter for the budget. But a high level of spending does mean taxation higher than it would otherwise be. The alternative would be more borrowing and higher inflation and interest rates.

6. Capital spending has been cut to allow more current spending?

Cash provision for capital expenditure has been cut from levels planned before. But most of reductions are on programmes where keen tendering will mean that cash reduction will not

prevent programmes being broadly maintained at previously planned levels. Expenditure is planned by programme, not type. Therefore changes reflect priorities among services, not primarily choices between capital and current.

7. Number of cash limits breached last year?

In aggregate, central government voted cash limits in 1980-81 were underspent by just over 1 per cent. There were 6 individual breaches of cash limits (4 on central government and 2 on local authorities) compared with 13 in 1979-80, and amounts involved were marginal. A full statement of provisional outturn of spending compared with cash limits in 1980-81 was published as a White Paper (Cmnd 8437) on 4 December.

8. Position on 1981-82 cash limits?

Provisional outturn figures for first half year were published with Winter Supplementary Estimates in Financial Secretary to the Treasury's note on 4 December. Central government cash limited expenditure overall is on course. For a number of individual cash limits expenditure was well in excess of profile for first half year. In many cases the excess is due to a shift on timing of expenditure and/or receipts; in other cases there have been cash limit increases. In remaining cases position is being discussed with relevant departments to ensure that corrective action, if necessary, can be taken in good time.

9. Should cut current not capital/Cut current to allow more capital spending?

The Government's objective is, wherever practicable, to give priority to worthwhile capital projects providing this involves no overall increase in public expenditure. Must not oversimplify distinction between current and capital spending. Capital expenditure frequently necessitates additional current expenditure which it is difficult to accommodate at a time when our main objective is to contain the overall level of public expenditure.

10. Public spending overwhelmingly on administration?

[90 per cent figure quoted by some critics]

Not all current expenditure is on administration. One-third is current payments such as money paid out to old age pensioners, and the unemployed, child benefit and so on. One-fifth is for purchase of goods and services, for example for defence. One-tenth is grants such as overseas aid and subsidies. Only a third of current expenditure is on wages and salaries, and much of that is for nurses, teachers, policemen, soldiers and so on. We made it clear in the White Paper, Efficiency in the Civil Service, (published last July) that the Government is seeking ways of improving efficiency and cost consciousness in the Civil Service.

11. Cut staff numbers in public services?

Numbers in public service have already fallen since we took office. Civil Service has been reduced by over 7 per cent to 679,800. This is the smallest for over 14 years and we are well on target to achieve our aim of having 102,000 fewer staff in post in April 1984 than when Government came into office; this will be smallest Civil Service since the war. Local authority manpower has been reduced by nearly 70,000 (over 3 per cent).

12. Moves to cash planning announced in Budget mean that Plowden system is being abandoned?

Government does recognise case for medium term planning. But it must be planning in relation to the availability of finance as well as in relation to prospective resources. Illusion to suppose there can be unconditional commitment to forward plans for services.

13. Ratio of public spending to GDP is getting back to the peak levels of the mid 1970's?

The ratios in 1980-81 (44½ per cent) and 1981-82 (45 per cent forecast) remain below the level of 1974-75 and 1975-76 (46½ per cent in both years). The large rise from 41½ per cent in 1979-80 is partly because of the "relative price effect" and partly because the volume of expenditure rose at a time when real GDP has fallen.

LOCAL GOVERNMENT

14. Spending plans for 1982-83?

We accept that it will not be practicable for local authorities to eliminate all their present overspending in a single year, and therefore propose to increase our plans by £1.35 billion. As a result, target is both reasonable and realistic.

15. Cut in RSG percentage will mean large rate increases?

Not at all. Must look at combined effect of increase of £1.35 million in plans and RSG percentage. If local authorities budget to spend in line with Government's plans, rate increases should be very low. Where they are high, it is because local authorities have chosen to overspend. [If pressed for a figure: Predictions of average rate increases are very unwise as any average figure rapidly becomes a minimum. Impossible to give a meaningful figure because of enormous variation in local authorities' spending intentions.]

16. Government plans too severe/too weak

We have accepted that it will not be practicable for local authorities to eliminate all their present overspending in a single year. We have therefore increased plans by £1.35 billion.

As a result targets will be both reasonable and realistic. (Too weak): but this does not mean we have conceded defeat. Substantial economies will still be required as plans allow only about 2 per cent more cash spending than latest budgets for this year. Pressure to curb overspending through RSG system and otherwise will be maintained.

17. Increased burden on industry?

Very conscious of harmful effect of large rate increases. But remedy lies with local authorities. Realism of Government's plans means that there is no need for high rate increases. [If asked: Green paper on Domestic Rates will soon be published and will discuss implications for non-domestic rates.]

18. Scotland and Wales?

Plans have also been increased. Rate increases will be very moderate if local authorities budget in line with Government's plans. [If pressed: Rate increases in Wales will be lower because overspending this year is much less.]

19. Measures to combat overspending?

We will continue to exert pressure through RSG system and otherwise to curb overspending. Pressure will be greatest on high spending authorities.

20. Rates: alternatives?

A Green Paper on alternatives to domestic rates will be published later this month.

F SOCIAL SECURITY

1. Increase in employees' national insurance contributions?

[Chancellor and Social Services Secretary announced on 2 December 1 per cent increase in employees' national insurance contribution from 7.75 per cent to 8.75 per cent to be made from April 1982, as part of review of National Insurance Contributions. Increase will help increase TPI from April - J4. Bill to implement this published on Thursday 3 December].

An increase in contributions was necessary to pay for increased benefit expenditure (notably retirement pensions), increased redundancy payments and to maintain expenditure on the health service. Relative share of these costs met by employers has increased in recent years; we considered it essential to avoid placing this additional burden on them. Employers will still be bearing a higher proportion of the burden than they did ten years ago.

2. What about Treasury Supplement?

[Bill also provides for a 1½ per cent reduction in the Treasury Supplement - from 14.5 per cent to 13 per cent].

Treasury Supplement represents only one part of cost of benefit expenditure met by the general taxpayer. If all such expenditure taken into account, general taxpayer still be funding a higher proportion of benefit expenditure next year than this year - and substantially more than a few years ago. Not, therefore, unreasonable for contributors, rather than general taxpayer, to meet these extra costs.

3. Burden on employers?

We have avoided making any increase in employers' rate of contributions. Some increase in cash burden is, however, inevitable simply because of higher earnings. In addition, Upper Earnings limit has been raised by £20 to £220 - which adds a relatively small additional cash burden. Real burden should, however, fall slightly, to add to slight fall in their real burden expected this year.

4. Balance on the Fund?

We are budgeting for a very small deficit (£9 million) this year. The accumulated balance in the National Insurance Fund is of order of £5 billion. This may seem large as a proportion of expenditure; it has, however, been falling, and now represents about 13 weeks benefit expenditure - as compared with 25 to 30 weeks ten years ago. We think it would be unwise to allow the balance to fall further.

G PUBLIC SECTOR BORROWING

1. PSBR in 1981-82

[Industry Act forecast published 2 December shows PSBR in 1981-82 was £10.2 billion; PSBR in April - September was £10 billion]

The Civil Service dispute has greatly affected the PSBR so far this year, but the underlying PSBR looks to be in line with the Budget forecast of £10½ billion.

2. Effect of civil service dispute on CGBR

[CGBR April-October was £9.2 billion. NB. April-November figure published Wednesday 9 December will be around same level.]

The shortfall of net revenue outstanding at the end of October from the start of the dispute was around £5½-6 billion. £¼-1 billion of this shortfall affected March; the remainder this financial year. Interest costs on the additional borrowing caused by the dispute are over £¼ billion.

3. Will the Government be able to collect all delayed revenue this financial year?

Some revenue is expected to be outstanding at the end of March.

4. Public expenditure likely to overrun this year?

[On 2 December, Chancellor referred to £107 billion - £2 billion above Budget time plans.]

It is too early to be certain what the outturn for the current year will be. The local authorities are, admittedly, spending above the Government's plans. We are taking measures to deal with that but these measures cannot be effective this year. Expenditure which is under the Government's direct control is running broadly according to plan in total.

5. Recession means that PSBR should be higher, not lower?

In my rhF's Budget statement earlier this year he explained that this year's PSBR would be larger on account of the recession. But experience shows that attempts to buy jobs with reflation simply fuel inflation and quickly have to be reversed. Our policies are designed to cut inflation and secure a sustainable improvement in output and employment.

6. What are implications for next year's PSBR of 2 December statement?

No decisions have yet been made on 1982-83 PSBR. Must await Budget. But on conventional assumption, set out in Industry Act Forecast, figures point to a PSBR next year broadly in line with 1981 Budget projections. This means PSBR is expected to decline as proportion of GDP (even before taking account of revenue delayed by civil service dispute).

H MONETARY AND FINANCIAL POLICY

[NB. November EM3 figure to be released Tuesday 8 December.]

1. Why is Bank of England appearing to brake the fall in UK interest rates when rates overseas, particularly in US, have fallen rapidly?

[US 1-month rates have fallen about 5½ per cent over past two months: UK rates by 2 per cent over same period.]

Of course we want to see lower rates. But must proceed cautiously if we are not to let up in the fight against inflation. Clearing banks have already reduced base rates by 1½ per cent from their peak. But wrong to think that rates could safely drop much further in near future without potentially dangerous consequences for inflation.

2. Why so much emphasis on cutting PSBR if efforts undermined so easily by high overseas rates and rapid pace of bank lending?

Interest rate decisions must take account of all potential risks of inflation. If we had not reined back the PSBR, interest rates would be still higher.

3. The death knell for the recovery?

Agree that higher interest rates will increase difficulties of industry. But companies' financial position generally much stronger than a year ago. No purpose served by allowing higher inflation, whether due to falling exchange rate or credit-financed consumer spending.

4. Two tier system of interest rates?

Not practicable in highly sophisticated financial market like UK's. Very difficult to prevent money borrowed at lower rate being on-lent at higher. A lower rate for specified borrowers would require extra Government subsidy which would push up borrowing or require cross-subsidisation by the banks. In either case the level of interest rates to other borrowers would be increased.

5. Will there be an overshoot of money supply?

[EM3 increased by 1.7 per cent in banking October, bringing recorded increase in first eight months of target period to 12½ per cent. Position remains seriously distorted by effect of civil service dispute and aftermath. Advice below is based on Industry Act forecast.]

Recorded figure for target period as a whole may be somewhat above top of target range. But too early to say by how much. Interpretation of recent figures very difficult because of civil service strike distortions. Some good features in monetary picture: 1981-82 PSBR

should be close to forecast; funding programme is on track. But bank lending is disturbingly high, particularly personal lending.

6. When will the strike distortions be eliminated?

[NB. November money figures release should refer to substantial recovery from strike in banking November.]

Distortion will continue for some months yet. It increased again in banking October as Customs & Excise made VAT repayments more rapidly than they recovered outstanding VAT. Customs & Excise have been giving priority to refunding businesses affected by the strike. But recoveries by Government are now exceeding repayments.

7. Status of MTFS if money supply overshoots for second year running?

MTFS remains basic framework of Government's economic policy. But as Chancellor said in Budget speech, also take account of other monetary indicators as well as sterling M3. Will continue to maintain steady but not excessive downward pressure on monetary aggregate.

8. But increase in bank lending not inflationary: house prices stagnant, retail sales flat or falling?

Very hard to distinguish upward pressure on prices due to bank lending from downward pressure due to other factors, especially falling real personal disposable incomes. Effect of higher bank lending will not be felt on prices immediately, but only with a lag.

9. Ceilings on non-priority bank lending?

In UK's complex financial system, ways would be found of by-passing credit controls. Any improvement to money figures would prove to be cosmetic. Would create distortions and inhibit competition between banks.

J PRICES AND EARNINGS

1. Inflation has increased under this Government?

Considerable progress has been made in bringing down inflation from a peak of 21.9 per cent in May 1980 to 11.7 per cent in October.

2. Inflation back on a rising trend?

[Year-on year rate of inflation rose to 11.7 per cent in October compared with 11.4 per cent in September and lowest recent level of 10.9 per cent in July. Effect of mortgage interest increases estimated at around $\frac{1}{2}$ per cent on RPI in November, some $\frac{2}{3}$ per cent in December.]

Progress on inflation has been affected by the fall in the exchange rate, and the rise in the mortgage interest rate will affect the RPI. We expect further progress in reducing inflation, but the timing is of necessity uncertain.

3. Industry Act forecast (12 per cent by Q4 1981; 10 per cent Q4 1982)

Progress in reducing inflation has been hindered by fall in exchange rate, and by higher mortgage interest rates. Government is confident that downward trend in inflation will be resumed.

4. Effect of 2 December measures on RPI/TPI?

[Measures include 1 per cent increase in employees' NIC, higher prescription charges, and council house rents.]

Effect of measures on RPI will be roughly 0.6 per cent from April 1982 [reflecting mainly increase in council house rents; higher prescription charges will have negligible effect]. Effect on TPI will be $1\frac{1}{2}$ -2 per cent from April 1982 [reflecting also higher NICs.]

5. Nationalised industry prices

Nationalised industry price rises have been due in substantial part to the ending of the previous Government's policy of artificial and distortionary price restraint. The rate of nationalised industry price rises is now coming more closely into line with the RPI.

6. TPI

The fact that the TPI has been increasing faster than the RPI ($3\frac{1}{2}$ per cent faster over the year to October) reflects the measures which have been taken to restrain Government borrowing, which is essential if inflation is to be controlled.

7. A 4 per cent pay policy?

The 4 per cent factor announced on 15 September [for calculations in Public Expenditure Survey] is not a pay norm. It is a broad measure of what the Government thinks reasonable and can be afforded as a general allowance for increases in pay, at this stage of fixing the programme from which the public service wage bill has to be met.

8. Does the 4 per cent apply to the Civil Service?

The 4 per cent factor does not imply that all public service pay increases will or should be 4 per cent. Some may be more; some less. [IF PRESSED: In response to enquiries from the civil service unions, they have been told that the assurance they were given earlier in the year about next year's pay negotiations are unaffected by the announcement of the 4 per cent factor.]

9. Public sector ignoring 4 per cent policy?

[Firemen have now settled at 10.1 per cent; NUM have rejected revised offer worth 7.3 per cent on earnings; and water manuals have rejected 7.8 per cent on earnings]

Pay negotiations in local government and the nationalised industries are a matter for the parties concerned, as are the financial consequences of any settlements reached. There is no pay norm. What we need are settlements which are consistent with maintaining economic recovery and improving employment prospects. [NB Not enough settlements so far in private sector to comment on trend there.]

10. Government aiming to cut living standards?

Government seeking to create conditions for sustained improvements in living standards. This requires creation of more competitive and profitable industrial sector. Means that less of increase in nominal incomes should be absorbed by higher pay. The lower the level of settlements, the greater the headroom for output and employment to expand.

11. Average earnings index

[Drop in year on year growth from 12.8 per cent in August to 9.4 per cent in September may attract attention, though (unpublished) underlying increase unchanged at 11 per cent]

I very much welcome the sharp reduction in pay settlements which has been achieved over the past year. Further moderation in settlements can only be helpful in maintaining jobs and getting inflation down.

12. Comparison of TPI and index shows that real take-home pay has fallen over the past year

Yes. But follows growth of 17½ per cent in personal living standards in three years 1977-80.

13. Layard's wage inflation tax?

Like any other attempt to rely on incomes policy, Layard's proposal (picked up by SDP) would entail all the familiar problems of setting norms and interfering with market forces. Experience gives no encouragement to the idea that incomes policies can be made to work on a permanent basis. They always succumb to the distortions they create.

14. Index-linked pensions and the Scott Report?

We are considering question of index-linking of public service and other public sector pensions, including the question of contributions made by public servants for their pensions. Changes in these arrangements could produce further savings in due course.

K BALANCE OF PAYMENTS

1. Trade figures for October

The October figures show that the current account continues in surplus. Exports have performed much better than many people expected and held up well. Imports have recovered from the depressed level at the start of 1981. This is consistent with a slowdown in destocking and recovery in output.

2. Exports

Export volumes in September/October have held up well under difficult circumstances, despite sluggish world trade and earlier losses of competitiveness. Export orders for British engineering industries show a 40 per cent increase since the summer.

3. Imports

The increase in import volumes confirms recent evidence of slowdown in destocking, and recovery in output. Import volumes are 16 per cent higher than in the first four months of 1981 but are only 1 per cent higher than in 1980.

4. Invisibles

Invisible earnings continue in substantial surplus and are likely to rise to about £200 million a month in the fourth quarter of 1981 due to budget refunds from the EC.

5. Capital flows

The net capital outflows in 1981 Q2 was about £1.9 billion compared to over £3 billion in 1981 Q1. These capital flows represent overseas investments which will provide a valuable source of overseas income in future years. There is no evidence that outflows deprive UK firms of capital to invest.

L FOREIGN EXCHANGE, RESERVES AND IMF

1. Sterling still too high?

[Since July sterling has remained broadly stable against the dollar but has depreciated against the Deutschemark due to a slacker oil market and improved German current account. Recent "lows" have been \$1.77 on 14 September, DM4.07 on 20 October. Rates at noon on 4 December were \$1.9505; DM4.33 and an effective rate of 91.9. Reserves at end November stood at \$23.5 billion, compared with \$23.2 billion at end October]

Our policy is to allow the rate to be determined primarily by the balance of market forces. The effective exchange rate is only slightly higher than when the Government took office. Manipulating the rate is no answer to problems in the real economy.

2. Has the Bank intervened to support the rate?

The Bank intervene to smooth excessive fluctuations and preserve orderly markets. They do not seek to maintain any particular rate.

3. Does the Government have an exchange rate target:

No. As my rhF the Chancellor told the TCSC in July 1980, it is very difficult to make judgments about the 'right' level for the exchange rate or to resist strong market trends That continues to be the Governments' view. However, the Government is not indifferent to exchange market developments: account is taken of the level and movement in the exchange rate when taking decisions on interest rates.

4. Sterling should join the EMS?

[See M13]

5. Exchange rate and competitiveness?

I welcome the improvement in UK cost competitiveness of perhaps 10 per cent so far this year. This is partly due to a decline in the exchange rate; more importantly because there are signs that our domestic unit labour costs are now growing more slowly than those of our major competitors.

6. Debt repayments

We have made substantial progress with our plans to reduce the burden of external debt substantially during this Parliament. We have now pre-paid the \$2.5 billion Eurodollar loan and are continuing with other scheduled repayments. By end of 1981, total official external debt will be reduced to around \$14 billion, compared with over \$22 billion when the Government took office.

M EUROPEAN MATTERS

MEMBERSHIP OF EUROPEAN COMMUNITY

1. Follow-up to European Council?

Further work concentrating on four issues - problems arising from Community milk surplus; support measures for Mediterranean agriculture; limiting spending on agriculture; and the Budget problem. Foreign Ministers to meet and report back to Heads of Government.

2. Net UK contribution to community too high?

A lot lower than it would have been without the refund agreement of 30 May last year.

3. Lower Commission estimates of net contributions in respect of 1980 and 1981?

We are examining the new Commission estimates. If our adjusted net contribution in respect of 1980 and 1981 turns out to be lower than expected, that is very satisfactory, because the 30 May Agreement left us paying a large net contribution even though we are one of the poorer Member States. The problem of 1982 and later years remains to be solved.

4. Budget refunds reduced if net contribution less than originally estimated?

The UK is clear that the minimum net refunds payable under the 30 May agreement are 1175 million ecus (European Currency Units) for 1980 and 1410 million ecus for 1981.

5. Do supplementary measures grants lead to additionality?

There is additionality in that refunds enable public expenditure in the regions and elsewhere to be higher than would otherwise have been possible.

6. Policy for CAP reform

Key measures are price restraint, curbs on surplus production and strict control of the growth of guarantee expenditure.

7. Costs of CAP to UK consumers

My rhF, the Minister of Agriculture, has dealt with a number of questions on this. Costs to consumers of the CAP as such depend on nature of alternative support system that is envisaged. Arrangements leading to a reduction in the cost of food to the consumer could well involve increased costs to taxpayers.

EUROPEAN MONETARY SYSTEM

8. What is the current attitude of the UK Government?

We fully support the EMS, and acknowledge the contribution which it has made to stability in the exchange markets. However, we do not yet feel able to join the exchange rate mechanism. We must wait until conditions are right for the system and for ourselves.

N INDUSTRY

1. Recent increases in interest rates - damaging for industry and investment?

(Each 1 per cent in interest rates raises interest payments on industry's borrowing by around £250 million.)

Government believes best way it can help industry and promote investment is to create a climate in which business can flourish. Essential to get rate of inflation down so as to create a stable environment for business decision-taking. Recent rise in interest rates must be seen in context of priority attached to reducing inflation and need to control growth in money supply underlying the MTFs. (See brief H).

2. Prospects for industry - recovery?

Encouraging evidence that fall in output has now come to an end. Too early to talk about recovery: but index of manufacturing output rose 1½ per cent in the third quarter with chemicals and engineering performing particularly well.

3. Company sector finances improved?

[Gross Trading Profits of industrial and commercial companies (ICCs) other than North Sea activities net of stock appreciation were around £3¼ billion in Q2 1981 for third successive quarter. Borrowing requirement of ICCs has improved over last year, and financial deficit turned into surplus. DOI's latest survey of company liquidity (published 4 December) shows further marked improvement in third quarter (particularly in manufacturing) bringing liquidity ratio back to 1979 Q3 level. NB figures difficult to interpret, however, particularly because of uncertain impact of CS dispute].

Figures mildly encouraging (but not wildly so). Company financial position is in any case confused by effects of civil service dispute. After adjustment for stock appreciation and excluding North Sea, ICC profits have stabilised since mid-1980. Improvement in financial position partly reflects destocking and action to reduce overmanning.

4. Industries' claim that 2 December package adds £600 million to employers' costs?

[Higher NIC £200 million; higher rates £400 million.]

In real terms burden of NIC/NIS on employer's likely to fall in 1982-83, for second year in succession. And company sector now in much stronger financial position than a year ago, partly through Government policies to switch fiscal burden.

SMALL FIRMS5. Government help for small firms

Over 70 measures taken which help important small firms sector: in particular the Business Start-Up Scheme, the pilot Loan Guarantee Scheme, the Venture Capital Scheme, and reduction in the burden of small firms' corporation tax.

6. Response to Loan Guarantee Scheme?

Scheme has got off to very good start. We have already issued more than 1500 guarantees - well over half to new businesses. Total lending under scheme is already over £52 million. Substantial demand for loans has led the Government to double this year's lending limit under the scheme. Ten new banks were admitted to the Scheme in November: a total of twenty-seven financial institutions are now participating.

ENTERPRISE ZONES7. Progress with setting up Enterprise Zones?

Excellent progress being made. Ten of the eleven zones are already in operation. We expect the final zone - Isle of Dogs - to come into operation early next year.

8. Response from private sector?

Initial response has been very encouraging. Many new firms are setting up in the zones, existing firms are expanding their activities and vacant land has been brought into use. Too early to assess success of zones.

P NATIONALISED INDUSTRIES

EXTERNAL FINANCING LIMITS

1. EFLs for 1982-83?

Despite constraints on public expenditure as a whole, Government has recognised the problems faced by the industries in a period of recession and has increased provision for 1982-83 by £1.3 billion cash. This is larger than the increase in any individual Departmental programme.

2. Pay assumptions?

Government does not set a uniform pay assumption for the industries. But industries' own assumptions have been discussed, and external financing limits have been set on assumption that reasonable settlements will be reached. Moderate pay settlements -and restraint of current costs generally - essential if investment programmes to be maintained and prices to consumers kept down.

3. Government simply forcing financing burden on to the consumer, ie through higher prices?

Some further prices rises have been assumed in reaching decision on EFLs as in previous years. Should be possible to avoid large real increases experienced in 1980-81, but this will require continuing effort to keep down current costs, particularly pay.

4. Why not give British Telecom more?

The £340 million EFL is still relatively large, particularly for a profitable industry. Ministers will be looking to British Telecom, as to others, to make a substantial contribution through reduced costs. There could be a higher figure if the bond proves feasible.

5. Government still cutting back the industries savagely?

Not so. The industries made very large original bids for additional external finance in 1982-83, totalling about £2.5 billion, in their medium-term financial plans presented to the Government in early summer. This would have brought their total external finance to around £4 billion. The agreed increase of £1.3 billion is roughly halfway between the industries' original bids and the White Paper figure.

INVESTMENT

6. Current year?

Last Public Expenditure White Paper showed nationalised industry planned investment 15 per cent higher in real terms this year than a year ago. Quantity of investment frustrated by tight EFLs is less than often implied. TSSC report published in August estimated in range of £250-500 million this year.

7. Future years?

Investment approvals for the years 1982-83, 1983-84 and 1984-85 have yet to be settled. They will be communicated to the industries in due course and will be published in the forthcoming Public Expenditure White Paper.

8. But announced EFLs for 1982-83 will make it hard for the industries to keep up their investment?

The industries should be able, in total, to maintain broadly the same level of investment in 1982-83 as planned in the last White Paper, despite lower revenue, with higher investment in important industrial priorities, eg telecommunications. This will enable the 15 per cent real increase over the 1980-81 level, which was included in the 1981-82 plans to be sustained. These plans, in turn, represented the highest real level of investment in the industries since 1975-76.

9. Take nationalised industry investment out of the PSBR?

Since nationalised industries are part of the public sector, their borrowing - for whatever purpose - must by definition form part of the public sector borrowing requirement. The real problem of pressure on resources cannot be solved by changing statistical definitions.

10. Private finance for NI investment?

(The NEDC Working Party's study of nationalised industry investment was discussed at the Council's 5 October meeting; agreed that there should be a review of progress to be completed by June 1982]

We have indicated our willingness to consider new financing proposals, most recently in the context of the review carried out by the NEDC Working Party. But direct market finance can only be justified if there is a genuine element of performance-related risk for the investor, in order to improve incentives to management efficiency, and if new forms of saving are tapped, so as to avoid adverse monetary consequences. Market financing does not of itself reduce the PSBR, nor does it lessen the burden on financial markets.

11. Status of proposed British Telecom bond. If agreed, will this bond be outside PSBR and relevant EFL?

No. This is borrowing by a public sector body, thus public sector borrowing. The Government, with its overall responsibility for BT's finance, must continue to place limits on its external finance. But we have agreed that announced EFL of £340 million be somewhat larger if agreement is reached on a bond.

12. What problems have delayed the expected announcement? Does proposal meet criteria set out in the NEDC Working Party Report?

[Two criteria:- extra cost must be justified by pressure for greater efficiency; terms of investment won't involve unfair competition with private sector].

An intensive effort has been made to conclude this question, in the context of the public expenditure exercise and the decision on BT's EFL for 1982-83. Certain problems remain to be resolved before a decision can be taken.

[IF PRESSED: They are:-

(a) Cost to BT of the borrowing - will be greater than gilts, but the Government and BT must be sure that this will be justified by the contribution the bond makes to pressures for improved efficiency and profit.

(b) BT's pricing policy - some arrangement is needed to assure investors that BT's profits would not be constrained by the Government's holding prices down. But Government must protect consumers as well as investors. This is an industry where prices ought to fall in real terms, because of technological advance, ie to rise by less than the RPI. We have not so far been able to agree on a formula to deal with this]

13. Finance more nationalised industry investment by cutting current spending?

Yes. In particular, moderate pay settlements are essential. The ability to finance new investment in the nationalised industries is bound to diminish if excessive pay settlements are agreed.

14. But you cannot finance much investment by cutting current costs alone?

Not true. Each 1 per cent off wage costs would save about £125 million per annum; and each 1 per cent off total costs saves £300 million.

NATIONALISED INDUSTRY PAY AND PRICES

15. Nationalised industries' prices have risen more rapidly than RPI?

True over last year or so, while adjustments from artificial and distortionary price restraints introduced by the Labour Government were working through the system. Unwelcome but inevitable: the only alternative is an increased burden on the taxpayer and a distortion of market forces.

16. What is happening now?

Nationalised industry price increases are falling relative to the RPI (14 per cent above in year to January, 3 per cent above in year to October). Fully expect them to come closer to RPI in next few months.

17. And the future?

Better price performance depends on improvements in efficiency and control of current costs, particularly pay. We are determined to see those improvements brought about. Privatisation and increasing competition have an especially important role here.

PRIVATISATION

18. The Government simply selling valuable national assets to achieve PSBR target?

Of course, the cash is welcome, but the benefits run wider than that. Not only will the main financial benefit be that future borrowing of these undertakings will be outside the PSBR and no longer burden the taxpayer, but the organisations concerned will be made responsive to market forces and thus have greater incentives to improve efficiency.

19. Does the Government have more privatisation plans to announce?

Legislation already passed to enable public to hold equity stake in British Airways, British Transport Dock Board, subsidiaries of British Rail; and to dispose of some of British Telecom's peripheral activities. We shall be announcing further measures in due course.

R NORTH SEA AND UK ECONOMY

1. Benefits of North Sea should be used to strengthen the economy?

[Direct contribution of North Sea oil and gas to GNP is estimated to rise from 3 per cent in 1980 to about 5 per cent in 1984; expected contribution to Government revenues estimated at £3½ billion in 1980-81 and £6 billion in 1981-82 (at current prices). Less susceptible of measurement is boost given by North Sea to local employment and to industry in offshore equipment].

Yes. Government's strategy derives greatest possible long-term benefit from North Sea. Revenues ease task of controlling public borrowing. This will help to achieve a lower level of interest rates to the benefit of industry and the economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Only one-twentieth of total general government receipts in 1981-82.

2. Will HMG change North Sea fiscal regime in line with oil industry's proposals?

[Memoranda lodged with Treasury and D/Energy 22 October].

I commend UKOOA (UK Offshore Operations Association) and BRINDEX for the hard work which they have put in. Obviously full study of their proposals is required. We shall look at their suggestions with an open mind, in close liaison with UKOOA and BRINDEX.

3. North Sea oil depletion policy?

Secretary of State for Energy announced in June that the Government would review in the Autumn the possibility of oil production cuts in 1982. We shall give the industry proper notice of our intentions.

4. Government revenues from the North Sea should be used to finance cheap energy for industry?

It would be inequitable and inefficient to use the benefits of North Sea oil to subsidise some users. The age of cheap energy is past. Energy prices should recognise the cost of marginal supply and reflect the competitive position of industrial fuels. Only then can consumers receive reliable signals on which to base their energy consumption and investment decisions.

5. North Sea revenues should be channelled into a special fund to finance new investment, particularly in energy?

North Sea revenues are already committed. Setting up a special fund would make no difference. More money would not magically become available. So the money for this

special fund would have to come from somewhere else - lower public expenditure, higher taxes or higher public borrowing.

6. North Sea oil bond?

Ministers concerned are currently finalising a decision on this.

S WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Governments' policies pushing world economy into recession?

[Output in OECD area grew modestly in first half 1981. Little information on Q3; but small rise in US and French GNP. Industrial production picture in Q3 mixed. Average unemployment rate rising.] [OECD believe output of member countries will have stayed flat in second half of this year, and will recover gradually in 1982. CONFIDENTIAL: NOT FOR USE This OECD forecast not yet published.]

No. Healthy growth only possible if anti-inflation policies persevered with. Some recovery of output expected next year. And unemployment should level off during the year.

2. OECD gloomier about world economic prospects?

[Draft report referred to in Sunday Times 15 November]

Latest OECD forecast is still being prepared. Most major forecasts, including the IMF's, expect modest growth next year. OECD forecasts unlikely to be markedly different.

3. Comment on latest NIESR Review forecast for industrial countries?

[Report published 26 November forecasts 'slow' economic growth and 'gradual' decline in inflation in industrial countries in 1982 and 1983.]

Interested to note that NIESR forecasts lower inflation and rising output in the industrial countries in next few years.

4. Anti-inflation policies not working?

[Year on year consumer price inflation in major countries around 10 per cent in September. Underlying rates increasing in US and France. OECD and IMF expect some decline next year.]

Takes time to squeeze inflation out of system. Year-on-year consumer price inflation in major economies down from peak of 13 per cent in April 1980 to around 10 per cent in September 1981. Further decline expected next year.

5. Governments' policies have failed or worsened situation?

No. Adjustment to second oil shock better than to first. Investment has performed better, impact on wages better contained and dependence on oil reduced. But these gains must be reinforced by continued firm policies.

6. Countries disagree over direction of policy?

No. Both Ottawa Summit and IMF Interim Committee agreed that a clear priority had to be given to firm policies to reduce inflation. They stressed importance of steady and careful

restraint on growth of monetary aggregates and emphasised need, in many countries, for reductions in size of budget deficits.

7. Other countries giving priority to unemployment rather than inflation?

No. All major countries agree that lasting reduction in unemployment can only be achieved when inflation brought down. France, an exception till October, is now acting to curb inflation. This best way to secure lower interest rates, encourage productive investment and achieve better rates of economic growth and employment.

8. Other governments not following such stern policies as UK?

[US, Canada and Germany have announced lower monetary targets for this year compared with last. Most major countries (US, Japan, Germany, Italy, Netherlands, Australia, Sweden) have recently announced measures to cut planned public spending. France has announced the deferral of FF15 billion (£1½ billion) of capital investment. Recent Canadian Budget will reduce deficit.]

Most governments persevering with firm policies to lay foundations of renewed non-inflationary growth. In particular, continuing with their efforts to control monetary growth, offset effects of recession on budget balances, and keep public spending in check.

9. US are pursuing mad policies and care nothing for their impact on rest of world?

US authorities have widespread international support in their battle against inflation. Sound \$ is in everyone's best interests. Concern is over monetary/fiscal mix - a problem all countries familiar with.

10. Deeper than expected US recession will kill recovery in other countries?

Some fall of output in the US may be inevitable before inflationary expectations are reduced. In everyone's interests that US inflation should come down. A sustainable recovery will then be possible.

11. Recent comments by US Budget Director have undermined confidence?

[Press reports of Dr Stockman's description of Budget spending cuts as "hastily prepared and enacted" and tax cuts "Trojan horse" favouring the rich, while casting doubt on "Supply side" policies].

I note that Dr Stockman has apologised for his "careless ramblings to a reporter".

12. Recent international interest rate developments?

True that international interest rates have been high over last year, but glad to see some easing of US prime rates - down to 16 per cent from peak of 21½ per cent; also German rates declining.

13. Prospects for international interest rates?

Always difficult to forecast interest rates with certainty, but firm policies should over a period bring lasting reduction in both inflation and interest rates.

7 December 1981

BRIEFING MEMOIRE ON THE UK ECONOMY

PRESENT SITUATION

Most recent major outside forecasts (NIESR, P&D, CBI, LBS, Industry Act Forecast (IAF)) assess recession's trough was reached in H1 1981, with some recovery in year to H2 1982 (in range $\frac{1}{2}$ - $2\frac{1}{4}$ per cent). Item are more pessimistic, seeing output fall a further 2 per cent in 1982, recovery thereafter. Unemployment (UK adult sa) forecast to increase to around 3 million by end 1982. (IAF does not assess unemployment prospects). Most major forecasters see year-on-year inflation in range 11-12 $\frac{1}{2}$ per cent for Q4 1981, falling to 9-11 per cent in Q4 1982. Item and St James are more pessimistic; forecasting range of 13-15 per cent. Item see a sharp drop, well into single figures in 1983. The IAF which sees inflation falling to 10 per cent in 1982 Q4, lies at the centre of the range.

GDP output estimate rose $\frac{1}{2}$ per cent in Q3 1981 the first rise for 7 quarters. In Q3 1981 industrial output rose $\frac{1}{2}$ per cent and manufacturing output rose 1 $\frac{1}{2}$ per cent.

Consumers' expenditure fell by $\frac{1}{2}$ per cent in Q3 1981 returning to the level of Q3 1980. Retail sales rose 1 per cent in October 1981. In September and October the Volume of visible exports was 4 per cent above the average in January and February. Volume of visible imports rose 21 per cent on the same comparison. Manufacturing investment (excluding assets leased from the service sector) fell 4 $\frac{1}{2}$ per cent in Q3 1981. Distributive and service industry investment (including shipping and leasing) was virtually unchanged in Q3 1981. DI investment intentions survey (conducted in April/May) suggests a fall in manufacturing investment after allowing for leasing of 11 to 14 per cent in 1981 with some recovery in 1982; distributive and service industries investment (including shipping) expected to rise by less than 5 per cent in both 1981 and 1982. Manufacturers', wholesalers' and retail stocks dropped by £0.2 bn (at 1975 prices) in Q3 1981 compared with destocking of £1.0 bn in H1 1981 and £1.9 bn in 1980 as a whole.

Unemployment (UK, seasonally adjusted excl. school-leavers) was 2,764,000 (11.4 per cent) at November count, up 36,000 on October. Vacancies rose slightly to 104,000 in November.

Wholesale input prices (fuel and materials) fell $\frac{1}{2}$ per cent in November; the year on year increase fell to 16 $\frac{1}{2}$ per cent. Wholesale output prices rose $\frac{1}{2}$ per cent and remain 11 per cent above a year ago. Year-on-year RPI increase was 11.7 per cent in October. Year-on-year increase in average earnings was 9.4 per cent in September. RPDI fell by 2 $\frac{1}{2}$ per cent in Q2 1981 after a 1 $\frac{1}{2}$ per cent fall in the previous quarter and a 17.5 per cent rise over the 3 years 1977 to 1980. The savings ratio fell 2 per cent to 12 $\frac{1}{2}$ per cent in Q2 1981.

PSBR £9.5 bn in the first half of 1981/82 and CGBR in April to October - £9.2 bn; but both distorted upwards by the civil service dispute. Underlying PSBR believed in line with Budget forecast (£10½ bn).

Sterling M3 increased by 1½-1¼ per cent in banking October but distorted by the consequences of the civil service dispute.

Visible trade showed an estimated surplus of £13 million in September and £116 million in October compared with an average monthly surplus of £368 million over the period July 1980 to February 1981. Invisibles surplus in first ten months of 1981 estimated at £2.3 billion.

Reserves at end-November \$23.5 bn. At the close on 4 December the sterling exchange rate was \$1.942 and the effective rate was 91.9.



Prime Minister

Scd ①
Pd

Agree to this agenda?

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

MUS 8/12

PRIME MINISTER

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I was very glad to hear that you would like to chair the February meeting of the NEDC. It will take place at 10 am on Wednesday 3 February at Millbank Tower.

2. The agenda which has emerged, under my guidance, from the customary discussion with the CBI and TUC is as follows:

- (i) inward and outward investment;
- (ii) small firms;
- (iii) Cancun;
- (iv) the electronics sector - Mr Baker's action programme.

The TUC have pressed for (i) and (iii); and (ii) and (iv) are ours. It is in fact a reasonable programme.

3. I expect that, on the inward and outward investment item, the TUC would want to criticise the Government for abolishing exchange controls, thus encouraging a large investment outflow. We, however, should be able to rebut this argument without too much difficulty. We could also point to what we are doing to encourage real investment in the UK from overseas, and explain how this is promoting jobs and activity.

4. The discussion on the small firms item would provide an opportunity for impressing on others the very real importance of the small firms sector in the economy. We would also be able to outline the many ways we are providing help for this particular sector.



5. The TUC have pressed very hard for a short discussion on Cancun. They feel that not enough was achieved at the Summit, and would like to put this point to you direct. We have already discussed Cancun twice - once before and once after: but the TUC have strong and sincere feelings on this topic. If you agree, I think the best thing would be for you to make a short statement on what was achieved at Cancun. The TUC (and the CBI) could then have their say. The item need not take at all long.

6. The agenda would be completed with a report by Kenneth Baker on the Government's policy for the electronics sector. This would follow an interesting discussion at the November Council, when the Chairman of the Electronics EDC, Sir Henry Chilver spelt out how he saw the industry developing.

7. The proposed agenda is inevitably something of a compromise. But it should form the basis of an interesting discussion, and allow us to put across our policies in a number of important areas. I hope you agree. Both the CBI and the TUC have indicated they would be content.

(G.H.)

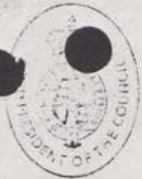
4 December 1981



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PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

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Prime Minister

(This was J Vercher's

draft)

MUS 3/12

The attached note on Pay Bargaining
is circulated on the authority of the
Lord President of the Council for the
guidance of all Ministers.

AW

amb

A WARD

3 December 1981

GUIDANCE FOR MINISTERS

The Effect of the 2 December Announcements on Pay Bargaining

Background

The Chancellor's statement on public expenditure, and the associated announcements of the Industry Act Forecast, the Government Actuary's Report, and the Government's decisions on the RSG, make it even more apparent than it has been hitherto that if those in work settle for pay increases in low single figures they will suffer a significant fall in living standards. It is likely that the announcements will lead to a desire on the part of pay bargainers to recoup such losses, and it is therefore particularly important that colleagues take every opportunity to explain why the measures the Government is now taking are right; and why continued pay restraint is necessary, even if it means falling living standards in the short term.

The Announcements

The bad news for pay bargainers is:

- (i) Take home pay will be lower because of the rise in National Insurance Contributions.
- (ii) The cost of living (November 81 - November 82 RPI) is now officially forecast to rise by 10 per cent this pay round. This covers the cost increases implied by other announcements (such as higher rents and rates) but of course the sudden rise in those items will have a greater effect on pay expectations than the steady rise in prices throughout the year.
- (iii) Average Earnings are now officially forecast to rise by 7½ per cent in the course of the pay round. Employees in the public services will regard the difference between that and their 4 per cent cash limit as an indication of the extent to which they are being asked to settle for less than the going rate because of their greater job security.

/The good news

The good news for pay bargainers is:

- (i) The worst off are protected from the sharpest rises in costs - many of those paying rents, rates and health service charges receive special assistance in the form of rebates or exemptions.
- (ii) Tight control of public spending means that taxes and/or interest rates are lower than they otherwise would be.

Points to make

1. The long term nature of any successful effort to get the economy competitive again. The Government has always said it would take years, not months. That is why it published a medium term strategy, covering the life time of this Parliament. We mustn't give up now just because things are looking difficult. The difficulties reflect the extent to which we allowed ourselves to fall behind our competitors in the 1960s and 1970s.
2. The Titanic struggle that any administration faces to keep public spending under control. All recent British Governments have faced regular public expenditure "crises". The fact is that public spending rises of its own accord unless it is strictly controlled. Controlling it in a recession is particularly difficult and some rise is inevitable. The Government has done well to keep it to a level which is consistent with a level of public borrowing for next year broadly in line with the projections published in the last budget.
3. We always said those in work would have to have a cut in their living standards. That is a necessary condition of becoming competitive again. It is widely recognised that there was a substantial moderation in pay settlements in the last pay round: but the rise in average earnings still almost kept pace with the rise in the cost of living. Getting competitive again does mean that sooner or later real pay has to be cut: the time for that is now.

4. So the 23 million who are employed will have to make some sacrifice to help the 3 million who are not. The unemployed have to be supported; and they also have to be given the hope of new jobs, which can only come if the employed help create a thriving economy. If wage earners won't accept the sacrifice in their pay packets, sooner or later the sacrifice will be made for them - in more job losses, or in higher taxation, or in higher interest rates.

5. We're starting to get the economy right again: don't let's throw it all away now. Over the five years to 1980, our labour costs (per unit of manufacturing output) nearly doubled. They rose by only one half in Canada, one third in the US, one sixth in Germany and not at all in Japan. But now for the first time for many years our unit labour costs are rising more slowly than those of our competitors. And as the Chancellor said in his statement, output next year is expected to rise by about one per cent, with manufacturing output growing more rapidly. There's a long way still to go, but we're going to get there.

PART 10 ends:-

B1 de H.M.T

PART 11 begins:-

LPC Guidance de Munkin 3/12

