PREM 19/715

PART 19

MT

Confidential filing

Economic Strategy
Pay + Prices Monthly Econ. Report
The Economic Project
Treasury Weekly Brief

ECONOMIC POLICY

Part 1: May 1979
Part 19: November 82

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Extract from Financial Times 30.11.82.

PART 20 begins:-

HMT brief 6.12.82.

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
CC(82)49th Conclusions, Minute 5	18.11.82
E(82)76	26.11.82

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

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'Defects' in medium term strategy

By Max Wilkinson, Economics Correspondent

THE GOVERNMENT'S medium term economic strategy is defective in a number of important ways, says the Institute.

In order to assess the likely impact of the Government's policies the Institute has extended its forecast up to 1987 for the main economic indicators on the assumption that policies remain unchanged. It admits that there are many uncertainties in these longer-term projections.

However it says: "In the absence of reflation or a major upturn in the world economy, there would have to be a strong spontaneous recovery in private demand for the economy to revert to a higher level of employment. In our view there is little ground for confidence that such a recovery will happen."

In what amounts almost to an obituary on the Government's first ideas about monetary policy, the Institute discusses the great difficulties in defining money satisfactorily and the further problem of controlling the money supply on any definition.

It says: "The instruments actually under the authorities' control are short-term interest rates and fiscal policy. But the relationship between these and the monetary aggregates are obscure, slow acting and imprecise."

The Institute discusses the difficulties in pinning down the relationship between the money supply variables and the output in money terms and prices. It comments: "This means that the authorities do not know what actions they must take using the instruments directly under their control to hit the targets they have set themselves.

The Institute finds little evidence that the Government's current emphasis on monetary policy at the expense of demand is likely to improve the supply potential of the economy. The main problems of the economy, it believes, are structural and it suggests that they might be solved more easily without a squeeze on demand.

Consumer spending could be key factor

Output has failed to grow in the last year. **Max Wilkinson** looks at the prospects for recovery

UK OUTPUT has not grown in the last 12 months, says the National Institute of Economic and Social Research in its Autumn Review.

It says: "Looking back it appears that the brief upturn which we saw in the latter part of 1981 was more than a rebound once stock levels had been adjusted to the downturn of the previous year.

"There has as yet been no sign that a general or sustained recovery is taking place. Unemployment has continued to rise at an irregular but generally increasing rate."

It says that the main support to the level of demand in the economy now appears to be consumer spending, which was stimulated by the lifting of hire purchase restrictions in the summer.

Real personal incomes could rise significantly during the next 12 months as the inflation rate falls and this would help to sustain consumer spending. Thereafter, consumer spending would have to be sustained by a further reduction in the proportion of income which goes into savings, the Institute says.

Modest stimulus to demand

It believes the sharp fall in interest rates this year should provide some modest stimulus to demand, especially through housing investment and the rebuilding of stocks. However, it cautions that after the falling inflation rate is taken into account, the "real" interest rate remains fairly high. It says the outlook for investment generally does not look very favourable.

In particular, it believes that manufacturing industries' investment plans will tend to be depressed by the poor outlook for overall demand and by the still low level of profits. Moreover, the fact that much of manufacturing industry still has surplus capacity would tend to inhibit investment when demand does pick up.

Even when domestic demand increases, the Institute, in common with most other major forecasting ordganisations, expects a significant leakage into imports. It forecasts an increase of 3 per cent in the volume of imports next year against an increase in only 2 per cent in total exports.

This is, however, rather less pessimistic than the recent forecast from the Treasury, which predicted no increase in the volume of exports next year against a 5 per cent increase in imports.

The Institute observes that recent data on the UK's trading performance has been erratic and difficult to interpret. The difference in interpretation has a substantial effect on forecasts for the balance of payments, itself notoriously difficult to predict.

The Treasury expects this year's current account of the balance of payments to show a surplus of about £3.5bn with a zero surplus next year. The Institute on the other hand predicts a surplus of £4.2bn this year, rising to £5.8bn next year and £6bn in 1984. This partly reflects the Institute's pessimistic views about the prospects for economic growth under present policies. It expects a slight fall in total output this year with growth of only 1 per cent a year for the next two years.

On the conventional assumption that policies remain unchanged, but that income tax bands and excise duties are raised in line with inflation, the Institute predicts that the public sector borrowing requirement next year will be about £8bn, broadly the same as is expected for this year.

This implies that the Chancellor would have little scope for tax cuts in the next Budget unless he were prepared to raise his borrowing target above the £8bn suggested in the last Medium Term Financial Strategy in March.

On the same assumption of unchanged policies, the Institute expects a sharp fall in the borrowing requirement for 1984-1985 to only £3¾bn, largely because of an expected rise in oil revenues. The institute says some reflationary measures would be needed even to maintain consistency with the figures set out in the March Budget statement.

The institute repeats the warnings of earlier forecasts that without some reflationary action by the Government, it sees no prospect that output will rise fast enough in the foreseable future to provide enough extra jobs for the increasing working population. Consequently, it expects unemployment to continue to increase.

After a detailed analysis of recent pay settlements, the Institute concludes that average earnings are likely to increase by about 8.3 per cent next year, somewhat faster than assumed by the Treasury in its published forecast.

The Institute assumes pay settlements of about 6½ per cent for employees in the Government service and 8 per cent for the rest of the economy. This gives an average for pay settlements of 7½ per cent for the economy as a whole.

It says: "Little can be said with any degree of confidence about the prospects for earnings in the 1983-84 wage round. Unemployment will continue to act as a restraining influence on claims. On the other hand, a long period of recession, followed by only weak recovery may well generate claims to make up for lack of growth in real incomes or to restore relativities disturbed during the recession."

On the prospects for manufacturing investment, the Institute says that recovery is likely to be extremely weak by historical standards, after a cyclical decline which was unusually prolonged and deep. However, the decline seems somewhat less if account is taken of the assets leased by manufacturing companies from financial institutions.

"Survey information shows that far the greater part of investment spending is for the purpose of replacement and 'deepening' and not for the purpose of extension of capacity. The current relatively high level of replacement investment may result simply from the fact that such investment can be put off for a short time but not for ever," it says.

In a special section on industrial profits and liquidity, the Institute identifies two possible explanations for the currently low level of industrial profits.

More competition from abroad

The first would be that companies cut margins in an effort to maintain sales during a recession. The second possibility is that margins have been cut in response to increasing competition from abroad following the high sterling exchange rate in 1980.

In either case, the institute sees little prospect that profitability will recover to the levels achieved before the recession.

The squeeze on profits would be likely to put pressure on companies' ability or willingness to invest, since, any gap between the two has to be covered by bank borrowing.

The Institute concludes: "For industrial and commercial companies in general and for manufacturing companies in particular, there does seem to have been some improvement in liquidity over the last one or two years.

"This could still be consistent with considerable variation around the average, and recently there have been warnings from the banks that many firms remain in serious difficulties."

● *National Institute Economic Review No. 4/83. Annual subscriptions £25 (home) and £35 (abroad) single issues £7 (home and £10 (abroad) postage 49p (home only) from The National Institute of Economic and Social Research, 2, Dean Trench Street, Smith Square, London SW1P 3HE. Students' subscription £10 a year.*

FORECAST FOR THE UK ECONOMY

Annual percentage rise

	Main Forecast			Further Outlook		
	1982	1983	1984	1985	1986	1987
Output	−0.3	1.0	1.0	1.5	1.8	1.6
Consumer spending	0.1	1.6	1.1			
Exports	−0.1	1.8	2.9			
Imports	3.8	3.1	2.7			
Inflation (RPI)	8.8	5.8	6.0	5.2	4.8	5.1
Unemployment (adults m)	3.1	3.2	3.4	3.6	3.5	3.7
Balance of Payments current account £bn	4.2	5.3	6.3	6.8	6.3	6.4
Public sector borrowing (£bn fiscal year)	8.0	7.9	3.7	2.8	0.0	−2.1

KEY FIGURES FOR THE WORLD ECONOMY

Annual percentage rate of change

	1960-67	1967-73	1973-80	1981	1982 (forecasts)	1983 (forecasts)	1982-87
OECD countries:							
Output	5.1	4.9	2.5	1.3	−0.3	1.9	2.6
Consumer prices	2.7	5.4	10.4	10.6	8.0	7.0	5.7
Prices (U.S.$):							
Exports of manufactures	1.0	6.5	11.5	−5.0	−1.0	0.5	4.0
Volume of world trade:							
Manufactures	7.0	11.0	5.5	2.0	−0.5	2.0	4.0

Robin Pauley looks at the institute's predictions for OECD states

Pessimistic outlook for world economy

FT 30/11

THE INSTITUTE has revised its forecasts for the world economy this year and next to give a much more pessimistic outlook for OECD countries than it expected in May.

A substantial fall in output for 1982 now looks certain and OECD states are expected to register a slight fall in Gross Domestic Product during the year.

The latest prediction for GDP is a fall of 0.3 per cent this year followed by growth of only about 2 per cent in 1983 and 2½ to 3 per cent in 1984. The forecast for the UK is only 1 per cent real growth in each of 1983 and 1984..

The July to September quarter appears to have brought the fourth successive quarterly fall in industrial production in the OECD. Declines in North America continued and there was a sharp fall in several Western European countries, notably West Germany.

‘Prospects for world trade look much worse . . . . particularly for exporters to developing countries.’

The main contributors to the 1982 fall in GDP will be the U.S., Canada (with an exceptionally steep fall) and West Germany. Declines are also expected in Belgium, Holland, Sweden and Switzerland.

The Institute expects the revival during 1983 to be more pronounced in the U.S. and in Canada than in the major Western European countries.

Restrictive domestic policies, the effects of weak demand in the rest of the world and drought in Spain and Australia, the two largest economies in the group of so-called smaller OECD countries, will all exert a depressive influence.

Japan stands out among the figures with an estimated 2.5 per cent real growth in 1982. This quite reasonable growth rate is forecast to accelerate to 3.5 per cent in 1983 and 4 per cent in 1984.

At the same time, Japan continues to register one of the lowest OECD unemployment rates—an estimated 2 to 2½ per cent in the last quarter of 1982 compared with more than 8½ per cent for the OECD. During 1983, the Institute expects unemployment to flatten out in North America but to continue rising in Europe at least into the second half of the year.

There was no clear change of trend in Western Europe, although increases in hourly earnings slowed sharply in the U.S. and Japanese mid-year bonuses were moderate in 1982. France and Italy still show exceptionally rapid rises in earnings.

Consumer price inflation continued to slow down in the third quarter even though the strong dollar tended to push up import costs of dollar-priced primary products, mainly petroleum, in Western Europe and Japan.

The 1982 OECD year-on-year change was likely to average 8 per cent but then to fall only slowly to 7 per cent for 1983 and 6.1 per cent for 1984. The average for Britain is forecast at 8.8 per cent for this year, 5.8 per cent for 1983 and 6 per cent for 1984.

There was still no clear sign of effective action against the rapid rise in Italian inflation. Belgium, the Nordic countries and Spain remained well above the OECD average and Portugal and Turkey still have very high inflation.

A major factor in the fall in inflation this year had been the fall in commodity prices in real terms which the institute does not expect to continue.

The total volume of world trade will probably fall slightly for 1982 as a whole. With no sign of a marked upturn in world activity, the prospects for 1983 look much worse than they did in May, particularly for exporters to developing countries.

The main current balance change in 1982 has been a big fall in the Opec surplus. This is not expected to increase again until 1984, although a partial reversal of the large swing into surplus of the OECD countries may begin sooner.

This swing has been most pronounced for the U.S., Canada, West Germany and some of the smaller countries whose export performances in 1982 seem to have been surprisingly good given the weakness of their main European markets.

There has been a marked increase against the general trend this year in France's deficit. This may continue for a time but it is in the U.S. that the expected deterioration in the OECD balance in the next two years is mainly concentrated.

It may be enough to return the OECD countries to collective deficit by 1984 even though by then the institute expects large surpluses for West Germany and, to a lesser extent, Japan.

OUTPUT GROWTH FOR INDUSTRIAL COUNTRIES

Annual percentage rise in volume

	U.S.	Canada	Japan	France	W. Germany	Italy	U.K.	Total	W. Europe
1970-80	3.0	4.0	4.9	3.6	2.8	3.1	1.9	3.3	3.0
1981 year	2.0	3.0	2.9	0.3	−0.3	−0.2	−1.9	1.3	−0.1
1982 year (forecast)	−1.5	−5.3	2.5	1.3	−0.8	0.5	0.3	−0.3	0.2
1983 year (forecast)	2.7	0.0	3.5	1.3	0.0	1.0	1.0	1.9	0.9
1984 year (forecast)	3.5	2.8	4.0	2.0	1.8	2.5	1.0	2.8	1.9

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and officials in HMT, Revenue Departments and other Departments in Whitehall

TREASURY BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 22 November, are sidelined.

M M Deyes

M M DEYES

RA

R I G ALLEN

29 November 1982

EB Division
H M Treasury
01-233-5503

ECONOMIC BRIEF: CONTENTS

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, lower interest rates and promotion of enterprise and initiative. Policy must continue to combine firmness and flexibility. Right for Government to have adjusted money supply and PSBR objectives in light of changed circumstances. But also right that medium-term direction of policy is maintained.

2. Significance of November Autumn Statement?

This first Autumn Statement. It explains autumn announcements in more complete and accessible way than in earlier years. Can expect the publication to evolve.

3. A S a mini Budget?

No. It brings together number of announcements about decisions - on public expenditure and next year's NIC - which are usually made at this time of year. It also includes a fuller economic forecast than has been issued in past - with much more complete statement of fiscal position; tax ready reckoners; and proposals for a reduction in NIS. Autumn Statement in no sense complete Budget - not even a mini Budget - though announcements obviously affect scope for fiscal action in Budget next spring.

4. A S reflationary/deflationary?

There is no change of policy compared with 1982 MTFS. Public expenditure planning total for 1983-84 unchanged. PSBR as percentage of GDP in 1983-84 also unchanged and lower than in 1982-83.

5. What help for industry?

Measures announced in Autumn Statement themselves have benefits for industry particularly in helping keep costs down -NIS (see P1-3), NIC (see P1-3), public expenditure decisions. Other announcements made around same time - energy prices (see R2-3), ending of regional development grant deferment (Industry Secretary 9 November), local authority capital spending initiative (see E12-14), a dozen or more sites chosen for enterprise zones (see P15) - all helpful. Also keep in mind wider benefits of lower inflation and interest rates and benefits of 1982 Budget measures still coming through.

6. Room for £2-3 billion tax cuts in 1983 Budget?

[CBI forecast £2½ billion fiscal adjustment for 1983-4]

Chancellor has effectively 'spent' nearly £1 billion by reducing NIS and holding down NIC increases. Scope for further worthwhile tax cuts for 1983-4 - the so-called fiscal adjustment - now estimated at about £1 billion. But figures very uncertain at this stage. Decisions taken in next Budget will depend on prospects as then seen for PSBR and economy. These factors will also affect choices of taxes to be modified.

7. Public spending decisions?

Planning total for 1983-84 held at level envisaged in the 1982 Budget - some £120 billion. Most welcome achievement - first time has happened since 1977. Unlike in 1977, Government not forced to hold to plans by outside intervention of IMF. (See also Section E.)

8. Implications of social security announcements

See Section G.

9. Recovery over/Activity flat?

Delayed but not over. Activity still 1 per cent above trough in Spring 1981. Flatness of output this year partly reflects external developments. Expected recovery in world trade and output expected at Budget time has not yet materialised. However, progress on inflation and interest rates more rapid than expected and renewed modest recovery expected in 1983. Expectations supported by upturn in cyclical indicators and by most outside forecasts. [For Industry Act forecast see B12 and last page of Commentary at end of Brief.]

10. Latest figures (for GDP and stockbuilding) throw doubt on Government forecasts for 1982?

GDP figures are quite consistent with Industry Act Forecast which shows no change in the average measure of GDP between first and second half of year. At first sight not so easy to reconcile size of third quarter destocking (nearly £420 million) with IAF expectation for second half (about £150 million). But quarterly movements in stocks tend to be erratic; also some of the destocking may represent adjustment to involuntary stock-building in first half of 1982.

11. Latest CBI assessments:further deterioration?

See B4.

12. Government policy on exchange rate?

See Section M.

13. Implications of recent exchange rate depreciation for domestic inflation, competitiveness and activity?

Government's forecast remains as set out in November Industry Act forecast.

14. Recent exchange rate depreciation signals weakening of monetary framework?

Government's role is to maintain firm, consistent, financial framework, in line with major economic objectives (see 1 above). Government will continue to interpret monetary developments firmly but flexibly. With inflation coming down, should be ample scope within target ranges for rising activity. (See also Section M.)

15. Where will growth come from?

Sources of growth are expected to be: some modest recovery in world activity; improved confidence as inflation comes down, encouraging more investment and risk-taking; lower interest rates improving than last year - companies' financial position and encouraging more fixed investment and stockbuilding; increased consumers' expenditure, partly reflecting lower inflation. Medium term prospects depend critically on further progress in reducing inflation and containing costs.

16. Policy far too tight, given world recession? Below FSBR forecast growth in output, prices and money GDP clear sign of deficient demand?

Government cannot fine-tune either money or real GDP. Domestic demand, has been rising at annual rate of 3 per cent since spring 1981. Problem is external demand and UK's falling share of home and foreign markets (reflecting weak competitiveness). Need improvements in supply performance as much as increased demand. Without former, a boost to demand may be largely wasted, even in the short term.

17. IMF team visiting UK: checking up on us?

[Treasury Press Notice about visit issued 16 November]

Visit from IMF team in December normal routine: part of the Fund's regular 'Article IV' consultations which provide for periodic review of member countries' economic policies.

18. Unemployment prospect?/Government 'fiddling' unemployment figures?

[NB November figures to be published 2 december].

See Section C.

19. Latest Labour Party proposals?

['Programme for Recovery' published Monday 22 November. Aim is to reduce unemployment to less than 1 million in one Parliament. Main points: increased public spending (phased from £5 billion more in first year to £18 billion in fifth), adjustment of £ to restore competitiveness; price controls and other measures, such as VAT cut, to offset effects of lower exchange rate; abolition of NIS and/or cuts in employers' NIC; cut in interest rates; agreement within National Economic Assessment for growth in incomes to achieve 'planned increase in living standards'.]

Despite attempts to confront some of the many problems such a programme would create, many more ignored - notably effects of package on confidence and financial markets. Testing packages on Treasury model does not mean results definitive - much depends on assumptions fed in. Claim that package would lead to a massive rise in output and un employment depend critically retaining confidence and on assumption of low earnings growth yet no clear ideas on how to achieve latter other than a toothless National Economic Assessment. We have been here before. Don't want to repeat. IMF brought back to reality in 1977. Electorate did in 1979. One or the other would certainly do so again.

20. When will the manual on the Treesury model be issued?

[Copies provided already to TCSC; document referred to by D Lipsey in S.Times 28 November].

Being published 1 December.

BULL POINTS 29.11.82

(i) Activity. Output broadly flat since Autumn 1981 but GDP and manufacturing output around 1 per cent above levels of spring 1981. IAF (published with Autumn Statement) and most recent major independent forecasts see prospect of modest recovery later this year and next.

(ii) Interest rates. Bank base rates have fallen 6 points since autumn 1981 (now about 10 per cent). Recent falls reflect several factors:- single figure inflation; moderate growth in monetary aggregates; Government borrowing under control, exchange rate broadly unchanged since summer 1981.

(iii) Inflation. Increase in RPI over the 12 months to October was 6.8 per cent. For first time in 10 years the rate is below 7 per cent and is lowest since August 1972. IAF estimates RPI inflation at 6½ per cent by end of 1982 and prospect of 5 per cent by early 1983. Manufacturers' output prices up 7½ per cent in year to October.

(v) Costs.

- Increase in average earnings halved in 1980-81 pay round; further moderation in 1981-82 round, to around 9 per cent.

- Manufacturers' unit wage and salary costs up less than 6 per cent in 3 months to August over a year earlier below average of major competitors.

- Manufacturers' input prices up only 3½ per cent in year to October.

- October CBI survey shows lowest degree of unit cost pressures for 15 years.

(v) Manufacturing productivity. Output per head has risen about 13 per cent since end 1980. Output per head and output per hour now about 6 and 9 per cent higher than previous cyclical peak in 1H 1979.

(vi) Competitiveness. Cost competitiveness (manufacturing) improved by about 15 per cent during 1981 reflecting lower exchange rate, greater pay moderation, higher productivity; but little further improvement during 1982 H1 and position remains a quarter worse than in 1979 H1 and one third worse than in 1975.

(vii) Profits: Industrial and commercial companies' gross trading profits (net of stock appreciation, exluding North Sea) up 16 per cent in 1H 1982 compared with 1H 1981. [NB recovery in profits from very low base: pre-tax real rate of return of ICC's (excluding North Sea) only 3 per cent in 1981.]

(viii) Housing starts (total) - up over a quarter in first nine months of 1982 compared with same period 1981.°NB But broadly flat during 1982.]

(ix) Special employment measures. Total planned provision for special employment schemes £1½ billion in 1982-83. Further measures announced end-July - new community work programme (started October), job splitting subsidy schemes (from January 1983); total planned provision for 1983-84 £2 billion.

(x) Overseas debt repayments. Official external debt reduced from over $22 billion in May 1979 to around $12½ billion at end-September 1982.

Economic Briefing Division, HM Treasury, 01-233 5514/5503

B ECONOMIC ACTIVITY AND PROSPECTS

1. Prospects for UK economy

[Industry Act Forecast Tables summarised in Commentary at end of Brief.]

Main points from Industry Act forecast and other recent forecasts:-

- Although recovery has been hesitant this year, partly reflecting de pressed world activity, it should gather pace in 1983: about 1½ per cent growth of GDP 1983 on 1982. All outside forecasts (some rather dated) expect recovery to continue in 1983; consensus is for year-on-year growth around 2 per cent.
- RPI inflation has come down much faster than expected. Now forecast to be 6 per cent in 1982 Q4 (9 per cent in Budget forecast) and 5 per cent early next year (7½ per cent in 1983 Q2 in Budget).
- Wage settlements are expected to decline further over next 12 months. [No forecast given in IAF but GAD Report assumes 6½ per cent earnings growth between 1982-83 and 1983-84, against 9 per cent in previous year.] Productivity growth still fast (level of output per head in manufacturing now 13 per cent above end-1980).
- Consumers' expenditure continues to recover and is provisionally estimated to be ½ per cent up in 1983 Q3 on previous quarter. Forecast is for 2½ per cent increase between 1982 and 1983.
- Current account of balance of payments expected to decline to zero in 1983.

2. Recent output figures

[GDP (O) in Q3 rose slightly for second successive quarter to level about 1 per cent higher than in 1981 Q2. Industrial production in 1982 Q3 unchanged from previous quarter, though underlying level of industrial output 1½-2 per cent above 1981 Q2 trough - almost entirely attributable to North Sea oil. Trend in manufacturing activity at best flat, though IAF expects 1 per cent increase in year to 1983 H2.]

Output remains disappointingly flat - partly due to depressed world economic activity. But expected higher world output should encourage some modest recovery in 1983, while lower interest rates and inflation, coupled with improved productivity and competitiveness, provide a sounder base for expansion in the medium term.

3. Other evidence of improvement in economy?

See Bull Points (following Section A).

4. Latest CBI assessments/Business confidence collapsed?

[CBI October Trends Quarterly Survey showed less optimism on general business outlook and export prospects over next 12 months (optimism net balance fell from minus 22 in July to minus 28 in October). Orders and output had fallen and most (94 per cent of participants) saw orders constraining future output. Stock reductions were continuing and investment intentions had weakened again. Cost and price pressure remained low, and company liquidity might improve slightly in next six months. CBI November Enquiry shows previus trends broadly continuing but with further deteriorations in export order books partly offset by some pick-up in home orders].

Results of October and November CBI reports still disappointing. Deterioration in optimism, and weakness of immediate outlook (next four months), probably reflect in part very depressed level of activity, at home and overseas, this year. But CBI not entirely gloomy -favourable developments continue in unit costs and price expectations; firms' liquidity also expected to improve. November Enquiry implicitly suggests some improvement in home orders. As witnessed by surveys from Times Business Forum in October and November, great majority of businessmen support Government's basic economic strategy and are optimistic about prospects for company growth/profits over next two years. Decisions announced 8 November aimed to reduce business and industry's costs and should boost confidence.

5. November CBI Forecast suggests no recovery next year?

[Forecast suggests 1¼ per cent GDP growth next year - a ¼ per cent downward revision to August forecast and ½ per cent below IAF; inflation money down broadly in line with IAF. Sees £2½ billion available for 'fiscal adjustment' in next Budget.]

CBI output forecast only marginally below IAF. Both show modest recovery in total and manufacturing output next year. On PSBR undershoot see A .

6. ABCC 'fast losing patience with Government'

[The Times 29 November reports ABCC as criticising Government's excessively tight fiscal monetary stance over past year as major factor in lost output and lost jobs. Requires a "coherent" industrial and commercial policy and a substantial reduction in industry's costs. Proposed policy measures: abolition of NIS, reductions in rates on industrial and commercial interest rates.]

Government has done well by industry this year. Cuts in NIS worth £1 billion and each percentative reduction in interest rates worth £250-300 million. These benefits derive from moderate restraint on fiscal and monetary aggregates and decision to help industry by reducing NIS rather than other costs. ABCC proposals themselves lack 'coherence'; lower inflation and lower interest rates are a product of fiscal and monetary stance.

7. New orders figures depressing?

[New construction rose by 1 per cent in 1982 Q3 on previous quarter but remains down on 1981 Q3. A 30 per cent increase in public sector housing new orders in 1982 Q3 but 5 per cent decline in private housing orders. Volume of new orders in engineering industries fell 12 per cent in three months to August compared previous three.]

Some figures encouraging signs but still manifesting depressed economic activity which itself partly reflects flatness in world trade.

8. Fall in investment and reduction in stocks?

[Capital expenditure by manufacturing, distributive and service industries in 1982 Q3 3 per cent higher than Q2 but 2 per cent down in latest six months compared previous six. Investment in manufacturing (including leased assets) in 1982 Q3 over 1 per cent up on Q2 but 4 per cent lower in latest six months than previous six. CBI October survey shows, for second successive survey, decline in investment intentions. IAF projects 3 per cent growth in fixed investment in 1982, 5 per cent in 1983.]

Figures reflect some modest recovery after disappointing second quarter. [IF PRESSED: latest DOI investment intentions survey shows slight fall in manufacturing investment between 1981 and 1982; Q2 figure not inconsistent with this.]

9. Stock levels a threat to recovery?

[Provisional figures for 1983 Q3 stockbuilding in manufacturing and distribution (80 per cent of total stocks) reveal unexpectedly sharp de-stocking of around £420 million. Apart from 1980 Q4, as large as any quarter in current recession.]

Quarterly movements in stocks tend to be erratic; Q3 de-stocking may partly reflect adjustment to involuntary stockbuilding in 1982 H1. Not too much weight should be placed on single quarter's data. GDP (output) figures (see B1 above) are a better guide to recent movements in activity.

10. Competitiveness not improved this year?

Cost competitiveness has improved about 15 per cent since 1981 Q1 [but virtually no change during 1982 H1]. Taking into account recent exchange rate movements, position remains some 20 per cent worse than when Government took office; though over same period exchange rate broadly unchanged. Further improvements, which are essential to regain markets and create new ones, depend above all on substantially lower wage settlements in this pay round than in the last one. Lower exchange rate makes it all the more important for companies to maintain close control over their costs. (see also section M).

11. Productivity growth falling off?

No; productivity growth in manufacturing up 4½ per cent over last year, and 13 per cent up on end-1980, is well above UK historical average.

12. CSO's index of leading cyclical indicators?

Longer leading index rose between July and October reflecting further falls in interest rates and an increase in share prices. Shorter leading index declined slightly in October (but based on two components only). Taken with other indicators - including lower inflation and interest rates - these changes are encouraging pointers to future recovery.

13. Outside forecasts

[GDP profile in recent major assessments and in IAF:

Per cent change

	LBS (Nov)	Phillips & Drew (Nov)	Simon & Coates (Nov)	CBI (Nov)	St James (Nov)	OECD (July)	NIESR (May)	IAF (Nov)
1982 on 1981	+¼	+½	+½	+½	+½	+1¼	+1	+½
1983 on 1982	+3	+¾	+2½	+1¼	+2	+1¾	+1	+1½]

Nearly all see prospect of continued recovery and lower inflation.

C LABOUR MARKET

[NB: Employment Secretary's Statement 18 November on changed basis for unemployment figures from November count onwards. November (provisional) figures will be published on 2 December. On new basis, October headline total would have been 246,000 lower and adult unemployment 173,000 lower.]

1. Recent unemployment figures (on new and old basis) and other labour market indicators?

[Underlying trend in unemployment has deteriorated since Q2, but October figures a little more favourable than of late. Because of seasonal factors, no further sharp rise in 'headline total' expected till January. Recent unemployment/vacancy figures shown in Table below on both old and new basis. Other Labour market indicators (eg overtime, short time, roughly that for last 6 months).

	1980 Q4	1981 Q1	Q2	Q3	Q4	1982 Q1	Q2	Q3	Oct
'Total' unemployment	2.16	2.46	2.59	2.93	2.96	3.04	3.01	3.28	3.30 (13.8%)
on new basis	-	-	-	-	2.77	2.86	2.80*	2.94*	3.05 (13.1%)
UK adult sa unemployment ~~(millions)~~	2.02	2.28	2.48	2.64	2.75	2.82	2.88	2.98	3.06 (12.8%)
~~on new basis~~	-	-	-	-	2.61	2.68	2.74	2.84	2.89 (12.4%)
increase in period (000's)	+105	+77	+62	+51	+26	+18	+30	+42	+44
on new basis	-	-	-	-	+24	+20	+28	+31	+24
Vacancies (000's)	99	98	89	96	104	112	107	111.0	112

]

* Excluding non-claimant school leavers.

~~Other labour market indicators (e.g overtime, short-time) roughly flat for last 6 months.]~~

October figures cannot provide indication of future trends but are nonetheless welcome. Level of unemployment still tragic but problems took a long time to build up; will also take a long time to check or reverse. Recent figures reflect levelling out in activity since last autumn. Looking further ahead, lower inflation and interest rates, and lower pay settlements and hence improved industrial competitiveness should help promote economic recovery and create climate for sustainable jobs.

2. Government fiddling the statistics?

No. New basis is cheaper, more accurate and cuts out wasteful procedures. New basis using voluntary registration also reveals similar trend to previous series.

3. What categories of unemployed affected by changes?

Severely disabled now included. Non-claimants registering at Job Centres, and far more people who find jobs before day of count, now removed. Non-claimants are principally married women paying reduced national insurance contributions and some may previously have been self-employed. Non-claimants number 110-150 thousand in most months of the year.

4. Headline total fell 246,000 in October?

Generally, difference between old and new counts would have been between 170 and 190 thousand. October difference was exceptionally large because many (about 100,000 people) still on register at Job Centres had in fact already found jobs.

5. Does new system affect GAD assumptions for 1982-83 and 1983-84?

Scale of the assumed increase will not be significantly affected, but the assumed GB levels of 2.9 million in 1982-83 and 3.2 million in 1983-84 (excluding school leavers) could be some 200,000 lower ie 2.7 million and 3.0 million. Number of claimants eligible will, of course be unaffected.

6. Unemployment in UK higher than in other countries?

[On standardised definitions in Q2 1982 UK unemployment was 12.7 per cent compared with 8.1 per cent OECD rate; little over doubling for UK compared with OECD rise of over one half since 1979.]

Unemployment now rising sharply in many industrialised countries - in last three months number unemployed (on national definitions - not strictly comparable) rose much more in Canada (up by over 20 per cent), Holland (9 per cent), Ireland (8 per cent), Germany (7 per cent) than in UK (4 per cent).

7. UK's true unemployment figures really much higher?

[TUC say 'true' figure just under 4½ million The Times 11 November.]

No one seeks to deny there are unregistered unemployed but reliable estimates of their numbers are difficult to obtain. Available estimates vary quite widely. Figures of registered unemployed are based on an accurate count of those eligible for benefit, and provide the best available estimates of trend.

8. Cost of unemployment/Effect on PSBR?

The effects of changes in unemployment on the public finances is likely to vary widely according to the underlying circumstances, for example changes in world trade, United Kingdom competitiveness, the level of United Kingdom earnings and so on. It is not, therefore, sensible to talk about the cost of unemployment as though there were a single figure.

Payments of unemployment benefit and supplementary benefit to people registered as unemployed are currently expected to total about £5 billion in 1982-83. Comparable figures for the total of taxes and national insurance contributions not collected cannot be given. There is no basis for estimating what the level of earnings and tax receipts would be if all the unemployed were working.

9. <u>What is Government's own forecast of unemployment</u>?

[Government Actuary was instructed to assume that number of unemployed in <u>Great Britain</u>, excluding school leavers etc, would average 2.9 million in 1982-83 and <u>3.2 million</u> in 1983-84, (or just under 3.4 million including school leavers). Assumption for 1982-83 same as in 1982 PEWP but for 1983-84 3000,000 higher than in 1982 PEWP.]

GA's assumptions are not predictions or forecasts. [IF PRESSED they provide reasonable assessment of prospect but <u>any</u> forecast of unemployment must be highly conditional.]

10. <u>Government concerned over unemployment?</u>

Of course Government concerned; so pursuing balanced fiscal and monetary policies to curb inflation and creating conditions for enterprise - only measures that will ensure sustainable increase in employment. Nevertheless has substantially increased spending on schemes to alleviate impact on especially vulnerable groups. Most crucial factor in influencing unemployment is ~~level of pay~~ settlements (See also Section K).

11. <u>Extent of help</u>?

Government plan to spend £1½ billion in cash in 1982-83 (40 per cent more than in 1981-82) on special employment and training measures and £2 billion in 1983-84. Within the latter, £950 million allocated to Youth Training Scheme and £260 million (gross) to (a) the new community programme - designed to provide up to 130,000 places for long term unemployed - and (b) the new Job Splitting Subsidy (open on 1 January next year) to encourage extension of part time work and provide additional opportunities for productive jobs for unemployed people.

12. <u>Employment continuing to fall</u>?

[Total employment declined 2.4 million (10½ per cent) between mid 1979 and Q2 1982. Decline of 94,000 in 1982 Q1 increased to 189,000 in 1982 Q2. Manufacturing employment in September fell 11,000 to 5,531,000 (compared 5,553,000 in September 1981).]

Only way to achieve permanent jobs is sustainable recovery, based on improved industrial competitiveness lower inflation and lower interest rates. Substantial provision (£1½ billion) being made to help most vulnerable groups (see C11 above).

13. Recent productivity gains inimical to higher employment/lower unemployment?

[Output per head in manufacturing up 12 per cent since end-1980.]

This may be true in the short run. But in the longer term, as experience in Japan and many other countries clearly demonstrates, higher productivity essential for growth and employment opportunities.

D TAXATION

1. Burden of taxation

[Total taxation (including NIC) as proportion of GDP was 34½ per cent in 1978-79 and is forecast to be 39¾ per cent in 1982-83. Corresponding figures excluding NIC are 28½ per cent and 33 per cent].

Burden has inevitably risen because of upward pressures on public expenditure caused by the recession. Increases in taxation are better - and more honest - means of financing this than borrowing, because of adverse effects borrowing has on interest rates and inflation.

2. British tax burden high by international standards?

Not so. Accurate comparisons difficult, but UK burden about average for OECD countries [1981 data from Lloyds Bank Economic Bulletin, October 1982]. Similarly, UK taxes on household income and employees' social security contributions about average for EC countries and lower than Japan and USA [1980 provisional OECD data].

3. Autumn Statement

Chancellor on 8 November announced proposals for further reductions in NIS which should be welcomed by industry: another ½ per cent for 1982-83 and 1 per cent for 1983-84 to bring the rate down to 1½ per cent. Less than half the 3½ percent level inherited from Labour. Each 1 per cent reduction worth some £800 million pa (full year) to private sector.

4. Cuts in taxation in 1983 Budget?

Decisions for 1983 Budget, both on PSBR and particular tax changes, will not be made for several months yet. NIS and NIC decisions do, of course, reduce scope for tax reductions in next Budget though sticking to public expenditure totals helps.

5. Why not integrate tax and NIC systems?

[Paper from Institute of Fiscal Studies reported in FT 25 November].

Government has done much to simplify and streamline income tax and NIC systems. Benefits of more radical changes of this sort must be set against disadvantages. Integration could result in substantial redistribution of incomes; action to compensate the losers could be costly. A sub-committee of the TCSC is currently inquiring into the structure of personal income taxation and income support; Government looks forward to reading the Committee's report.

6. Future of married men's personal allowance?

[Guardian article 29 November contains details of Government's plans for White Paper on Taxation of Husband and Wife].

Government launched debate with December 1980 White Paper on Taxation of Husband and Wife. Green Paper set out a number of different options; these are being considered in the light of the very wide range of views received. [NB Labour Party commitment to phase out in favour of increased CB etc; SDP proposals ('Attacking Poverty') to abolish as part of new scheme to assist lower paid.]

7. SDP plan to abolish poverty trap?

Their scheme ('Attacking Poverty') costs £4½ billion and still leaves marginal tax rates, for people in the poverty trap, of 80-85 per cent. What is more, they extend the trap both up and down the income scale. Claims to have eliminated the trap are based on artificially restricted definitions.

8. SDP re-distributing to the poor?

SDP plan involves massive re-distribution. But it is not redistribution from rich to poor in any accepted sense. On SDP's own figures single people worse off on anything over half average earnings; married couple without children worse off if have income of more than ¾ average earnings; married couple with children worse off if have average earnings or even a bit less unless they have 3 children or more.

9. Government unconcerned about poverty and unemployment traps

Government concerned about poverty and unemployment traps, in context of incentives as a whole. Traps caused by attempts of successive Governments to alleviate poverty and hardship while keeping costs in bounds. Alternatives are to give less support for poor and unemployed or to let costs rip. A necessary step in right direction is to reduce burden of income tax by restraining public expenditure - which is Government policy. Long-term solution is increased wages resulting from sustained improvement in productivity and economic performance: this too a goal of Government policy.

10. Burden of taxation risen most for the poor?

Proportion of income paid in income tax and NICs has fallen in 1982-83 for lowest paid taxpayers. Low paid with children are also entitled to benefits such as FIS.

11. Previous reductions in personal taxation favour the rich?

1979 Budget cut absurdly high top rates of income tax to European levels, as part of package which also involved substantial increase in thresholds. Such action was essential to restore incentives. No 'pot of gold' in higher rate tax; restoration of 83 per cent top rate would finance a cut of under ¼p in the basic rate.

12. Changes in corporation tax on way?

[Speech by FST on 24 November].

Government will shortly start limited trial of new type of corporation tax return form. If trial successful, could open way to new arrangements for assessing and collecting corporation tax. But trial is exploratory. Government will not make move to self-assessment for corporation tax without wide consultation. Trial not concerned with structure of corporation tax, which government is examining in light of responses to Corporation Tax Green Paper.

E PUBLIC EXPENDITURE AND FINANCE

[Total spending of £120.1 billion in revised plans for 1983-84 announced 8 November. Compares with total of £120.7 billion in 1983-84 in Cmnd 8494 published 9 March, adjusted for Budget (and other minor changes). Revised plans for 1984-85 and 1985-86 will be published in next Public Expenditure White Paper in late January/early February 1983. Plans now announced are firm. Precise figures may change slightly between now and White Paper in light of more detailed calculations. Contingency Reserve will also be reviewed before White Paper finalised.]

PUBLIC EXPENDITURE REVIEW AND AUTUMN STATEMENT

1. Does underspending indicated by provisional outturn figures for first half 1982-83 imply substantial underspend for year as a whole?

[Figures presented to Parliament in FST's Note on Winter Supplementary Estimates].

At the moment we are tentatively estimating that 'Supply Expenditure' will amount to about £79½ billion. Total provision including Winter Supplementaries [of £1½ billion] is just over £81 billion. If there are no substantial Spring Supplementaries, the underspend in 1982-83 will be about £1½ billion. Underspends in 1980-81 and 1981-82 were about £1½ billion and £2 billion respectively.

2. How do revised plans for 1983-84 compare with those previously announced?

[PM on 3 November referred to 'holding to the total of £120.5 billion' announced at time of last Budget].

Outcome of annual review of public expenditure plans has been to hold planning total within previously announced plans. First time this has happened since 1977. Unlike 1977, Government not forced to hold to plans by outside intervention of IMF.

3. What is change in real terms?

Small fall in expenditure in 'real' (cost) terms now planned for 1983-84 compared with 1982-83 plans. [NB cost terms means cash adjusted for general level of inflation as measured by GDP deflator]. No 'volume' (constant price) figures available.

4. Is it ~~time~~ true that although the total of public expenditure in 1983-84 has been held to the Budget time total in cash it is higher in cost terms?

Public expenditure is planned in cash. Expenditure for future terms expressed in cost terms depends upon assumptions made about the change in the GDP deflator. For a given cash total, the lower the increase in the relevant prices, the greater the level of service that can be provided.

5. Should not all programmes have been reduced with the fall in inflation?

Under cash planning we do not go about it in this way. Presumption is that planning totals will be maintained, unless any major change invalidates the main assumptions on which they were based. Level of services is then what can be obtained with the cash available after making every effort to reduce costs. Inflation in 1983-84 is now being put at about 5 per cent higher than in 1982-83 which compares with 6 per cent implicit factor used when the old 'volume' series converted to cash ~~cont~~; in reviewing the plans took view this reduction not great enough to justify wholesale adjustment to plans.

6. Cuts in services?

Decision to contain expenditure has inevitably meant reductions in some programmes to compensate for increases in others. But Government's success in reducing inflation and interest rates has made it possible to accommodate such changes without major cuts in services.

7. Hasn't Government gone too far in reducing public expenditure?

Still planning for an increase (£5½ billion) between plans for 1982-83 and 1983-84. Reduction below Budget-time plans largely accounted for by two factors: £400 million benefit from NIS clawback: revised forecasts of receipts from special sales of assets. When effect of these discounted, Government has held closely to its previous plans.

8. What are public expenditure totals now planned for years following 1983-84? How do they compare with those announced at Budget time?

[Chief Secretary 23 November referred to figures for '1984-85 and 1985-86' being entirely within the provisional totals announced at the Budget.]

Figures for these years will be published will be published in next Public Expenditure White Paper, early in New Year. Planning total for 1984-85 will be within total announced at Budget time. [NB No figure for 1985-86 has yet been announced].

PUBLIC EXPENDITURE - GENERAL

9. Ratio of public spending to GDP

Ratios in 1980-81 (43 per cent) and 1981-82 (44½ per cent estimated) remain below level of 1974-75 and 1975-76 (46 per cent in both years). Rise in ratio in 1981-82 compared 1980-81 mainly reflected higher expenditure on social security at a time when real GDP falling. Ratio expected to fall in next few years. Autumn Statement gives figures of 45 per cent in 1982-83 and 44 per cent in 1983-84.

10. Increase spending in recession?

No good trying to spend way out of recession. Any benefits would be short-term. If increased spending not financed responsibly, would soon lead to more inflation. If financed prudently, would lead to higher interest rates and/or higher taxes. We are responding, within limits of prudence, to needs of current circumstances.

11. Capital spending in public sector?

Government's policy is that provision made for capital expenditure both in central government and local authorities, should be fully spent, subject to the normal prudential margin. (Of course always necessary to take account of implications for future current running costs - and interest). In nationalised industries, criterion is that capital expenditure should show an adequate return. (See also E16-18 and R10).

12. Cut public sector pay bill/administrative costs of central government?

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. Provision for public service pay increases 1982-83 limited to 4 per cent. Administrative costs are not far short of 10 per cent of total public expenditure. We are determined to reduce that proportion, and to maintain drive for more efficient management throughout public sector.

13. Cost of pay rises for public servants - equivalents in public spending programmes?

Every 1 per cent extra on pay for public servants (excluding Nationalised Industries) costs £335 million - the approximate equivalent of two frigates, 50 Harriers or about 70 miles of motorway.

14. What allowance will Government make for pay increase in public services for 1983-84?

Government attaches great importance to realistic wage settlements next year, in both public and private sectors. Provision for public service pay will be made from within cash plans.

15. 3½ per cent pay assumption for 1983-84

Assumption is not a 'norm'. Nor is it a decision on the offer to be made in any particular case. Each will be considered on its merits. It concerns the provision in public expenditure plans for next year for those groups for which Government is directly responsible, other than NHS. It does not directly cover local authorities, or nationalised industries, which are not within Government's direct control. But they will be controlled by the rate support grant and the external financing limits.

LOCAL GOVERNMENT

16. LA capital underspending in 1982-83

Following underspend of £¾ billion in 1981-82, local authorities seem set to underspend their capital cash limits for 1982-83 by between £1 and £1½ billion (GB figures). Some steps in hand to reduce the underspend: Prime Minister has written to local authority associations; local authorities can apply for extra allocations, and can spend without limit on improvement grants; extra £150 million made available to the Housing Corporation.

17. LAs cannot increase capital spend because of revenue consequences?

Plans for relevant LA current expenditure allow for financing costs of full planned capital programme. Many capital projects have no immediate running costs eg roads, reclamation of derelict land. Others will reduce running costs by rationalisation. LAs would be able to afford running costs of worthwhile investments if curbed wasteful expenditure and held down pay settlements.

18. LA capital spending plans for 1983-84

Plans for LA capital as a whole allow net spending one third higher than likely outturn in 1982-83; (gross) housing spending up £350 million (13 per cent); urban programme (including Urban Davelopment Grant) up by £70 million (to £350 million). Local authorities will be allowed to spend above allocations on improvement grants.

19. LA current overspending in 1982-83

Budget returns from LAs indicate overspend of over £1 billion on current expenditure is under way. Secretaries of State have announced intentions to abate rate support grant to overspenders in response. (For details, refer to statements in Parliament 27/28 July by Secretaries of State.)

20. Local government finance 1983-84?

[Announcements in Autumn Statement.]

Plans for LA current spending have been increased by over £1 billion to ensure that they are realistic. Only some £270 million of this increase will be allocated to service programmes the rest will be included in expenditure targets as it represents an extra provision which the Government does not consider desirable, but which has been included to make plans realistic in relation to this year's overspend.

21. Rate increases implied by plans?

What happens next year depends on what LAs decide to spend. If LAs comply with their expenditure targets, rate increases need only be very modest overall, and in some areas will be no need for any increase. Of course, if LAs decide to overspend, the rate burden they have to impose will be higher, and they may lose rate support grant if they exceed targets.

22. Holdback of RSG in 1983-84?

Refer Written Answer from Environment Secretary (Hansard 4 November) announcing options for holdbacks in England. Consultation with LAs under way (also in Scotland and Wales). Schemes adopted will depend on outcome of consultations.

23. Higher council house rents?

[85p assumption referred to in Autumn Statement].

In Government's view, LAs should not need to increase rents in real terms in 1983-84. For them to decide. Government decision is about provision for housing subsidy - Environment Secretary will be consulting LA associations on basis of figure of 85p per week per dwelling. If that figure confirmed, will be possible to provide for real increase in capital investment in housing next year.

24. Green Paper on Domestic Rating System: Government response?

Carefully considering representations. Need scheme to run that will remedy shortcomings of present rating system which will command widespread support. Taking account of pleas from industry, business, etc. (See also P10.)

FALKLANDS EXPENDITURE

25. Falklands defence costs?

[Parliamentary Answers 26 October cols 885-6; 28 October cols W 453-4.]

Latest assessment of costs of operation, and of replacing equipment lost during the conflict, is about £700 million in current year; over next three years the cost will be £200 million, £350 million and £320 million respectively. For the garrison extra provision of some £420 million has been made in 1983-84. [Composition of garrison to be announced in Defence Secretary's White Paper in December].

26. How will the various costs be met?

Extra costs in current year will be met from Contingency Reserve. The block defence cash limit for 1982-83 has been increased by £371 million on account of operations in the South Atlantic. (Hansard col W 108 9 November 1982) For 1983-84, an increase to the Defence Budget of just over £620 million has been announced. Future years' provision will be announced in the 1983 Public Expenditure White Paper. Extra defence costs will be met out of monies additional to path of annual real growth of 3 per cent.

27. What will be costs of repairing damage and reconstructing the Islands' economy?

Too soon to say what these costs will be. Work has begun on restoration of essential services and on implementing Civil Commissioner's recommendations for priority action (accommodation, inter-Islands air service, education). About £8.6 billion is now expected to be spent this year of which £3 million will be found from the Aid Programme and the balance from the Contingency Reserve. Ministers studying Shackleton Report proposals for long term development of Islands; in advance of decisions, impossible to say what costs will be.

[BACKGROUND WHICH CAN BE DRAWN UPON: Estimates of cost given in the Report are £31-36 million for new development aid; £40 million for offshore fishing; up to £12 million for additional housing/infrastructure. Total estimate of £83-89 million (at 1982 prices) excludes aid for rehabilitation and compensation for war damage already being made available.]

28. Cost of paying compensation for war damage?

Too soon to say what total will be. Claims are being processed, and further claims may be received. About £1½ million has so far been paid out, but this is no guide to what the final total might be. Costs this year will be absorbed within the FCO programme.

F CIVIL SERVICE STAFFING AND PAY

1. Civil service too big/does too much/is over staffed?

Since Government came to office, Civil Service has been reduced by 10½ per cent to 655,000. Results from reduction in functions, privatisation and improvements in efficiency. On course to achieve aim of having Civil Service of 630,000 by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean smallest Civil Service since end of Second World war.

2. Civil service efficiency?

[Government reply to TCSC was published 28 September entitled 'Efficiency and Effectiveness in the Civil Service Government Observations on TCSC Report' Cmnd 8616].

Measures to increase efficiency in civil service set out in Government's recent White Paper welcoming Report from TSCS, and accepting (totally or with reservations) no less than 20 of the Committee's 26 recommendations. White Paper gives details of new financial management initiative, and responds to Committee recommendations on management information systems, training in management and financial management, and the filling of senior posts.

3. Civil service pay in 1983?

Unions have asked Government, in light of 3½ per cent planning assumption announced 1 October (see E 12), whether Government intend to have genuine negotiations, and whether arbitration will be available. They believe arbitration should be unconditionally binding ie not subject to Parliamentary over-ride.

4. Megaw Report

Report of Megaw Inquiry into arrangements for deciding civil service pay in future (Cmnd 8590) contained number of important recommendations which are now being considered. Government pleased with widespread support that has emerged for the general approaches which the Inquiry endorsed. Preliminary 'ground-clearing' discussions with unions have commenced. A new system will not be agreed in time for 1983 pay.

5. Scott Report/Public sector pensions?

See K 21.

G SOCIAL SECURITY

NATIONAL INSURANCE CONTRIBUTIONS

[National Insurance contribution rates for employees and employers to be increased by 0.25 per cent from next April, thus increasing contracted-in rates for Class 1 from 8.75 per cent to 9 per cent (employees) and from 10.2 per cent to 10.45 per cent (employers). (Because of reduction in rebate on contracted-out rates - announced last March and not part of the annual contributions review - of 0.35 per cent for employees and 0.4 per cent for employers, Class 1 rates for contracted-out rise by 0.6 per cent (employees) and 0.65 per cent (employers); thus increasing rates from 6.25 per cent to 6.85 per cent (employees) and from 5.7 per cent to 6.35 per cent (employers).) Lower Earnings Limit rises from £29.50 to £32.50 and Upper Earnings Limit from £220 to £235. Change in the rate of National Insurance Surcharge also affects employers' total payments, see P1-3]

1. Why increase employees' contributions?

Recognise employees hard hit recently (increase of 2.5 per cent overall since Government came to power). Some increase necessary because of rise in cost of benefits paid from NI Fund. But, to protect contributors, increase is less than needed to balance Fund (in consequence, Fund will be in deficit in 1983-84 by £262 million).

2. Very large increase for contracted-out?

Change in contracting-out terms announced last March - following report by Government Actuary - and not part of this year's review. Reduction in rebate reflects Government Actuary's assessment of fall in cost to contracted-out schemes of providing guaranteed minimum pensions.

BENEFITS

[Benefits being uprated by 11 per cent later this month (22 November 1982). Includes 9 per cent to take account of inflation. 9 per cent clearly too high hence announcement in Autumn Statement that uprating in November 1983 will be adjusted to have regard to this].

3. Government reneging on pledge to maintain value of pensions?

On contrary, pensioners will be better off during next year by extent of overshoot. Only question how much of this real increase will continue beyond November 1983. Maintaining real value bound to mean adjustments from year to year; nothing extraordinary about this.

4. Level of overshoot?

Cannot say exactly until late December, when November RPI available. Industry Act forecast is 6 per cent inflation for fourth quarter 1982. So overshoot of 2½-3 per cent reasonable estimate. Reflects Government success in reducing inflation.

5. Public expenditure saving?

Recovery of a 2½ per cent overshoot would save £250 million in 1983-84; more in a full year. But social security programme has been reduced by £180 million in 1983-84. This reflects Government's judgement of appropriate level of expenditure. Exact level of November 1983 uprating will be settled at Budget time, when Government will, as usual, take wide range of factors into account.

6. Improvements in benefits?

[Ie, using difference between reduction of £180 million and full saving of £250 million if overshoot is £250 million.]

There is constant pressure from both sides of House for whole variety of improvements. Government will have to determine priorities, eg between change in individual benefits and adjustment to next year's uprating. Decisions will, as usual, be taken at Budget time.

7. Uprate pension by pensioners' price index?

[Two PPI's for one and two person households; both exclude housing costs. Both indices have moved less than RPI between fourth quarter 1978 Q4 and third quarter 1982 Q3. The gap has, however been narrowing in recent times. Moreover, comparison with the full RPI, ie including housing costs, shows that over time they produce very similar results.]

Pensioner's price index is not necessarily representative of pattern of pensioners' spending, and is constructed on limited information from a very small sample of pensioners. We consider RPI to be best measure of general level of prices, and appropriate for uprating of pensions. In any case, pensioners would not have done any better had we used the PPI to uprate pensions since we came into office.

8. Retirement age?

[Social Services Committee Report published 24 November: principal recommendation a more flexible State retirement scheme with 'fulcrum' pension age of 63 for both men and women].

Government welcomes this Report and the political consensus the Committee achieved. Report deals with important issues which Committee recognises as not for this Parliament. Their emphasis on equality and flexibility absolutely right.

9. Restore abatement of unemployment benefit?

Social Services Secretary made Government position clear in debate on 22 November. Government do not regard abatement of unemployment benefit as permanent measure; are considering question of its restoration in light of available resources and other decisions on uprating of benefits which will be taken as usual in context of uprating statement to be made at Budget time.

10. Death grant - increase to realistic level?

[Consultative document published 3 March, deadline for comments 30 July.]

Social Services Secretary grateful for comments received on consultative document on death grant published in spring and is considering them carefully.

ALTERNATIVE PROPOSALS BY OTHER PARTIES

11. Cost of social security proposals in 'Labour's Programme 1982'?

[Proposals include raising single/married pension to one-third/half of average earnings; reducing pension age to 60; increasing Child Benefit to £7.75; paying unemployment benefit for men, without limiting duration, at rate equal to RP.]

Cost of implementing Labour's proposals in full probably over £20 billion in full year - an increase of over 60 per cent in social security programme. Labour proposes revenue increases to finance changes of less than £4 billion (abolition of married man's tax allowance and of upper earnings limit of contributions). To raise remainder would require, for example, rise in employee's NIC from current 8.75 per cent to around 22 per cent; or rise in basic rate income tax to 46p in £.

12. SDP proposals?

See D7-8.

H FISCAL POLICY AND THE PSBR

1. Progress on fiscal policy?

[Aim is to achieve reduction in PSBR as percentage of GDP over run of years, so as to achieve lower inflation and interest rates.]

Have made progress; Government has succeeded in reducing PSBR as percentage of GDP, and further reduction is projected. Inflation has fallen fast and is expected to fall further (see Section K). Short term interest rates 6½ per cent below last autumn's peak. ~~have been much lower~~ Benefits seen in recovery of debenture market. [IF PRESSED : Government would like to see rates lower still, so long as further reductions not likely to endanger progress on inflation.]

2. How does UK fiscal stance compare with other countries?

[IMF Annual Report noted that among major industrial countries by far the largest 'restrictive shift' over past two years, equivalent to more than 3½ per cent, was that of UK.]

Many countries reducing borrowing; UK budget deficit now well below average of OECD countries. France demonstrates problems with reflation option and US experience shows that fiscal and monetary policy must be broadly consistent.

3. PSBR for 1982-83 now expected to be lower than FSBR forecast?

[1982-83 FSBR forecast £9½ billion. New Industry Act Forecast (IAF) £9 billion.]

Change is small (and insignificant compared with forecast errors of plus or minus £2 billion at this stage in year). Outturns for PSBR and CGBR so far consistent with PSBR of £9 billion this year.

4. How can Industry Act forecast of £9 billion PSBR in 1982-83 be reconciled with seasonally adjusted outturn for first half of year?

[Seasonally adjusted, PSBR April-September £3.0 billion.]

Wrong to multiply seasonally adjusted half-yearly outturn by two to get PSBR for 1982-83. Many erratic and irregular influences which seasonal adjustment does not pick up (nor is it meant to). Examples: public corporations expected to borrow more in rest of year than first half; outstanding pay awards (eg nurses); National Insurance benefits up-rating of 11 per cent.

5. PSBR seriously undershooting and Government has been forced to inflate the economy?

Government does not control the PSBR out of a wish to wear a hair shirt. Chancellor said in Mansion House speech [22 October] that PSBR seemed to be undershooting; in light of this

Government has decided to take further worthwhile measures to help industry and in other ways, e.g housing announcements by Environment Secretary.

6. Why then hasn't Government acted to get PSBR back to £9½ billion?

PSBR forecasts not precise targets - would not make practical sense to fine tune in that way. Must also remember margins of error in forecasting PSBR (see Q3).

7. Why has Government cut PSBR for 1983-84?

[IAF figure of £8 billion for 1983-84 compares with £8½ billion in this year's MTFS.]

PSBR figures in IAF and MTFS for 1983-84 are not targets. The actual plan will depend on judgement taken in next Budget. Both PSBR figures are same percentage (2¾ per cent) of money GDP. Reduction in money GDP forecast since March merely means that this implies £8 billion rather than £8½ billion.

8. More than £1 billion available for tax cuts next year?

[IAF showed £1 billion 'fiscal adjustment' 1983-84; CBI suggest scope for £2.5 billion].

PSBR figures in Industry Act forecast illustrative, not targets. Final decisions about PSBR and tax cuts planned for 1983-84 will be made at Budget time, not before.

9. Cyclically adjusted PSBR better guide to policy?

Government fiscal policy has taken account of recession. Acid test of PSBR is level of interest rates at which it can be financed, not its value at some hypothetical cyclically adjusted level of output.

10. Inflation-adjusted or 'real' PSBR in surplus - isn't fiscal policy too tight?

['Real' PSBR subtracts from actual PSBR erosion by inflation of real value of Government debt. Calculations by Bank of England and others produce a surplus 'real' PSBR in most years since the 60's.]

No. Fall in inflation has raised the 'real' PSBR (because the 'inflation tax' is reduced). Real PSBR is interesting indicator but poor guide to setting policy e.g. suggests raising PSBR when inflation accelerates.

J MONETARY AND FINANCIAL POLICY

1. Monetary growth in 1982-83 on target

[(Full) money and banking figures for October published 18 November heavily distorted upwards by oversubscription for STC. Bank gave more prominence to their estimates of underlying increases. Target aggregates M1 £M3 and PSL 2, adjusted for STC distortion, grew by ½ - 1¼, ¾ - 1¼ and ¾ - 1¼ per cent respectively in banking October. Implied rates of growth in 1982-83 target period were 9-10½, 11¼-12¼ and 8¾-9½ per cent per annum respectively, compared with target range of 8-12 per cent (all figures seasonally adjusted).]

Estimated rates of growth in target period are within Government's 8-12 per cent range for M1 and PSL 2 and at top end of range for £M 3.

2. Adjustment for STC attempts to cover up large October increases?

Distortion to recorded October money figures by STC effect was widely anticipated in the City. The clearing banks' own statement consistent with that of Bank of England. Nothing to be gained by covering up as distortion will correct itself in figures for later months.

3. Benefit of interest rate falls to home buyers

[Mortgage rates have fallen 5 percentage points since this year's peak in March. Latest cut to 10 per cent comes into effect for all home buyers on 1 December.]

Mortgage rate falls including latest cut mean for average couple buying first home net saving of over £50 a month since March.

4. Effect of US developments?

[US interest rates fell substantially during July/August, and in October. Discount rate cut again 19 November and prime rates cut 22 November.]

The falls in US interest rates were helpful and facilitated reductions in our own. But of course US rates are not sole determinant of UK's, and this spring progress was made in reducing ours at a time when US rates were rising. UK rates are determined in the light of domestic monetary conditions generally, including the behaviour of the exchange rate. Effect of high US money supply figures and delay in cutting Federal discount rate combined, weakened gilts market and sterling in last fortnight.

5. Will slide in sterling affect monetary conditions?

Exchange rate is one of several important factors taken into account in judging domestic monetary conditions. Government has no intention of allowing lax financial conditions to jeopardise progress in defeating inflation. Steadfastness of Government reaffirmed by PM 26 November (Edinburgh speech).

6. Why have interest rates gone up?

[Barclays Bank increased their base rates by 1 per cent (to 10 per cent) and Midland theirs by 1¼ per cent (to 10¼ per cent) on 26 November. Lloyds and Natwest followed on 29 November with increases at 1 per cent (to 10 per cent) but still down by 6 points since peak in October 1981. Long term interest rates also reduced significantly over past year.]

Structure of interest rates in domestic money markets has been dislodged by fall in sterling. Interest rates in domestic money markets rose sharply at end of last week. Bank base rate increases and increase in Bank of England's dealing rates reflected this. Government remain determined to maintain sound monetary conditions and to continue progress towards lower inflation.

7. Rise in interest rates will stifle recovery (as in autumn 1981)

The fall in the exchange rate will, of course, be of benefit to many companies provided they maintain control over domestic costs. But no purpose would be served by allowing inflationary conditions to reappear. Overall, interest rate reductions over past year are still substantial.

8. Did Government engineer rise in interest rates?

Rises in base rates and Bank of England's dealing rates were a response to higher market rates, but are consistent with Government's intentions to maintain sound monetary conditions.

9. Bank lending growing too fast?

[Lower growth rate in May/June not maintained. Increased by (seasonally adjusted) £1.3 billion in banking August, £2 billion in September , and £1.8 billion in October. (October figure distorted upwards by sale of STC.).]

Reasons for growth of bank lending to companies not entirely clear. Companies may have been trying to build up gross liquidity levels which fell back in spring. Strong growth in personal lending is partly result of structural changes, such as move by banks into home loans market, replacing lending by building societies; ending of HP controls in July does not appear to have had a large effect. To the extent that increases in bank lending are additional, ie not just in substitution for lending by eg building societies, do represent potential cause for concern, as add to monetary growth. To be taken into account in interest rate policy.

10. Why has Bank of England been providing such large-scale money market assistance?

The rapid growth of bank lending has caused problems for conduct of monetary policy. By selling long-term Government debt on a larger scale outside the banking system, it has been possible to contain the rapid growth in money which could otherwise have taken place. This in turn has created shortages of liquidity in money markets. If Bank had not intervened, short-term interest rates would have been forced up to unnecessarily high levels.

K PRICES AND EARNINGS

PRICES

1. October RPI

[Year on year increase in RPI 6.8 per cent in October, compared with 7.3 per cent in September].

Annual rate of inflation again fell sharply in October to 6.8 per cent, its lowest level for 10 years (compared 6.6 per cent in October 1972).

2. Further falls likely in 1983?

Industry Act forecast is for 5 per cent early next year. That assessment still stands.

3. No decline in inflation between spring and autumn 1983?

[Mansion House speech: 5 per cent by spring. Industry Act forecast: 5 per cent in fourth quarter 1983.]

Obviously we cannot expect to maintain the very rapid progress on inflation which is now being made. What we will maintain are the policies which have given us this success; confident that they will keep inflation down.

4. Inflation lower than under previous Government?

[Average year-on-year rate of inflation between February 1974 and May 1979 was 15.4 per cent; average level of inflation since May 1979 has been 12.7 per cent.]

Year-on-year rate of inflation was 10.3 per cent and rising when previous Government left office in May 1979. Now (October 1982) 6.8 per cent and falling. We will be first Government for quarter of a century to achieve a lower average rate of inflation during its term of office than the previous Administration.

5. Inflation still not as low as competitors?

[September figures UK inflation 7.3 per cent compared with 5.0 per cent in US, 4.9 per cent in West Germany, and 3.2 per cent in Japan.]

UK inflation now lower than Western European (OECD Europe) average, and well below many countries - such as France and Italy. Still some way to go to match US, West Germany and Japan, but good progress being made in right direction.

6. Long term inflation objective?

Recent developments encouraging. But inflation rate still higher than some competitors e.g Germany. Must not let up. Have always made it clear that price stability not unattainable.

7. TPI now shows pay increases need to be ½ per cent higher than RPI to maintain living standards?

[Increase in TPI over 12 months to October 7.4 per cent, compared with RPI increase of 6.8 per cent].

The gap between the RPI and the TPI (now 0.6 percentage points) widened in July when benefits paid to the unemployed became taxable. Pay increases go to people in work, who will not pay any more tax as result of the change - except for the minority who have a spell of unemployment during the year.

8. Nationalised industry prices

[Increase over 12 months to October 15.1 per cent, compared RPI increase of 6.8 per cent].

Increases regrettable, but holding prices down artificially would distort market forces and add to burden on taxpayer. But sustained improvement only possible if industries succeed in holding down current costs, particularly pay. (See also R1).

PAY

[NB: GAD Report published 8 November included assumption that average earnings in 1983-84 6½ per cent higher than in 1982-83.]

9. What pay settlements does Government now want?

Low enough to be consistent with improved job prospects in the industry concerned. The lower the better. Certainly lower than in the past year.

10. 5-5½ per cent settlements in year ahead?

[5-5½ per cent settlements quoted by T Burns to TCSC 16 November as consistent with 6½ per cent assumption given to Government Actuary.]

True that settlements around 5 per cent would be consistent with Government Actuary assumption. But so would lower figures. If 'drift' was 2 per cent - as last year - 6½ per cent earnings would imply 4½ per cent settlements. But important point is not the assumptions used but the need to get settlements as low as possible.

11. What has been average over past year/pay round?

[CBI Databank suggests 7 per cent average for manufacturing in last (1981-82) pay round.]

Average has been in single figures, and moving downwards, in each of past two years. We need a substantial further reduction, with really low settlements, and thus a better outlook for jobs, in the year ahead.

12. Pay settlements failing to come down?

[FT article (1 November) and November Incomes Data Services Report suggest pay settlements still averaging 7% in spite of falling inflation.]

Too early to say. Few settlements so far this autumn. But in everyone's interest that pay settlements should come down, and come down sharply.

13. A 3½ per cent pay policy?

The 3½ per cent pay assumption [announced 1 October for calculating the pay element in cash expenditure plans for 1983-84] does not represent a 'norm', still less an 'incomes policy'. Nor is it a decision on the offer to be made in any individual case. Settlements higher or lower than the assumption are not ruled out. Each case will be considered on merits.

14. Government exhortations on pay imply aiming to cut living standards?

[Real earnings show little variation over past two years; August 1982 broadly similar to August 1981 and about 1 per cent higher than August 1980.]

Low pay increases do not necessarily mean a reduction in living standards. But whether they do or not, they are essential if we are to create a competitive and profitable productive sector, and thus secure the conditions for sustained improvement in living standards.

15. 1982 New Earnings Survey shows public services falling behind?

Taking account of the effect of overtime on those working in the private sector, and public service settlements which were delayed beyond the Survey date, difference shown between public services and private sector pay movements over period covered by April 1981 and 1982 Surveys no more than 2 per cent.

16. Average earnings index

[Year on year growth 6.8 per cent in September compared with 7.8 per cent in August. Underlying increase about 8¾ per cent in September.]

Encouraging that underlying rate of growth continues to fall. Further moderation in settlements can only be helpful in maintaining jobs and getting inflation down.

17. Incomes Policy

Proposals for incomes policies, including recent refinements, do not avoid many of the familiar problems of norms, administrative costs, and interference with market forces. Experience gives no encouragement to the idea that incomes policy can be made to work on a permanent basis. They always succumb to the distortions they create.

18. Top Salaries Review Body increases too large?

[Government announced on 12 May increases of 14.3 per cent for senior civil servants and senior members of armed forces, and 18.6 per cent for judiciary.]

Government believes these increases are fully justified. Essential to ensure adequate supply of candidates of sufficient calibre for the Bench, and to provide adequate career structure and differentials in higher levels of civil service and armed forces. Before the increases, TSRB were the only group whose salaries were below those recommended for April 1980.

19. Performance-related pay for nationalised industry board members?

This is an attractive concept. Practicalities and implications of it are being studied jointly with representatives of the Nationalised Industries' Chairmen's Group, at Government's initiative. Individual boards are free to make proposals of this kind for their own circumstances.

20. Pay increase for nationalised industries' boards this year?

No general level of increases for board members this year. Proposals for each board are being considered individually on their merits, in light of circumstances of the board. When relatively large increases have been approved by Ministers responsible (in consultation with Chancellor) it is because these have been justified by such factors as the need to recruit people of ability, inadequate differentials with senior staff and the performance of the industry. Because board pay has been held back in previous years, many salaries are now seriously out of line with market rates.

21. Index-linked pensions and Scott report?

Question debated in House of Commons 22 October, when Government announced they favoured Megaw Committee suggestion that civil service pension scheme be made contributory. Reduction in inflation has greatly eased disparity between private and public sector pensions; Government's main aim at present is to ensure appropriate contributions are paid for index-linked benefits.

L BALANCE OF PAYMENTS

1. Trade figures and current account

[October trade figures show trade account in broad balance though non-oil trade remains in deficit; invisibles surplus of £260 million a month in Q2 and projected £200 million a month from Q3 onwards. Cumulative current account surplus of £3.0 billion in ten months to October. IAF shows zero current account balance in 1983.]

Current account remains in substantial surplus, albeit reduced from last year's levels - current account surplus for 1981 was £6 billion.

2. Trade in manufactures in deficit this year for first time?

[Max Wilkinson in FT 23 November].

'Financial Times' got it wrong. Trade in manufactures not in deficit this year when exports and imports are valued on a comparable basis. On the contrary, a substantial surplus so far this year - around £2 billion up to October. [NOT FOR USE: Figures underlying IAF suggest that trade in manufactures may go into deficit next year].

3. Export trends - recent

Month-to-month movements in exports during 1982 have been very erratic. There was a sharp recovery in exports in September and October from the erratically low August level but underlying level of non-oil exports has probably fallen since the spring. To a large extent this appears due to world recession; world trade in manufactures has probably fallen in 1982-83 - first year-on-year fall since 1975.

4. Export trends last few years?

Growth in UK exports of manufactures significantly below world trade growth over 1977 to early 1981, when competitiveness worsening, but with improvement in competitiveness since then, our share appears to have stabilised.

5. Import trends

Manufactured imports fell ½ per cent in 3 months to October: there has been little change in underlying level of manufacturing imports since end-1981. Manufacturing output has fallen back a little this year, so there has probably been some continued growth in import penetration, although not at anything like same rate as in 1981.

6. New import controls on way?

[Continuing Press speculation].

We are concerned at the extent of unfair trading practices and the damaging effect of very high tariffs and quotas in some other countries. Pressing for positive European Community action to remedy this. But wish to make clear, as Chancellor said recently [Caterham 22 October] that 'we will be continuing to defend the open trading system'. A free and fair trading system is in the interest of all trading nations.

7. Overseas investment takes jobs away from UK?

30 per cent of UK exports are bought by overseas firms connected with UK companies. By increasing links between UK and overseas companies, overseas investment helps UK exports and production, so producing more jobs. If UK does not take profitable opportunities to invest overseas, others will.

M EXCHANGE RATE AND THE RESERVES

1. Policy towards the exchange rate/falling £?

[£ suffered repeated bouts of selling pressure during the two weeks from Friday 12 November, touching low points on Friday 26 November. Confidence in the pound has been restored following the firming of interest rates on that day.
:

	12 Nov close	26 Nov low points	29 Nov noon	12-29 Nov % change
$/£	1.6512	1.5700	1.6036	-2.9
DM/£	4.2783	3.9584	3.9925	-6.7
£ effective	91.3	84.9	86.2	-5.6

Previous lows for sterling were $1.5675 (28.10.76), and DM 3.9475 (31.1.80). The fall reflected a number of factors: the market's reassessment of sterling in the light of poorer balance of payments prospects and weakening oil markets; some profit-taking moves out of gilts by non-residents; and a mistaken fear that the Government was easing domestic monetary conditions.]

Government has no target for the exchange rate. Policy is for rate to be determined largely by market forces with intervention limited to that required to seek to moderate excessive ~~fluctuations~~ and maintain orderly markets. Exchange rate only one of factors taken into account in interpreting domestic monetary conditions and taking decisions on policy. But it should be beyond doubt (after Friday's developments) that the Government has no wish to devalue sterling whether by 7 or 10 per cent or any other figure.

2. The rise in base rates proves the Government has an exchange rate target

No. Interest rates last week were affected by the fall in sterling and movements in other currencies; and towards the end of the week rates in the domestic money markets rose sharply. This triggered the subsequent increase in clearing bank base rates. Government policy is one of unchanged determination to maintain sound monetary conditions and progress towards lower inflation. In judging monetary conditions the policy remains to take account of movements in a range of indicators alongside the monetaryaggregates, including the exchange rate.

3. Should not Government welcome fall in pound?

A lower exchange rate means higher costs to industry and the consumer: no-one should welcome that. Of course, recent fall in pound may bring some relief to British firms that are facing difficult com~~m~~petitive pressurees in home and overseas markets, particularly from Europe and the Far East - but they must contain their costs rigorously in order to retain that benefit. We cannot solve our basic problems of com~~m~~petitiveness by depreciation, and no-one should doubt our determination to adhere to our counter-inflation policies. Sound money remains at the heart of the Government's economic strategy. As PM said in Edinburgh last Friday, those who attribute to us ambitions to see our curreency devalued are talking utter nonsense. They do not understand the steadfastness of this Government.

4. <u>Why not improve UK competitiveness directly by encouraging exchange rate down further</u>?

Past experience shows that devaluation is no answer. Any temporary gains in competitiveness are eventually swamped by the effects of higher inflation. UK's problems caused by failure to contain costs (effective rate now at level in May 1979 but cost competitiveness perhaps 18 per cent worse). Industry itself has mixed views about desirability of bringing the rate down (illustrated at CBI Conference in October).

5. <u>Influence rate differentially as against DM/yen and dollar</u>?

Could only do so by depressing value of dollar against DM/yen. Over recent months both German and Japanese authorities have indicated that a desirable end but one which they are powerless to achieve. Dollar/DM and dollar/yen exchange rates are even less within power of UK authorities to influence.

6. <u>Bank of England intervention</u>?

Policy is unchanged. Bank intervene to smooth excessive fluctuations and preserve orderly markets particularly when conditions unsettled. But Bank do not attempt to resist underlying trend of rate. Not practice of Government to comment in detail on intervention undertaken.

7. <u>Debt repayments</u>

We have made excellent progress with our plans to reduce the burden of external debt substantially during this Parliament. We aimed to reduce official external debt to $14 billion by end of 1981. This has been more than achieved - external debt is now around $13 billion, compared with over $22 billion when the Government took office.

N EUROPEAN MATTERS

MEMBERSHIP OF EUROPEAN COMMUNITY

1. UK budget settlement

Foreign Ministers agreed on 25 May to a settlement for the UK budget contribution for 1982 which provides for a basic refund of about £470 million with provision for change if our unadjusted net contribution varies from the Commission estimate of £880 million. Final agreement on implementation on the settlement was reached by Foreign Ministers on 25/26 October. Although UK will only be compensated for 75 per cent of our contribution to German refunds, we shall receive our 1982 refund of 1092 million ecus, about £600 million gross, much earlier than originally envisaged.

2. Progress in implementing 1982 Budget Agreement

Commission has submitted draft implementing Regulation which is now being considered by the Council and the European Parliament. The Parliament is also considering draft supplementary and amending budget which Council established on 8 November to provide necessary budgetary provision for our refunds payments. [IF PRESSED ON consequences of Parliament blocking either the Regulation or the Amending Budget: cannot speculate on hypothetical question].

3. Refunds for 1983 and later

On 17 November Commission produced its proposals for dealing with UK budget problem in 1983 and later. Commission communication does not suggest what size of our refunds or our net contribution after refunds should be. We think it provides a suitable framework for discussion of problem within the Community. However, we recognise with regret that end-November deadline for decisions on 1983 and later will not now be met: hope nevertheless that progress will be made quickly.

4. UK objectives for longer-term negotiations?

Government has made it clear that, in spite of our relative economic position, UK is prepared to remain a net contributor - but only on a very modest scale.

5. Will Government withhold contributions?

We hope very much that the issue of our Budget contributions can be satisfactorily settled without the need for recourse to such a step.

6. <u>15/16 November ECOFIN/'Jumbo Council' discussions on economic policy</u>

All member states agreed to conclusions of the Joint Council which stress need to control level of public borrowing and inflation as precondition for lasting reduction in unemployment.

7. <u>Commission's ideas for changes to 'own resources' system</u>

Understand that Commission are considering measures to diversify Community's revenue sources. If they put forward proposals we will consider them. Our opposition to any increase in the 1 per cent VAT ceiling is well known.

8. <u>Policy for CAP reform</u>

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

9. <u>Costs of CAP to UK consumers</u>

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

10. <u>What is the current attitude of the UK Government</u>?

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.

11. <u>Join the EMS for exchange rate stability</u>?

There is no reason to suppose that by the simple act of joining the EMS exchange rate mechanism we would guarantee exchange rate stability. This has not been the experience of the current participants. Genuine stability requires a return to low inflation rates throughout the Community.

P INDUSTRY

1. Effect of NIC and NIS changes on private sector employers?

[Chancellor announced further reduction of 1 percentage point in National Insurance surcharge for 1983-84, cutting the rate to 1½ per cent; also half of the 1 percentage point reduction in the rate next year will be brought forward into the current financial year. Effect will be as if private sector had paid at 2 per cent rather than 2½ per cent (rate announced in 1982 Budget) during 1982-83. Small increase in employer's NIC as from April 1983 also announced on 8 November (see G: NI contributions.]

The special reduction in NIS is worth about £350 million to private sector employers this year, and the announced NIC and NIS changes taken together will benefit them by over £400 million next year. Constitute a substantial reduction in the costs faced by private sector commerce and industry.

2. How does this compare with burden as at May 1979?

Private employers will pay around £1 billion less next year than they would have done under the rate of NIS and employers' NIC inherited from the previous Administration.

3. Won't contracted-out employers be worse off?

No; their combined rate of NIC and NIS falls by 0.35 per cent next year. [Reduction of contracted-out rebate was announced last March, so not part of Autumn Statement, but included in this calculation.]

4. Prospects for industry-recovery?

See A 9 and Section B.

5. Prospects for construction industry?

[Construction employers still looking for more public investment FT 22 November.]

Current picture for industry rather mixed (construction orders falling off recently, private housing starts showing little increase recently, though more than 20 per cent higher than last year) but Government has been doing a good deal to help. Lower inflation and above all lower interest rates - including mortgage rate down 5 percentage points from autumn 1981 peak - especially valuable to construction industry. Decisions announced 8 November - additional capital allocations to local authorities and increased spending provisions for the Housing Corporation - could give an extra £¾ billion of work to the industry in 1982-83. And Autumn Statement plans for 1983-84 include provision for a one third increase over 1982-83 (to £4 billion) in LA capital spending; a substantial increase in capital spending on urban and derelict land programmes; and a £350 million increase in housing investment.

6. Companies' financial position?

[

	1979	1980	1981 Year	H1	H2	£bn 1982 H1
Net borrowing requirement (+)/repayments (-)	+6.3	+6.5	+5.1	-1.5	+6.6	+5.6
Financial surplus (+)/deficit (-)	-2.9	-1.4	+1.8	+1.0	+0.8	-1.3]

Financial position of industrial and commercial companies (excluding North Sea) improved last year, relative to 1979 and 1980. Improvement in part reflected companies' efforts to cut costs, for example by de-stocking. Some apparent deterioration in second half 1981 financial position due to slowdown in de-stocking and unwinding of delays in tax payments because of the civil service dispute. Figures for H1 1982 suggest reduction in companies' borrowing requirements relative to H2 1981; but borrowing needs still high.

7. Profits rate of return still too low?

[Gross trading profits of industrial and commercial companies (ICCs) (net of stock appreciation) rose 18 per cent to 1982 H1; but increase was from a very low base ICC's real pre-tax rate of return (except North Sea was just over 3 per cent in 1981, and only 2 per cent in manufacturing - half previous cyclical low figure in 1975.]

Government can help best by getting inflation down and setting sound basis for sustained recovery. Fundamental improvement in ICC's rates of return depend on better performance by companies. Some encouragement from recent productivity gains and trend towards moderate pay settlements.

8. Real rates of return on capital lower in UK than elsewhere?

[OECD statistics comparing UK, Japan, France and UK show net rates of return to fixed capital in non-financial corporations in 195-80 lowest in UK - though all on a downward trend. 1980 figures: US 13 per cent, Japan 15 per cent, France 9 per cent, UK 5 per cent.]

Figures show how policies of earlier administrations have allowed profitability to slide in UK. Sound basis for sustained recovery rests on reducing inflation, increased productivity gains, and moderation in pay settlements which creates conditions for better performance by companies.

9. High interest rates damaging for industry and investment?

Before last weekend banks' base rates had fallen 7½ percentage points since last October, and 3½ points over last three months. Outside analysis suggests that a 1 per cent reduction in interest rates improves the net financial position of the company sector by about £250 million over a full year. Lower interest rates reflect Government's firm fiscal and monetary stance and will help industry and investment.

10. Lower rates for industry?

De-rating one of a number of possible ways of assisting industry and business, but in last Budget preference given to other forms of relief, notably reductions in NIS. De-rating would be expensive, though less so if applied to industry alone - even so, 10 per cent de-rating would cost about £140 million per annum. Legislation would be required.

11. Lower energy prices

See R2-3.

12. Government help for small firms

Budget provided further help for small businesses, increasing the number of measures taken so far to over 100. Enterprise package included further reduction in weight of corporation tax; further increases in VAT registration limits; increase in global amount available for loans under Loan Guarantee Scheme (see below); and doubling of investment limit under Business Start-Up Scheme to £20,000 a year. New measures will encourage start-ups and existing firms.

13. How many new firms starting up?

[Correspondence in progress between Treasury and D Industry about value of giving 'net' figures of 'birth' of minus 'deaths' of companies based on VAT registrations.]

On a very rough average some 10,000 new companies come into being every month.

14. Response to Loan Guarantee Scheme?

[Well over 6,900 guarantees already issued - about half to new businesses. Total lending under scheme over £230 million. Budget provided for lending ceiling in first year (to May 1982) to be raised from £100 million to £150 million and for further £150 million to be available in second year (to May 1983). Thirty financial institutions now participating.]

Scheme operating successfully. Too early to assess overall cost . After first year, out of over 6000 guarantees issued, only 150 have so far been 'called'. Cost has been covered by the premium income received over the period. Scheme is kept under continuous review.

15. New enterprise zones

Proposed sites for new zones in England announced by Environment Secretary 15 November; sites for two new zones for Scotland, one for Northern Ireland and one (possibly for more) for Wales have also been announced. Total (12 or 13 in all) slightly more than the eleven new zones announced by Chancellor (27 July); this reflects number and quality of applications received from local authorities.

16. First group of enterprise zones

All first eleven zones now in operation. 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.

R NATIONALISED INDUSTRIES

NATIONALISED INDUSTRY PAY AND PRICES

1. Nationalised industries' prices

[Having risen approximately in line with retail prices for several months, the latest figures show bigger 12 months increase in nationalised industry prices, water charges and London Transport fares than all items RPI (15.1 per cent in October compared 6.8 per cent). This differential reflects March increase in LT fares. Removal of these temporary distortions confirms that nationalised industry prices are still increasing somewhat faster than RPI, largely because of increases in energy sector.]

Gap between nationalised industry price increases and RPI has been due in large measure to cumulative effect of years of artificial price restraint. World oil price rises of 1979 and 1980 have also played an important part. We greatly regret the need for these increases, but holding prices down artificially would distort market forces and add to burden on taxpayer. Differential between RPI (all items) and NI prices (including water charges and London Transport fares) now currently about 8 per cent compared with 14 per cent in January 1982. But sustained improvement will only be possible if the industries succeed in holding down their current costs, particularly pay.

2. Freeze on industrial gas prices?

[BGC announced 8 November that freeze on renewal prices for contract gas due to expire at end of year would be extended for further nine months].

Government welcomes BGC's decision to freeze industrial gas prices for a further nine months from the end of this year. Decision was taken on purely commercial grounds - BGC judge that they can accommodate the freeze within their present EFL.

3. Electricity prices?

As announced by the Secretary of State (for Energy and for Scotland) on 12 November, electricity prices (domestic and industrial) will not, on average, be increased at all in 1983. This is consistent with the EFLs announced 8 November. The standstill follows the recent review of the bulk supply tariffs.

4. What is Government doing to improve nationalised industries' efficiency?

We continue to press for greater efficiency within NIs. We are setting realistic financial targets and performance aims. A rolling programme of Monopolies and Mergers Commission investigations has been set up. The introduction of market forces provides greatest incentive to efficiency.

5. Nationalised industry boards' pay?

See K ~~20-21~~ 19-20.

INVESTMENT

6. Nationalised industries' investment should be stepped up to/improve infrastructure/provide orders to private sector/as boost to economy?

Government has not prevented the industries from carrying forward a large number of profitable investment programmes. Wasteful to provide funds for public sector projects with lower returns than those in private sector. Unfortunately, pre-tax rate of return on nationalised industries' capital (including subsidies) in 1980 (latest available figures) was minus one per cent, compared with 3 per cent for industrial and commercial companies.

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

As in private sector, moderate pay settlements and control of other costs are essential. Ability to finance new investment in nationalised industries bound to diminish if excessive pay settlements agreed. Each 1 per cent off wages saves about £140 million this year; and each 1 per cent off total costs saves £330 million this year.

8. Take nationalised industry investment out of PSBR?

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

9. Private finance for NI investment?

In discussions in NEDC and elsewhere, we have indicated our willingness to consider new financing proposals, provided they can be structured so as to induce improvements in efficiency at least sufficient to offset the extra cost, and provided the finance is raised in fair competition with the private sector.

10. Investment plans unlikely to be attained?

[PM has stressed to chairman of NI Chairmen's Group importance of maintaining NI investment programme: £900 million underspend 1981-82, £500 million expected underspend 1982-83.]

No Government can unconditionally guarantee a particular level of investment by the nationalised industries. NI planned investment for 1982-83 26 per cent higher than estimated outturn 1981-82. Some signs plans may not be fulfilled. Events outside industries' control may cause investment plans to be revised downwards. PM has made it clear that industries should make full and proper use of their allocation.

EXTERNAL FINANCING LIMITS

11. EFLs for 1982-83

Nationalised industries' total external finance increased by £1.3 billion in 1982-83 (£1.2 billion after allowing for NIS cut and other changes). Increase in 1982-83 was roughly half what the industries bid for. Government has given full recognition to problems faced by the industries in a period of recession.

12. EFLs for 1983-84?

Nationalised industries EFLs for 1983-84 announced in Autumn Statement. Overall, external finance in line with previous plans. £2.7 billion being made available to nationalised industries in 1983-84.

PRIVATISATION

13. Special asset sales in 1981-82

Gross sales in 1981-82 totalled £481 million, so target published in 1981 Public Expenditure White Paper of £500 million nearly met. Pleasing result - included two large sales - Cable and Wireless (£182 million) and Amersham International (£64 million). True that delivery of BNOC oil in 1981-82 paid for in 1980-81 and taken into account in special disposals figure for that year reduced 1981-82 receipts by £573 million to total of -£92 million. But it is gross figure which is true measure of success of Government's privatisation programme. As Chancellor said in Cambridge 3 July, 'Public utilities and the so-called "natural monopolies" cannot be allowed permanently and without challenge to remain within State ownership'.

14. What further sales expected?

Special sales of assets in 1982-83 forecast at around £600 million and expected to increase in subsequent years. This year's and next year's involve primarily very large sales of energy assets - Britoil and the British Gas Corporation's major offshore oil assets - made possible by Oil and Gas (Enterprise) Act (which received Royal Assent in June). Industry Secretary announced 19 July plans to sell 51 per cent of British Telecom - but not before next Election.

15. Why Britoil sale by tender?

Choice between tender and fixed price offer considered carefully. Tender allows price to take into account upward movements in market during period of offer for sale. In fact, movements were down. This does not make the choice wrong.

16. Marketing of public assets unsuccessful - Amersham and Britoil failures in different ways?

[Heavy oversubscription for British Aerospace, Cable and Wireless, Amersham International, followed by large increases in prices when shares first traded; about 75 per cent of Britoil shares left with subunderwriters and large discount when first traded].

No. These companies successfully privatised. Pricing an issue not easy especially when company's shares have not previously been traded. In addition, cannot accurately anticipate movements in market after price fixing but while offer still open.

17. Contribution to giving people satisfaction of property ownership?

Exercise of returning enterprises from State ownership to ownership by the public has included measures to promote employee share ownership in the enterprise they work for; for example free offers of shares (British Aerospace, Cable and Wireless, Amersham, Britoil); preference in allocation of shares (B Ae, C & W, Amersham, Britoil, BP); provision for matching shares - one for each share subscribed for - (B Ae, Amersham, Britoil, BP). Most radical initiative taken by consortium of managers and employees who bought National Freight Company. Inclusion of small sharesholders' bonus in Britoil sale designed to reeward small investors who retain an interest in the company.

S NORTH SEA AND UK ECONOMY

1. New forecast of North Sea revenues?

[Autumn Statement (Industry Act forecast) projections (in money of the day) of Government revenues from North Sea: £6½ billion in 1981-82, £7 billion in 1982-83, £7½ billion in 1983-84. Higher than 1982 FSBR projections, partly because of higher production, partly higher oil prices].

Must remember that oil revenue projections are crucially dependent on inherently uncertain cost, price and production assumptions. Prospects for North Sea tax receipts have improved since 1982 FSBR because of higher than assumed oil prices and production. New projections assume oil prices do not change much from present levels.

2. Onerous tax system damaging future field developments?

[Shell/ESSO have shelved plans for Tern partly because of tax system; Phillips postponing T-block complex and BP their Andrew field; BP statement issued with their interim results criticised fiscal regime.].

Other adverse factors - falling oil prices earlier this year; high development costs - much more important. Detailed study has shown that under new tax structure, levels of profitability should still be sufficient to make exploration and development attractive. Hope that present structure will provide more secure and stable tax regime. Aberdeen University study shows UK taxation on marginal fields to be one of world's 'more lenient'.

3. Taxation of petrochemical feedstocks

[Government has announced that new rules on valuation of ethane for petrochemical use in interaffiliate transfers (Finance Act Section 134) should be extended to mixed streams of gas with a large ethane component. ICI complain that the extension and the rules themselves give unfair advantage to their integrated oil company competitors and have taken out writ against the Government.]

Government convinced that new formula will give fair valuation. New valuation will not have effect of providing subsidy to ICI's competitors. Have done best to reassure ICI. Will resist ICI's legal action.

4. Government should do more to promote UK Continental Shelf oil production in 1990's?

[Select Committee on Energy's Report on Depletion Policy published 18 May: emphasised development of fields entering production in 1990s by increasing pace of licensing rounds and overhauling fiscal regime. Recommended reserve powers to impose production cuts. Energy Secretary and Chancellor replied in joint memorandum on 29 July].

HMG agrees with general conclusions encouraging North Sea exploration and development, thereby maximising economic oil production over time; eg decision recently announced not to impose production cuts before 1985. Agree uncertainties in oil markets too great to justify deferring new field developments in foreseeable future. Cannot accept Committee's criticism of North Sea fiscal regime - opposed to another fundamental review; industry does not want a structural upheaval.

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

[Contribution of North Sea to GNP estimated at 4 per cent of GNP in 1981. Not projected to rise significantly before 1985.]

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 lower level of interest rates to benefit of industry and economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Less than 6 per cent of total General Government receipts in 1982-83.

6. North Sea revenues should be channelled into special fund?

North Sea revenues are already committed. Setting up special Fund would make no difference. More money would not magically become available.

7. Are we really any better off for our North Sea oil?

We are better off with oil - at current oil prices - than we would have been without it. We have been spared fall in real national income that other industrial countries have suffered following oil price rises. But North Sea oil costly to produce, so we are not necessarily any better off than we would have been had oil prices not risen. No need therefore for possession of oil to require a contraction in our industrial base.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Prospects for world recovery?

Output in major economies appears to have recovered slightly in spring 1982 after downturn last winter. Since then, major European economies have remained depressed. In US output flat in Q3 after small rise in Q2. Lower inflation and interest rates however offer prospects for better growth next year.

2. Why don't major industrial countries together expand demand?

Widespread agreement among leaders of the major countries expressed at the OECD, Summit and IMF and, most recently, 'jumbo council' meetings on the need to continue the fight against inflation. As the OECD's Economic Outlook explains, Governments are convinced 'a significant part of any stimulus to demand would increase public sector deficits, and dissipate itself rather quickly as an increase in inflation'.

3. Anti-inflation policies are working

[Consumer price inflation down from a year ago in all 7 major economies on latest available figures: US (from 11.0 to 5.0 per cent), UK (11.7 to 6.8 per cent), Japan (3.9 to 3.2 per cent), Italy (18.3 to 17.2 per cent), Canada (12.5 to 10.4 per cent) France (13.9 to 10.1 per cent), Germany (6.5 to 4.9 per cent).]

Inflation has fallen in all major countries in the past year. Firm fiscal and monetary responses to 1979-80 oil price rise vindicated. UK close behind US and Germany in bringing down inflation, and ahead of some other European countries. Realism in wage settlements is growing; US, Germany and Japan all have wage settlements in single figures.

4. Cuts in public expenditure in other countries?

[Many countries seeking economies. Countries planning to curb public sector pay and costs include Germany, France, Japan, Canada, Belgium and Denmark. Also Germany, France, Canada, Belgium all plan to make economies in welfare programmes.]

UK not alone in facing up to hard decisions. Coming to power of goverments committed to curbing public spending in UK, US, Norway, Denmark and now Germany suggests increasing awareness of need to reduce it.

5. International financial collapse?

Concern about effects of over-borrowing noted at Toronto IMF meeting. But should not exaggerate alarm. Important of course to sustain system's stability. Lower interest rates should help, as should IMF programmes to restore countries' credit-worthiness. Further progress needed on banking supervision including risk assessment and prudential standards; also watertight allocation of supervisory responsibilities.

6. US economy?

[Revised figures show that US GNP was flat in Q3 instead of small rise previously indicated through GNP rose ½ per cent in Q2. Interest rates have fallen 4 points since July while inflation has fallen to 5 per cent. Press reports suggest that Administration now admit Federal deficit likely to rise over next few years, instead of declining as previously forecast. Director of Budget Bureau reportedly forecasting deficit for FY 1984 maybe US $175 billion.]

US output flat in Q3 after small rise in Q2. Still too early to say that a strong recovery is under way, but falls in interest rates and inflation hold out better prospects for next year. However, important that US Administration curb budget deficit if progress in reducing inflation and interest rates is to be maintained.

7. US monetary policy

[US interest rates have fallen and Federal Reserve last Friday reduced discount rate from 9½ to 9 per cent. Chairman Volcker has said US authorities will be attaching much less than usual weight to M1 over period ahead. Press reports suggest that Federal Reserve has suspended M1 target and intends to allow M2 growth above long term ceiling set in February.]

Accept that monetary indicators in US must be interpreted flexibly in light of financial innovations. Federal Reserve Chairman, Mr Volcker, has made clear recently in evidence to Congress that reduction of inflation remains a priority and that monetary targets have not been abandoned. Mr Feldstein, chairman of Council of Economic Advisers, has commented: 'no reason to be concerned about the Fed's policy being too expansionary'.

8. Gloomy prospects for Europe?

[EC Commission Annual Report predicts only 1.2 per cent growth in Europe next year and 10.3 per cent unemployment. Medium-term forecast gives gloomy picture of 1983-87 with growth in EC averaging only 2½ per cent and inflation of nearly 8 per cent.]

Short-term prospects for recovery in Europe weaker than in US or Japan. But budget deficits higher and inflation rapid in many European countries. Note that EC Commission draws attention to need to curb budget deficits and reduce labour costs. Always difficult to see into medium run but improvements in competitiveness, lower inflation and interest rates all offer better prospects.

9. Competitive devaluations

IMF rules forbid countries to manipulate exchange rates to gain unfair competitive advantage. Authorities in Sweden will have noted strong objections from her major trading partners. Recent 'jumbo' council re-affirmed Community's determination to combat protection and in particular competitive devaluations. Prosperity of world economy depends on maintaining open and fair trading system. Large devaluations may hinder this, and risk encouraging competitive devaluations by others. [IF PRESSED: IMF examining Swedish action.]

COMMENTARY ON RECENT ECONOMIC DEVELOPMENTS AND STATISTICS 29 NOVEMBER 1982

Summary comment

The effective exchange rate has fallen by about 5 per cent and interest rates have risen 1 point. Activity remains flat but generally financial developments remain favourable compared with last year and inflation continues to fall.

World Economy: expectations held by most forecasters for an upturn in activity of 1 per cent this year unfulfilled. IAF expects 2% increase in GNP of major 6 in 1983.

. world commodity prices are at their lowest level in real terms for thirty years;

. oil prices are weak and likely to remain so for the near future;

. consumer price inflation (OECD major 7) around 6½ per cent in September ranging from 17 per cent in Italy to 5 per cent in Germany and 3 per cent in Japan;

. average world 3-month interest rates 10 per cent at 22 November a fall of 4 points since October 1981; US 3 month rate stood at 8.9 per cent on 22 November; real interest rates remain clearly positive;

. world trade volume has been more or less flat since the middle of last year;

. total industrial production for the OECD Major 7 fell 5 per cent in the twelve months to Aug; in the US it fell by 9½ per cent in the 12 months to September;

. unemployment (major 7) now 8½ per cent, compared with 6½ per cent in mid-1981.

UK Balance of Payments: non-oil trade balance has deteriorated quite sharply but current account remains in strong surplus this year. But both the loss of competitiveness during 1979 and 1980 and a smaller world market are affecting our non-oil trade at home and abroad.

. OPEC and Third World countries are cutting back on imports because of low commodity prices, high interest rates and debt problems in some countries. Non-oil export volumes have weakened slightly recently after remaining broadly unchanged between 1981 H2 and 1981 H1.

. import volume rose sharply as activity recovered last year and import penetration rose too; this year non-oil import volumes have shown little change since 1981 H2.

. the effective exchange rate fell 5 per cent last week as sterling depreciated against the dollar; currently at 86.7. The pound has now fallen below the range 87-93 that it occupied for the last year.

Financial Developments

.M1, PSL2 within target range for 1982-83, £M3 towards top of range;

.most banks raised base rates by 1 point wef 29 November; short term interest rates down 6½ points since October 1981; base-rates down about 6 points;

.mortgage interest rates down to 10 per cent, first time since 1978;

.real interest rates remain clearly positive (higher real rates are being experienced in the US and Japan);

.CGBR £6.5 billion in 7 months to October, consistent with IAF assessment of £9 billion PSBR for 1982-83.

Inflation

.retail price inflation, 6.8 per cent in year to October. Forecast 6½ per cent before Xmas, with prospect of 5 per cent by spring 1983 and at Q4 1983;

.TPI increase in 12 months to October was 7.4 per cent;

.Wholesale price inflation also moderating; input prices up almost 3½ per cent in year to October; output prices 7½ per cent;

GDP and industrial production

.GDP rose slightly in Q3 1982 for second successive quarter but remains at Q4 1981 level. Underlying level of industrial production also remains broadly flat but is 1½-2 per cent above spring 1981 trough largely due to increased oil and gas production; the underlying level of manufacturing output only slightly above its trough level.

Demand Components

.consumer spending has remained broadly unchanged since 1979, over period when other components of final demand fell some 4-5 per cent. Some fall in RPDI (see below) offset by lower savings ratio. Retail sales in August-October 2½ per cent higher than preceding 3 months, partly reflecting abolition of HP controls. Consumers' expenditure in Q3 1982 (provisional) over 1½ per cent up on previous quarter.

.gross fixed investment fell back by 4 per cent in 1982 Q2 - from a strong first quarter - to a level similar to that in 1981 H1 and 10 per cent below the level in 1979. Manufacturing investment has been weak. Plant and machinery investment, however, has held up.

.destocking of £420 million occured in 1982 Q3. The CBI's October Survey suggested there was some scope for further destocking but stock figures are volatile and too much should not be made of one quarter's figures;

.government consumption in 1982 H1 was 2 per cent above its level in the same period last year. 1982 Q2 data suggests that the upward trend in volume may be flattening out;

.non-oil exports have weakened since 1982 H2 after remaining broadly stable since 1981 H1;

.imports rose very sharply between the two halves of 1981, reflecting both the increase in activity and increased import penetration, before stabilising but non-oil import volumes this year have shown little changed in 1981 H2.

Productivity and Competitiveness

.manufacturing productivity continues to rise strongly - at 6½ per cent annual rate so far this year, following 8½-8¾ per cent last year;

.manufacturers' unit wage/salary costs up less than 6 per cent in 3 months to August on a year earlier;

.during 1981 external price and cost competitiveness improved around 15 per cent but less than 1½ per cent improvement during 1982 H1.

Company Sector

.ICCs pre-tax real rates of return on capital in 1981 were very low; only 2 per cent in the manufacturing sector. Some slight improvement likely this year.

.after falling in first quarter of 1982 gross trading profits (net of stock appreciation) of ICCs rose in the second quarter by 5 per cent; this follows the strong recovery in 1981;

.non-North Sea profits in 1982 H1 were 22 per cent above their level in 1981 H1;

.gross profits of North Sea oil companies rose 10 per cent over the same period;

.ICCs financial deficit was £1.3 billion in 1982 H1, following £0.8 billion surplus in 1981 H2, partly reflecting less destocking. Over same period net borrowing requirement fell from £6½ billion to £5½ billion.

Personal Sector

.wage settlements in 1981-82 were on average around 7 per cent, 2 per cent lower than in the previous round;

.underlying rate of increase in average earnings in year to September 1982 was about 8¾ per cent;

.real earnings broadly flat in last 12 months but RPDI is about 1½ per cent lower than the average for 1981.

Labour Market

.UK employment fell 2.4 million (10½ per cent) between 1979 Q2 and 1982 Q2 (two-thirds concentrated in manufacturing); between 1981 Q2 and 1982 Q2 employment fell by 670,000; manufacturing employment fell a further 95,000 (1¾ per cent) between Q3 and Q2 1982;

.Total employment fell more in the second quarter of 1982 (189 thousand) than in the previous quarter (94,000);

.total registered unemployment fell by 48,000 to 3.3 million (13.8 per cent) in October reflecting seasonal falls in school leavers which more than offset the underlying upward trend (which itself slowed to 23,000); on the new basis the headline total for October was 246,000 lower at 3.1 million (13.1 per cent);

.UK adult unemployment rose by (only) 23,000 to 3.1 million (12.8 per cent) in October; previously the trend (since June) was accelerating. On the new basis unemployment in October at 2.9 million (12.4 per cent) was 173,000 lower than on the old basis;

.vacancies have not altered much in recent months;

.other labour market indicators - short time, overtime working, etc - continue to suggest some flattening out following last year's improvements.

Forward Indicators

.car production (seasonally adjusted) recovered to 78,000 in October from 60,000 in September;

.steel production (not seasonally adjusted) fell from 230,000 tonnes per week in September to 228,000 tonnes per week in October;

.the volume of new construction orders, which remained broadly flat since the first half of 1981, rose 1 per cent in 1982 Q3, but remains 2 per cent down on Q2 1981. Within the total, private housing orders fell 5 per cent in Q3 1982 but remain 25 per cent higher than Q3 1981. Engineering orders also disappointing with a 12 per cent fall in the lastest 3 months.

.total manufacturing order books, as monitored in the CBI's monthly industrial trends enquiry, after strengthening last year, have shown some decline; and export order books have weakened.

.total housing starts, having increased from an average 40,000 a quarter in 1980 to 53,000 in 1982 Q1, fell back in the spring, but average for the first nine months is over 25 per cent up on the same period a year ago. Total completion have remained fairly flat during 1981 Q2 and Q3 having previously drifted slowly downwards.

.seasonal falls in school leavers registrations continue into November and December but a sharp seasonal rise in unemployment occurs in January;

.CSO's index of longer leading indicators rose between July and October reflecting lower interest rates and higher share prices, following 3 months of little change.

CBI's October (Quarterly) Trends Survey suggests a further decline in business confidence, further slight falls in total new orders and output. Stock reductions are continuing and investment intentions have weakened again. The survey suggests no recovery in new export orders and deliveries over the next four months. Cost pressures are expected to slow further and a slight improvement in firms liquidity is in prospect. Consumer goods industries are benefiting slightly from some improvement in demand. November Trends Enquiry suggest a deterioration in export orders but implicitly also shows a pick up in domestic orders. CBI November forecast projects GDP(O) growth at 1¼ per cent next year with manufacturing investment contracting. Also assumes £2½ billion fiscal adjustment in 1983/84 whereas IAF suggests £1 billion.

Outside forecasts

.Outside forecasting groups are now less optimistic about recovery in 1982, suggesting that growth this year will be ½-1 per cent - about ½ per cent less than expected at Budget time; for 1983 consensus of outside forecasts around 2 per cent, assuming some recovery in world economy, with inflation/interest rates falling at least for some time into next year.

New Industry Act Forecast

.New Treasury forecast published November 8th assumes a modest (2 per cent) world recovery in 1983. Forecast includes a £1 billion fiscal adjustment in 1983-84 within a fiscal/monetary stance broadly in line with 1982 MTFS. Between 1982 and 1983 GDP grows by 1½ per cent and manufacturing output by ½ per cent. Principal demand increases are from consumers expenditure (2½ per cent) and capital investment (5 per cent). Reflecting strong import growth balance of payments current account goes to zero in 1983. RPI inflation is about 5 per cent in early 1983 and 1983 Q4. Government Actuary assumes unemployment (old basis) averages 2.9 million (GB, ex school leaver) in 1982-83 and 3.2 million in 1983-84. On new basis figures could be up to 200,000 lower.

Key Statistics Week-Ending Friday 3 December

Mon 29	:	New vehicle registrations (Oct)
	:	CBI trends (Nov)
Thurs 2	:	UK official reserves (Nov)
	:	UK unemployment and vacancies
Fri 3	:	Company liquidity survey (3rd qtr)

Econ. Pol.

FROM: HUW EVANS

29 November 1982

CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (R)
Minister of State (C)
Sir D Wass
Mr Burns
Sir K Couzens
Mr Quinlan
Mr Byatt
Mr Middleton
Mr Cassell
Mr Lovell
Mr Kemp
Mr Monck
Mr R I G Allen
Mr Hall
Mrs Lomax
Mr Riley
Mr Sedgwick
Mr Shields
Mr Page
Mr Mowl
Mr Ridley
Mr Harris
Mr French

NATIONAL INSTITUTE REVIEW

The November issue is being released at 9 pm today and will be in tomorrow's papers. It is the first issue to be published since Andrew Britton took over as Director.

2. The Review contains the usual chapters on short-term prospects for the UK and the world. It also contains a medium-term forecast (to 1987), and a summary and commentary on this by Rachel Lomax is attached. The brief policy appraisal calls for an expansion of demand by cutting taxes or increasing spending. This, the Institute believe, would raise output, and create a better climate for tackling the underlying problems of inflexibility and low productivity.

The short-term forecast

3. In most respects the Institute's forecast is similar to the Treasury forecast published in the Autumn Statement: a modest recovery in the world economy allows slow growth in the UK in 1983, along with a further fall in inflation. The forecast claims to have (but has not) taken into account the measures - such as NIC and NIS changes - announced on 8 November; but the Institute do not allow for any fiscal adjustment: as it happens their PSBR forecast for 1983-84 emerges at £8 billion anyway. (For later years, there is a substantial difference). The NIESR forecast was completed before the real fall in sterling, and their forecast is based on the assumption that the Government pursues a monetary policy which maintains the exchange rate constant in effective terms (at a level of 92).

4. The table below compares the Institute's forecast with that published in the Autumn Statement:

		NIESR	Autumn Statement
GDP, per cent change over a year earlier	1982	0.3	½
	1983	1.0	1½
RPI, per cent change between fourth quarters of 1982 and 1983		"5 per cent or slightly higher"	5
Current account, balance of payments, £bn	1982	4	3½
	1983	5½	0
PSBR, £bn 1982-83		8	9
1983-84		8	8
(Implied fiscal adjustment in 1983-84		0	+1)

5. On the prospects for demand, NIESR see the same modest (2 per cent) recovery in world output in 1983 as we do. But they see a better performance by UK exports, partly because they discount heavily the low outturn in the third quarter of

1982. On domestic demand, NIESR see a rise of 1-1½ per cent in both 1983 and 1984, much slower than the 3 per cent shown in the AS for 1983. The main factors here are lower fixed investment in both public and private sectors; and lower consumer spending (less of a fall in the savings ratio, perhaps because of a weaker effect from lower inflation).

6. The net effect is that the Institute see a rise of 1 per cent in total output in 1983, a little below the 1½ per cent shown in the AS. For 1982, NIESR's estimate of a rise of 0.3 per cent in GDP refers to the output measure (which has been running below the average GDP measure used in official forecasts).

7. On inflation, the Institute are looking for a further fall in 1983. But in 1984, while the exchange rate remains at 92, and earnings growth again falls a little, a rise in commodity prices, as the world economy picks up, is apparently sufficient to bring about slightly faster inflation. The Institute do not expect the weakness in the oil market to be reflected in any drop in world oil prices. A 5 per cent rise is forecast for 1984.

8. The Institute present a substantially different picture of the current account of the balance of payments staying in large surplus throughout the period (and helping to justify their assumption of no change in the exchange rate). A major part of the difference lies in a more optimistic assessment of UK trade performance, especially in export markets, despite no improvement in competitiveness. A higher exchange rate in the Institute's forecast is accompanied, as expected, by better terms of trade.

9. On the PSBR, the Institute estimate £8 billion for the current financial year, but note that the gap between their estimate and the £9 billion in the AS is "well within the margin of error". For 1983-84, they are looking for a PSBR on present policies (excluding any fiscal adjustment) of £8 billion.

10. There are a large number of differences in the detailed projections of revenues and expenditures.

11. Most worryingly, the policy basis of the Institute forecast is unclear: despite a claim on page 10 that the "forecast incorporates the measures announced on 8 November", our enquiries today show that they have not in fact allowed for NIS or NIC changes in their forecast. By extension, they have probably also not allowed for other measures which affect 1982-83 and 1983-84. Had they taken on board the various measures affecting 1982-83, then their PSBR forecast for that year would have been higher. Had they incorporated the NIC/NIS decisions for 1983-84 (which tend to offset each other) it is less clear how the forecast would be affected.

12. The Institute do not present a clear forecast of interest rates, though it seems that they assume not much change. M1 is forecast to rise 12½ per cent during 1983-84 (in response to the decline in 1982 in short-term interest rates) and £M3 is forecast to rise 11½ per cent, compared with the MTFS range of 7-11 per cent.

Line to take

13. There will be a tendency to dismiss the Review as out of date because it was completed before the recent fall in sterling, for which it makes no allowance. We should not ourselves push this line too far, since the same point could be made about the recent Industry Act Forecast. Nor should the large difference in the forecasts of the balance of payments be ascribed mainly to the exchange rate path, since model simulations suggest very little effect in the first year (because of J curve effects) on the current account. Large differences on this aspect of the forecast reinforce the message from the Industry Act Forecast that any assessment of the current account is subject to a large margin of error.

14. On fiscal estimates and the scope for fiscal adjustment in 1983-84, it is not easy to know precisely what has been assumed about policy.

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POLICY ISSUES AND THE MEDIUM TERM OUTLOOK

1. Chapter III contains a critique of the Government's strategy, together with a generally gloomy appraisal of the medium term outlook up to 1987, on the Institute's interpretation of "unchanged policies".

The Strategy

2. The Institute can see little merit in basing policy on announced targets for financial variables. ("Intermediate targets so far have served only to obscure the real issues"). The attempt to use monetary aggregates as "the centre-piece of economic strategy" has not been a success :-

(i) At the technical level, the poor track record in hitting targets reflects our very poor understanding of the links between £M3 and the instruments actually under the authorities' control - fiscal policy and short term interest rates. Other measures of money raise their own difficulties, and looking at them all is inevitably arbitrary, the message depending critically on the choice of weights.

(ii) The fundamental problem underlying these technical difficulties is the pace of innovation in financial markets since the late '60's. Indeed, it would be remarkable if financial aggregates did convey consistent information from one year to the next.

The exchange rate is arguably a more relevant economic indicator, and, as people become increasingly disenchanted with the monetary aggregates, it is probably inevitable that it will receive more attention as an index of policy. But pre-set targets would be a mistake. Conditionality and 'pragmatism' are far more desirable.

3. The distinguishing feature of the current strategy, according to the Institute, is a continuing refusal to reflate, despite the depth

and persistence of the recession, on the view that reflation would be damaging to the longer term performance of the economy. They question the basis for this belief on several counts :-

(i) while a lower level of activity is likely to lead to a lower level of inflation, they doubt whether a reduction in the rate of inflation will do much to cure problems of slow growth etc. The empirical evidence that high inflation inhibits growth is mixed, and inconclusive as to causality. The economic inefficiencies due to inflation can be (and are being) reduced by indexation;

(ii) there is no reason to suppose that a low level of activity has a directly beneficial effect on the supply potential of the economy. The opposite may be true, to the extent that low activity and tight policies have contributed to the strength of sterling. The recent exceptional improvement in UK productivity should be seen as a defensive reaction to the sharp deterioration in competitiveness which itself has had a damaging effect on supply;

(iii) a low pressure of demand may inhibit change, and make it politically more difficult to introduce the structural reforms needed to tackle underlying problems;

(iv) lower inflation _per sé_ is unlikely to do very much to reflate demand. The links are there in principle, but quantitatively they are not very powerful - hence the combination of low growth and low inflation shown in the Institute's medium term projections.

Comment

4. The analysis is not new, nor is it supported by fresh evidence, though, coming from a recent member of the Treasury, it may attract some attention. The following points are worth noting :-

(i) Intermediate targets are not simply internal decision rules used by the authorities. They are an important means of conveying information about the stance of policy to the private sector. The information conveyed by the MTFS may be somewhat imprecise, given the problem of interpreting the various financial indicators (including the exchange rate); but it is still a statement that the Government intends to pursue a generally non-accommodating policy towards inflationary shocks. A policy focussed on "real variables" would not give that assurance, and it would thus provide a much less secure basis for longer term expectations about inflation.

(ii) However difficult it is to base policy on objectives for financial variables, post war experience suggests it is even more difficult to do without them. The only period when policy has not been based on either exchange rate or monetary targets was 1972-76 - when arguably something of the same role was assigned to incomes policy.

(iii) There is substantial room for disagreement about the relationship between inflation and growth. Only a couple of months ago another ex-Treasury economist, reviewing much the same evidence, concluded that lower inflation would help long term growth potential (Alan Budd : LBS briefing paper on "The Costs and Benefits of Cutting Inflation"). The process of growth is not well understood - other alleged explanations for faster or slower growth are just as difficult to substantiate as inflation.

The Medium Term Outlook

5. On the basis of "unchanged policies" the Institute are projecting real GDP growth of little more than 1½ per cent a year after 1984; inflation fairly steady at around 5-6 per cent a year; a substantial current account surplus, and unemployment rising steadily to around 3¾m by 1987.

6. The projections assume very little stimulus to demand either from external demand or from domestic fiscal policy:

(i) world trade in manufactures grows by only 4 per cent a year between 1982 and 1987; world inflation is broadly the same as in the UK, and given the assumption of a more or less unchanged nominal exchange rate, there is no improvement in competitiveness. We would regard both assumptions as rather pessimistic.

(ii) No tax cuts are allowed for: "Unchanged fiscal policy" implies a sharply falling nominal PSBR after 1984 - from £3¾bn to zero in 1985, and a surplus of £2 bn in 1987. This is clearly an extreme assumption (The PSBR is nearly £3 bn below the MTFS figures even in 1984).

7. The outlook reflects these generally pessimistic assumptions, and the fact that lower inflation and lower interest rates do not have sufficiently powerful effects (in the Institute's model) to generate a strong spontaneous upturn in private sector demand. Given the outlook for activity, the rise in unemployment is surprisingly modest.

8. The Institute rightly emphasises the major uncertainties involved in reaching such a conclusion.

MP1 Division
29 November 1982

CHANCELLOR OF THE EXCHEQUER

With the Compliments
of the
Chancellor of the Exchequer's
Private Secretary

Treasury Chambers,
Parliament Street,
S.W.1.

cc CST
MST(R)
Sir D Wass
Mr Quinlan
Mr Lovell
Mr Hopkinson
Mr Mortimer
Mr Harris
Mr Traynor
Mr Potter

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

24 November 1982

The Rt. Hon. Michael Heseltine MP
Secretary of State for the Environment

Dear Michael

PLANNING POLICIES AND MISC 14

In recent months I have received letters which criticise two aspects of planning policies and their application. First, there are complaints from small businesses about the efficiency of the authorities and the inflexibility of the planning system in handling their planning applications - you will recall some specific cases in my constituency about which I wrote in the summer. Secondly, the House Builders' Federation have called for a radical reappraisal of green belt policies and a re-examination of the land so classified. They urge a more flexible policy which is responsive to changing housing needs.

I am aware of circular 22/80, which dealt with both matters. I welcome the action Giles Shaw is taking to canvass the view of small businesses and their representatives on how well it is working, and whether planning authorities are being more flexible in their attitudes. I look forward to learning the outcome of these consultations. Perhaps you could ensure that my officials are associated with any proposals which might follow.

On the question of green belt policy, I understand you have asked officials to review the policy and report back. In view of the wider concern about this policy, I wonder whether the future of green belt policy might not be a suitable topic for discussion at MISC 14, which is concerned to identify areas for de-regulation and removing burdens on industry? It is some time since planning policies were considered; and green belt policy may offer scope for some useful action.

More generally, I wonder whether we might look thoroughly at the planning system in the context of our longer term policy thinking for the next Parliament A general paper reappraising our approach to planning in the light of ' experience in enterprise zones and the Government's commitment to regulation, might usefully be taken by MISC 14 early next year.

I am copying this letter to the other members of MISC 14 and to John '

Geoffrey

GEOFFREY HOWE

PPS/CHANCELLOR

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copied to:

Mr Salveson (for transmission to No.10)
PS/CST
PS/FST
PS/EST
PS/MST(C)
PS/MST(R)
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 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 BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 15 November, are sidelined.

M M Deyes

M M DEYES

R I G Allen

R I G ALLEN

22 November 1982

EB Division
H M Treasury
01-233-5503

ECONOMIC BRIEF: CONTENTS

	1980 Q4	1981 Q1	Q2	Q3	Q4	1982 Q1	Q2	Q3	Oct
'Total' unemployment	2.16	2.46	2.59	2.93	2.96	3.04	3.01	3.28	3.30 (13.8%)
on new basis	-	-	-	-	2.77	2.86	2.80[b]	2.94[b]	3.05 (13.1%)
UK adult sa unemployment (millions)	2.02	2.28	2.48	2.64	2.75	2.82	2.88	2.98	3.06 (12.8%)
on new basis	-	-	-	-	2.61	2.68	2.74	2.84	2.89 (12.4%)
increase in period (000's)	+105	+77	+62	+51	+33[a]	+21[a]	+30[a]	+42	+23
on new basis	-	-	-	-	-	+20	+28	+31	+20
Vacancies (000's)	99	98	89	96	104	112	107	111.0	112

a. After allowing for over 60's transferring to supplementary benefit
b. Excluded non-claimant school leavers.

Other labour market indicators (e.g overtime, short-time) roughly flat for last 6 months.]

October figures cannot provide indication of future trends but are nonetheless welcome. Level of unemployment still tragic but problems took a long time to build up; will also take a long time to check or reverse. Recent figures reflect levelling out in activity since last autumn. Looking further ahead, lower inflation and interest rates, and lower pay settlements and hence improved industrial competitiveness should help promote economic recovery and create climate for sustainable jobs.

6. Unemployment in UK higher than in other countries?

[On standardised definitions in Q2 1982 UK unemployment was 12.7 per cent compared with 8.1 per cent OECD rate; little over doubling for UK compared with OECD rise of over one half since 1979.]

Unemployment now rising sharply in many industrialised countries - in last three months number unemployed (on national definitions - not strictly comparable) rose much more in Canada (up by over 20 per cent), Holland (9 per cent), Ireland (8 per cent), Germany (7 per cent) than in UK (4 per cent).

7. UK's true unemployment figures really much higher?

[TUC say 'true' figure just under 4½ million The Times 11 November.]

No one seeks to deny there are unregistered unemployed but reliable estimates of their numbers are difficult to obtain. Available estimates vary quite widely. Figures of registered unemployed are based on an accurate count of those eligible for benefit, and provide the best available estimates of trend.

8. Cost of unemployment/Effect on PSBR?

The effects of changes in unemployment on the public finances is likely to vary widely according to the underlying circumstances, for example changes in world trade, United

A GENERAL ECONOMIC STRATEGY

[NB Chancellor appearing at TCSC Tuesday 23 November; officials attended last Tuesday 16 November. Chancellor saw TUC Monday 22 November.]

1. Government's main economic objectives

Main objectives are to achieve, over a period, a sustained improvement in the economy through reduction of inflation, lower interest rates and promotion of enterprise and initiative. Policy must continue to combine firmness and flexibility. Right for Government to have adjusted money supply and PSBR objectives in light of changed circumstances. But also right that medium-term direction of policy is maintained.

2. Significance of November Autumn Statement?

This first Autumn Statement. It explains autumn announcements in more complete and accessible way than in earlier years. Can expect the publication to evolve.

3. A S a mini Budget?

No. It brings together number of announcements about decisions - on public expenditure and next year's NIC - which are usually made at this time of year. It also includes a fuller economic forecast than has been issued in past - with much more complete statement of fiscal position; tax ready reckoners; and proposals for a reduction in NIS. Autumn Statement in no sense complete Budget - not even a mini Budget - though announcements obviously affect scope for fiscal action in Budget next spring.

4. A S reflationary/deflationary?

There is no change of policy compared with 1982 MTFS. Public expenditure planning total unchanged. PSBR as percentage of GDP in 1983-84 also unchanged and lower than in 1982-83.

5. What help for industry?

Measures announced in Autumn Statement themselves have benefits for industry particularly in helping keep costs down -NIS (see P1-3), NIC (see P1-3), public expenditure decisions. Other announcements made around same time - energy prices (see R2-3), ending of regional development grant deferment (Industry Secretary 9 November), local authority capital spending initiative (see E12-14) 12 or more new sites for enterprise zones (se P15) - all helpful. Also keep in mind wider benefits of lower inflation and interest rates and benefits of 1982 Budget measures still coming through.

6. Implications of social security announcements

See Section G.

7. Recovery over/Activity flat?

Delayed but not over. Activity still 1 per cent above trough in Spring 1981. Flatness of output this year partly reflects external developments. Expected recovery in world trade and output expected at Budget time has not yet materialised. Progress on inflation and interest rates more rapid than expected and, together with continued rapid improvements in productivity argues well for future.

8. Latest figures (for GDP and stockbuilding) throw doubt on Government forecasts for 1982?

GDP figures are quite consistent with Industry Act Forecast which shows no change in the average measure of GDP between first and second half of year. At first sight not so easy to reconcile size of third quarter destocking (nearly £420 million) with IAF expectation for second half (about £150 million). But quarterly movements in stocks tend to be erratic; also some of the destocking may represent adjustment to involuntary stock-building in first half.

9. Recovery next year?

Although recovery has been hesitant this year renewed modest recovery expected in 1983. Expectation supported by upturn in cyclical indicators and by most outside forecasts. [For Industry Act forecast see B11 and commentary at end.

10. Implications of recent exchange rate depreciation for domestic inflation, competitiveness and activity?

Government's forecast remains as set out in November Industry Act forecast.

11. Where will growth come from?

Sources of growth are expected to be: some modest recovery in world activity; improved confidence as inflation comes down, encouraging more investment and risk-taking; lower interest rates improving companies' financial position and encouraging more fixed investment and stockbuilding; increased consumers' expenditure, partly reflecting lower inflation. Medium term prospects depend critically on further progress in reducing inflation and containing costs.

12. Policy far too tight, given world recession? Below FSBR forecast growth in output, prices and money GDP clear sign of deficient demand?

Government cannot fine-tune either money or real GDP. Domestic demand has been rising at annual rate of 3 per cent since spring 1981. Problem is external demand and UK's falling share of home and foreign markets (reflecting weak competitiveness). Need improvements in supply performance as much as increased demand. Without former, a boost to demand may be largely wasted, even in the short term.

13. Recent exchange rate depreciation signals weakening of monetary framework?

Government's role is to maintain firm, consistent, financial framework, in line with major economic objectives (see 1 above). Government will continue to interpret monetary developments firmly but flexibly. With inflation coming down, should be ample scope within target ranges for rising activity. (See also Section M.)

14. IMF team visiting UK: checking up on us?

[Treasury Press Notice about visit issued 16 November]

Visit from IMF team next month normal routine: part of the Fund's regular 'Article IV' consultations which provide for periodic review of member countries' economic policies.

15. Room for £2-3 billion tax cuts in 1983 Budget?

Chancellor has effectively 'spent' nearly £1 billion by reducing NIS and holding down NIC increases. Scope for further worthwhile tax cuts for 1983-4 - the so-called fiscal adjustment - now estimated at about £1 billion. But figures very uncertain at this stage. Decisions taken in next Budget will depend on prospects as then seen for PSBR and economy. These factors will also affect choices of taxes to be modified.

16. Public spending decisions?

Planning total for 1983-84 held at level envisaged in the 1982 Budget - some £120 billion. Most welcome achievement - first time has happened since 1977. Unlike in 1977, Government not forced to hold to plans by outside intervention of IMF. (See also Section E.)

17. Unemployment prospect?/Government 'fiddling' unemployment figures?

See Section C.

18. Latest Labour Party proposals?

[Proposals 'trailed' in weekend Press; announced Monday 22 November. Aim at lowering unemployment to less than 1 million. Main points: increased public spending (phased from £5[illegible] billion more in first year to £18 billion in fifth), adjustment of £ to restore competitiveness; price cutting measures such as VAT cut, to offset effects of lower exchange rate; cut in real interest rates; agreement within national economic assessment for 'planned increase in living standards'. (Weekend reports suggested 30 per cent devaluation recommended.)

Note that proposal for massive devaluation now being given less prominence; but whole package none the less irresponsible and incoherent for all that. Does disservice to nation and to unemployed to lay claim to objectives that proposals incapable of achieving. They gloss over implicit need for incomes policy and other controls. Only result would be higher unemployment, worsening competitiveness, and substantially lower inflation and interest rates. No miracle cures: success on inflation best help for sustainable improvement in employment prospects.

B ECONOMIC ACTIVITY AND PROSPECTS

1. Prospects for UK economy

[Industry Act Forecast ~~Tables reproduced~~ summarised in Commentary at end of Brief.]

- Although recovery has been hesitant this year, partly reflecting de pressed world activity, it should gather pace in 1983: about 1½ per cent growth of GDP 1983 on 1982. All outside forecasts (some rather dated) expect recovery to continue in 1983; consensus is for year-on-year growth around 2 per cent.

- RPI inflation has come down much faster than expected. Now forecast to be 6 per cent in 1982 Q4 (9 per cent in Budget forecast) and 5 per cent next year (7½ per cent in 1983 Q2 in Budget).

- Wage settlements are expected to decline further over next 12 months. [No forecast given in IAF but GAD Report assumes 6½ per cent earnings growth between 1982-83 and 1983-84, against 9 per cent in previous year.] Productivity growth still fast (level of output per head in manufacturing now 13 per cent above end-1980).

- Consumers' expenditure has been rising at annual rate of 3 per cent since 1981 Q2, after 3 flat years, and is forecast to rise 2½ per cent 1983 on 1982.

- Current account of balance of payments expected to decline to zero in 1983.

2. Recent output figures

[GDP (O) in Q3 rose slightly for second successive quarter to level about 1 per cent higher than in 1981 Q2. Industrial production in 1982 Q3 unchanged from previous quarter, though underlying level of industrial output 1½-2 per cent above 1981 Q2 trough - almost entirely attributable to North Sea oil. Trend in manufacturing activity at best flat, though IAF expects 1 per cent increase in year to 1983 H2.]

Output remains disappointingly flat - partly due to depressed world economic activity. But expected higher world output should encourage some modest recovery in 1983, while lower interest rates and inflation, coupled with improved productivity and competitiveness, provide a sounder base for expansion in the medium term.

3. Other evidence of improvement in economy?

See Bull Points (following Section A).

4. Latest CBI assessments/Business confidence collapsed?

[CBI October Trends Enquiry shows less optimism on general business outlook and export prospects over next 12 months (optimism net balance fell from minus 22 in July to minus 28 in October). Orders and output have fallen and most (94 per cent of participants) see orders constraining future output. Stock reductions continue and investment intentions have weakened again. Cost and price pressure remain low, and company liquidity may inprove slightly in next six months. CBI August forecast suggested GDP growth next year of 1-1½ per cent; more recently, CBI emphasising lower end of range.]

Results of October Survey certainly disappointing. But deterioration in optimism, and immediate outlook (next four months), probably reflect in part very depressed level of activity, at home and overseas, this year. Survey not entirely gloomy -favourable developments continue in unit costs and price expectations; firms' liquidity also expected to improve. As witnessed by surveys from Times Business Forum in October and November, great majority of businessmen support Government's basic economic strategy and are optimistic about prospects for company growth/profits over next two years. Decisions announced 8 November aimed to reduce business and industry's costs and should boost confidence.

5. New orders figures depressing?

[New construction orders in August fell by 22 per cent from around £450 million to £350 million (at 1975 prices) compared previous month. In three months to August, orders fell 6 per cent compared previous three. Volume of new orders in engineering industries fell 12 per cent in three months to August compared previous three.]

Figures manifest depressed economic activity which itself partly reflects flatness in world trade.

6. Fall in investment and reduction in stocks?

[Capital expenditure by manufacturing, distributive and service industries in 1982 Q3 3 per cent higher than Q2 but 2 per cent down in latest six months compared previous six. Investment in manufacturing (including leased assets) in 1982 Q3 over 1 per cent up on Q2 but 4 per cent lower in latest six months than previous six. CBI October survey shows, for second successive survey, decline in investment intentions. IAF projects 3 per cent growth in fixed investment in 1982, 5 per cent in 1983.]

Figures reflect some modest recovery after disappointing second quarter - result of depressed economic activity. [IF PRESSED: latest DOI investment intentions survey shows slight fall in manufacturing investment between 1981 and 1982; Q2 figure not inconsistent with this.]

7. Stock levels a threat to recovery?

[Provisional figures for 1983 Q3 stockbuilding in manufacturing and distribution (80 per cent of total stocks) reveal unexpectedly sharp de-stocking of around £420 million. Apart from 1980 Q4, as large as any quarter in current recession.]

Quarterly movements in stocks tend to be erratic; Q3 de-stocking may partly reflect adjustment to involuntary stockbuilding in 1982 H1. Not too much weight should be placed on single quarter's data. GDP (output) figures (see B1 above) are a better guide to recent movements in activity.

8. Competitiveness not improved this year?

Cost competitiveness has improved about 15 per cent since 1981 Q1 [but virtually no change during 1982 H1: position remains about one quarter worse than when Government took office]. Further improvements, which are essential to regain markets and create new ones, depend above all on substantially lower wage settlements in this pay round than in the last one. Lower exchange rate makes it all the more important for companies to maintain close control over their costs. (see M1-3).

9. Productivity growth falling off?

No; productivity growth in manufacturing up 4½ per cent over last year, and 13 per cent up on end-1980, is well above UK historical average.

10. CSO's index of leading cyclical indicators?

Longer leading index rose between July and October reflecting further falls in interest rates and an increase in share prices. Shorter leading index declined slightly in October (but based on two components only). Taken with other indicators - including lower inflation and interest rates - these changes are encouraging pointers to future recovery.

11. Outside forecasts

[GDP profile in recent major assessments and in IAF:

Per cent change

	LBS (Nov)	Phillips & Drew (Nov)	Simon & Coates (Nov)	CBI (Aug)	St James (Aug)	OECD (July)	NIESR (May)	IAF (Nov)
1982 on 1981	+¼	+½	+½	+½	+1¼	+1¼	+1	+½
1983 on 1982	+3	+¾	+2½	+1½	+2½	+1¾	+1	+1½]

Nearly all see prospect of continued recovery and lower inflation.

C LABOUR MARKET

[NB: Employment Secretary's Statement 18 November on changed basis for unemployment figures from November count onwards. November (provisional) figures will be published on 2 December. On new basis, October headline total would have been 246,000 lower and adult unemployment 173,000 lower.]

1. Recent unemployment figures (on new and old basis) and other labour market indicators?

[Underlying trend in unemployment has deteriorated since Q2, but October figures a little more favourable than of late. Because of seasonal factors, no further sharp rise in 'headline total' expected till January. Recent unemployment/vacancy figures shown below on both old and new basis:

	1980 Q4	1981 Q1	Q2	Q3	Q4	1982 Q1	Q2	Q3	Oct
'Total' unemployment	2.16	2.46	2.59	2.93	2.96	3.04	3.01	3.28	3.30 (13.8%)
on new basis	-	-	-	-	2.77	2.86	2.80[b]	2.94[b]	3.05 (13.1%)
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a. After allowing for over 60's transferring to supplementary benefit
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Other labour market indicators (e.g overtime, short-time) roughly flat for last 6 months.]

October figures cannot provide indication of future trends but are nonetheless welcome. Level of unemployment still tragic but problems took a long time to build up; will also take a long time to check or reverse. Recent figures reflect levelling out in activity since last autumn. Looking further ahead, lower inflation and interest rates, and lower pay settlements and hence improved industrial competitiveness should help promote economic recovery and create climate for sustainable jobs.

2. Government fiddling the statistics?

No new basis is cheaper, more accurate and cuts out wasteful procedures. New basis using voluntary registration also reveals similar trend to previous series.

3. What categories of unemployed affected by changes?

Severely disabled now included. Non-claimants registering at Job Centres, and far more people who find jobs before day of count, now removed. Non-claimants are principally married women paying reduced national insurance contributions and some may previously have been self-employed. Non-claimants number 110-150 thousand in most months of the year.

4. Headline total fell 246,000 in October?

Generally, difference between old and new counts would have been between 170 and 190 thousand. October difference was exceptionally large because many (about 100,000 people) still on register at Job Centres had in fact already found jobs.

5. Does new system affect GAD assumptions for 1982-83 and 1983-84?

Scale of the assumed increase will not be significantly affected, but the assumed GB levels of 2.9 million in 1982-83 and 3.2 million in 1983-84 (excluding school leavers) could be some 200,000 lower ie 2.7 million and 3.0 million. Number of claimants eligible will, of course be unaffected.

6. Unemployment in UK higher than in other countries?

[On standardised definitions in Q2 1982 UK unemployment was 12.7 per cent compared with 8.1 per cent OECD rate; little over doubling for UK compared with OECD rise of over one half since 1979.]

Unemployment now rising sharply in many industrialised countries - in last three months number unemployed (on national definitions - not strictly comparable) rose much more in Canada (up by over 20 per cent), Holland (9 per cent), Ireland (8 per cent), Germany (7 per cent) than in UK (4 per cent).

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[TUC say 'true' figure just under 4½ million The Times 11 November.]

No one seeks to deny there are unregistered unemployed but reliable estimates of their numbers are difficult to obtain. Available estimates vary quite widely. Figures of registered unemployed are based on an accurate count of those eligible for benefit, and provide the best available estimates of trend.

8. Cost of unemployment/Effect on PSBR?

The effects of changes in unemployment on the public finances is likely to vary widely according to the underlying circumstances, for example changes in world trade, United

Kingdom competitiveness, the level of United Kingdom earnings and so on. It is not, therefore, sensible to talk about the cost of unemployment as though there were a single figure.

Payments of unemployment benefit and supplementary benefit to people registered as unemployed are currently expected to total about £5 billion in 1982-83. Comparable figures for the total of taxes and national insurance contributions not collected cannot be given. There is no basis for estimating what the level of earnings and tax receipts would be if all the unemployed were working.

9. What is Government's own forecast of unemployment?

[Government Actuary was instructed to assume that number of unemployed in Great Britain, excluding school leavers etc, would average 2.9 million in 1982-83 and 3.2 million in 1983-84, (or just under 3.4 million including school leavers). Assumption for 1982-83 same as in 1982 PEWP but for 1983-84 3000,000 higher than in 1982 PEWP.]

GA's assumptions are not predictions or forecasts. [IF PRESSED they provide reasonable assessment of prospect but any forecast of unemployment must be highly conditional.]

10. Government concerned over unemployment?

Of course Government concerned; so pursuing balanced fiscal and monetary policies to curb inflation and creating conditions for enterprise - only measures that will ensure sustainable increase in employment. Nevertheless has substantially increased spending on schemes to alleviate impact on especially vulnerable groups. Most crucial factor in influencing unemployment is level of pay settlements (See also Section K).

11. Extent of help?

Government plan to spend £1½ billion in cash in 1982-83 (40 per cent more than in 1981-82) on special employment and training measures and £2 billion in 1983-84. Within the latter, £950 billion allocated to Youth Training Scheme and £260 billion (gross) to (a) the new community programme - designed to provide up to 130,000 places for long term unemployed - and (b) the new Job Splitting Subsidy (open on 1 January next year) to encourage extension of part time work and provide additional opportunities for productive jobs for unemployed people.

12. Employment continuing to fall?

[Total employment declined 2.4 million (10½ per cent) between mid 1979 and Q2 1982. Decline of 94,000 in 1982 Q1 increased to 189,000 in 1982 Q2. Manufacturing employment in August fell 35,000 to 5,531,000 (compared 5,871,000 in August 1981).]

Only way to achieve permanent jobs is sustainable recovery, based on improved industrial competitiveness lower inflation and lower interest rates. Substantial provision (£1½ billion) being made to help most vulnerable groups (see C1 above).

13. Recent productivity gains inimical to higher employment/lower unemployment?

[Output per head in manufacturing up 12 per cent since end-1980.]

This may be true in the short run. But in the longer term, as experience in Japan and many other countries clearly demonstrates, higher productivity essential for growth and employment opportunities.

D TAXATION

1. Burden of taxation

[Total taxation (including NIC) as proportion of GDP was 34½ per cent in 1978-79 and is forecast to be 39¾ per cent in 1982-83. Corresponding figures excluding NIC are 28½ per cent and 33 per cent].

Burden has inevitably risen because of upward pressures on public expenditure caused by the recession. Increases in taxation are better - and more honest - means of financing this than borrowing, because of adverse effects borrowing has on interest rates and inflation.

2. British tax burden high by international standards?

Not so. Accurate comparisons difficult, but UK burden about average for OECD countries [1981 data from Lloyds Bank Economic Bulletin, October 1982]. Similarly, UK taxes on household income and employees' social security contributions about average for EC countries and lower than Japan and USA [1980 provisional OECD data].

3. Autumn Statement

Chancellor on 8 November announced proposals for further reductions in NIS which should be welcomed by industry: another ½ per cent for 1982-83 and 1 per cent for 1983-84 to bring the rate down to 1½ per cent. Less than half the 3½ percent level inherited from Labour. Each 1 per cent reduction worth some £800 million pa (full year) to private sector. (For NIC announcement, see G and P).

4. Cuts in taxation in 1983 Budget?

Decisions for 1983 Budget, both on PSBR and particular tax changes, will not be made for several months yet. NIS and NIC decisions do, of course, reduce scope for tax reductions in next Budget though sticking to public expenditure totals helps.

5. Future of married man's personal allowance?

[Labour party commitment to phase out in favour of increased child benefit etc; SDP proposals to abolish as part of new scheme to assist lower paid.]

Government launched debate with December 1980 Green Paper on Taxation of Husband and Wife. Very wide range of views received, which government is considering. Abolition of married man's allowance advocated in some quarters would affect many millions of taxpayers and by itself leave a basic rate taxpayer £5 a week worse off. Abolition makes the poverty and unemployment traps worse for some people. (See also G11 on Labour's proposals.)

6. SDP plan to abolish poverty trap?

['Attacking Poverty', published 11 November.]

Their scheme costs £4½ billion and still leaves marginal tax rates, for people in the poverty trap, of 80-85 per cent. What is more, they extend the trap both up and down the income scale. Claims to have eliminated the trap are based on artificially restricted definitions.

7. SDP re-distributing to the poor?

SDP plan involves massive re-distribution. But it is not redistribution from rich to poor in any accepted sense. On SDP's own figures single people worse off on anything over half average earnings; married couple without children worse off if have income of more than ¾ average earnings; married couple with children worse off if have average earnings or even a bit less unless they have 3 children or more.

8. Government unconcerned about poverty and unemployment traps

[IEA document reported in Press 1 November 'The Moral Hazards of Social Benefit' claims 5½ million adults at risk from the traps.]

Government concerned about poverty and unemployment traps, in context of incentives as a whole. Traps caused by attempts of successive Governments to alleviate poverty and hardship while keeping costs in bounds. Alternatives are to give less support for poor and unemployed or to let costs rip. A necessary step in right direction is to reduce burden of income tax by restraining public expenditure - which is Government policy. Long-term solution is increased wages resulting from sustained improvement in productivity and economic performance: this too a goal of Government policy.

SDP proposals: far from complete solution - see D7, above.

[IF PRESSED ON ON IEA paper: exaggerates numbers affected and offers few concrete proposals.]

9. Burden of taxation risen most for the poor?

Proportion of income paid in income tax and NICs has fallen in 1982-83 for lowest paid taxpayers. Low paid with children are also entitled to benefits such as FIS.

10. Previous reductions in personal taxation favour the rich?

1979 Budget cut absurdly high top rates of income tax to European levels, as part of package which also involved substantial increase in thresholds. Such action was essential to restore incentives. No 'pot of gold' in higher rate tax; restoration of 83 per cent top rate would finance a cut of under ½p in the basic rate.

11. Deferment of excise duty on wines and spirits

[From 15 February 1983 average of 4 weeks' deferment of excise duty will be allowed on imports and deliveries from bonded warehouses of all wines and spirits.]

Assists cash flow of industries concerned and discharges commitment made when in Opposition. Cost to Exchequer about £12 million in full year.

12. Duty free allowances : importation of beer and mechanical lighters

[From midnight on 17 November 1982 relief limited by Order to no more than 50 litres of beer and 25 mechanical lighters per person.]

Designed to stop significant alleged trade in those items which has built up as a result of generous personal allowances (the £120 'other goods' allowance).

13. Not enough tax officials?

Although overall numbers have fallen in Inland Revenue and Customs and Excise in line with Government's manpower targets, both departments now have more staff carrying out investigation work than when Government took office. There is always a backlog of work. This is a little higher than in the past - partly as a result of last year's strike.

14. Easier to avoid tax than commit social security fraud?

Inland Revenue, Customs and Excise and DHSS all have staff working to stop abuse. Numbers deployed are determined by each department in light of its priorities. Cost/yield ratios are only one of a number of considerations. Others include the deterrence effect and the public acceptability of increased investigations.

E PUBLIC EXPENDITURE AND FINANCE

[Total spending of £120.1 billion in revised plans for 1983-84 announced 8 November. Compares with total of £120.7 billion in 1983-84 in Cmnd 8494 published 9 March, adjusted for Budget (and other minor changes). Revised plans for 1984-85 and 1985-86 will be published in next Public Expenditure White Paper in late January/early February 1983. Plans now announced are firm. Precise figures may change slightly between now and White Paper in light of more detailed calculations. Contingency Reserve will also be reviewed before White Paper finalised.]

PUBLIC EXPENDITURE 1982-83 AND AUTUMN STATEMENT

1. How do revised plans for 1983-84 compare with those previously announced?

[PM on 3 November referred to 'holding to the total of £120.5 billion' announced at time of last Budget].

Outcome of annual review of public expenditure plans has been to hold planning total within previously announced plans. First time this has happened since 1977. Unlike 1977, Government not forced to hold to plans by outside intervention of IMF.

2. What is change in real terms?

Small fall in expenditure in 'real' (cost) terms now planned for 1983-84 compared with 1982-83 plans. [NB cost terms means cash adjusted for general level of inflation as measured by GDP deflator]. No 'volume' (constant price) figures available.

3. Cuts in services?

Decision to contain expenditure has inevitably meant reductions in some programmes to compensate for increases in others. But Government's success in reducing inflation and interest rates has made it possible to accommodate such changes without major cuts in services.

4. Hasn't Government gone too far in reducing public expenditure?

Still planning for an increase (£5½ billion) between plans for 1982-83 and 1983-84. Reduction below Budget-time plans largely accounted for by two factors: £400 million benefit from NIS clawback: revised forecasts of receipts from special sales of assets. When effect of these discounted, Government has held closely to its previous plans.

PUBLIC EXPENDITURE - GENERAL

5. Ratio of public spending to GDP

Ratios in 1980-81 (43 per cent) and 1981-82 (44½ per cent estimated) remain below level of 1974-75 and 1975-76 (46 per cent in both years). Rise in ratio in 1981-82 compared 1980-81 mainly reflected higher expenditure on social security at a time when real GDP falling. Ratio expected to fall in next few years. Autumn Statement gives figures of 45 per cent in 1982-83 and 44 per cent in 1983-84.

6. Increase spending in recession?

No good trying to spend way out of recession. Any benefits would be short-term. If increased spending not financed responsibly, would soon lead to more inflation. If financed prudently, would lead to higher interest rates and/or higher taxes. We are responding, within limits of prudence, to needs of current circumstances.

7. Capital spending in public sector?

Government's policy is that provision made for capital expenditure both in central government and local authorities, should be fully spent, subject to the normal prudential margin. (Of course always necessary to take account of implications for future current running costs - and interest). In nationalised industries, criterion is that capital expenditure should show an adequate return. (See also E13-14 and R10).

8. Cut public sector pay bill/administrative costs of central government?

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. Provision for public service pay increases 1982-83 limited to 4 per cent. Administrative costs are not far short of 10 per cent of total public expenditure. We are determined to reduce that proportion, and to maintain drive for more efficient management throughout public sector.

9. Cost of pay rises for public servants - equivalents in public spending programmes?

Every 1 per cent extra on pay for public servants (excluding Nationalised Industries) costs £335 million - the approximate equivalent of two frigates, 50 Harriers or about 70 miles of motorway.

10. What allowance will Government make for pay increase in public services for 1983-84?

Government attaches great importance to realistic wage settlements next year, in both public and private sectors. Provision for public service pay will be made from within cash plans.

11. 3½ per cent pay assumption for 1983-84

Assumption is not a 'norm'. Nor is it a decision on the offer to be made in any particular case. Each will be considered on its merits. It concerns the provision in public expenditure plans for next year for those groups for which Government is directly responsible, other than

NHS. It does not directly cover local authorities, or nationalised industries, which are not within Government's direct control. But they will be controlled by the rate support grant and the external financing limits.

LOCAL GOVERNMENT

12. LA capital underspending in 1982-83

Following underspend of £¾ billion in 1981-82, local authorities seem set to underspend their capital cash limits for 1982-83 by between £1 and £1½ billion (GB figures). Some steps in hand to reduce the underspend: Prime Minister has written to local authority associations; local authorities can apply for extra allocations, and can spend without limit on improvement grants; extra £150 million made available to the Housing Corporation.

13. LAs cannot increase capital spend because of revenue consequences?

Plans for relevant LA current expenditure allow for financing costs of full planned capital programme. Many capital projects have no immediate running costs eg roads, reclamation of derelict land. Others will reduce running costs by rationalisation. LAs would be able to afford running costs of worthwhile investments if curbed wasteful expenditure and held down pay settlements.

14. LA capital spending plans for 1983-84

Plans for LA capital as a whole allow net spending one third higher than likely outturn in 1982-83; (gross) housing spending up £350 million (13 per cent); urban programme (including Urban Davelopment Grant) up by £70 million (to £350 million).

15. LA current overspending in 1982-83

Budget returns from LAs indicate overspend of over £1 billion on current expenditure is under way. Secretaries of State have announced intentions to abate rate support grant to overspenders in response. (For details, refer to statements in Parliament 27/28 July by Secretaries of State.)

16. Local government finance 1983-84?

[Announcements in Autumn Statement.]

Plans for LA current spending have been increased by over £1 billion to ensure that they are realistic. Only some £270 million of this increase will be allocated to service programmes the rest will be included in expenditure targets as it represents an extra provision which the Government does not consider desirable, but which has been included to make plans realistic in relation to this year's overspend.

17. Rate increases implied by plans?

What happens next year depends on what LAs decide to spend. If LAs comply with their expenditure targets, rate increases need only be very modest overall, and in some areas will be no need for any increase. Of course, if LAs decide to overspend, the rate burden they have to impose will be higher, and they may lose rate support grant if they exceed targets.

18. Holdback of RSG in 1983-84?

Refer Written Answer from Environment Secretary (Hansard 4 November) announcing options for holdbacks in England. Consultation with LAs under way (also in Scotland and Wales). Schemes adopted will depend on outcome of consultations.

19. Higher council house rents?

[85p assumption referred to in Autumn Statement].

In Government's view, LAs should not need to increase rents in real terms in 1983-84. For them to decide. Government decision is about provision for housing subsidy - Environment Secretary will be consulting LA associations on basis of figure of 85p per week per dwelling. If that figure confirmed, will be possible to provide for real increase in capital investment in housing next year.

20. Green Paper on Domestic Rating System: Government response?

Carefully considering representations. Need scheme to run that will remedy shortcomings of present rating system which will command widespread support. Taking account of pleas from industry, business, etc. (See also P10.)

FALKLANDS EXPENDITURE

21. Falklands defence costs?

[Parliamentary Answers 26 October cols 885-6; 28 October cols W 453-4.]

Latest assessment of costs of operation, and of replacing equipment lost during the conflict, is about £700 million in current year; over next three years the cost will be £200 million, £350 million and £320 million respectively. Decisions have yet to be taken on size (and thus cost) of garrison.

22. How will the various costs be met?

Extra costs in current year will be met from Contingency Reserve. The block defence cash limit for 1982-83 has been increased by £371 million on account of operations in the South Atlantic. (Hansard col W 108 9 November 1982) For 1983-84, an increase to the Defence Budget of just over £620 million has been announced. Future years' provision will be announced in the 1983 Public Expenditure White Paper. Extra defence costs will be met out of monies additional to path of annual real growth of 3 per cent.

23. What will be costs of repairing damage and reconstructing the Islands' economy?

Too soon to say what these costs will be. Work has begun on restoration of essential services and on implementing Civil Commissioner's recommendations for priority action (accommodation, inter-Islands air service, education). Up to £10 million is being made available for this. Not yet able to say whether these costs will require additions to existing FCO and ODA funds and how far additional sums will be needed. Ministers studying Shackleton Report proposals for long term development of Islands; in advance of decisions, impossible to say what costs will be.

[BACKGROUND WHICH CAN BE DRAWN UPON: Estimates of cost given in the Report are £31-36 million for new development aid; £40 million for offshore fishing; up to £12 million for additional housing/infrastructure. Total estimate of £83-89 million (at 1982 prices) excludes aid for rehabilitation and compensation for war damage already being made available.]

24. Cost of paying compensation for war damage?

Too soon to say what total will be. Claims are being processed, and further claims may be received. About £1 million has so far been paid out, but this is no guide to what the final total might be. Not yet clear whether the compensation scheme will require an addition to existing FCO programme.

F CIVIL SERVICE STAFFING AND PAY

1. Civil service too big/does too much/is over staffed?

Since Government came to office, Civil Service has been reduced by 10½ per cent to 655,000. Results from reduction in functions, privatisation and improvements in efficiency. On course to achieve aim of having Civil Service of 630,000 by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean smallest Civil Service since end of Second World war.

2. Civil service efficiency?

[Government reply to TCSC was published 28 September entitled 'Efficiency and Effectiveness in the Civil Service Government Observations on TCSC Report Cmnd 8616].

Measures to increase efficiency in civil service set out in Government's recent White Paper ~~welcoming Report~~ from TSCS, and accepting (totally or with reservations) no less than 20 of the Committee's 26 recommendations. White Paper gives details of new financial management initiative, and responds to Committee recommendations on management information systems, training in management and financial management, and the filling of senior posts.

3. Civil service pay in 1983?

Unions have asked Government, in light of 3½ per cent planning assumption announced 1 October (see E 12), whether Government intend to have genuine negotiations, and whether arbitration will be available. They believe arbitration should be unconditionally binding ie not subject to Parliamentary over-ride.

4. Megaw Report

Report of Megaw Inquiry into arrangements for deciding civil service pay in future (Cmnd 8590) contained number of important recommendations which are now being considered. Government pleased with widespread support that has emerged for the general approaches which the Inquiry endorsed. Preliminary 'ground-clearing' discussions with unions have commenced. A new system will not be agreed in time for 1983 pay.

5. Scott Report/Public sector pensions?

See K 22.

G SOCIAL SECURITY

NATIONAL INSURANCE CONTRIBUTIONS

[NB Statutory Instrument effecting increase to be debated Wednesday 24 November]

[National Insurance contribution rates for employees and employers to be increased by 0.25 per cent from next April, thus increasing contracted-in rates for Class 1 from 8.75 per cent to 9 per cent (employees) and from 10.2 per cent to 10.45 per cent (employers). (Because of reduction in rebate on contracted-out rates - announced last March and not part of the annual contributions review - of 0.35 per cent for employees and 0.4 per cent for employers, Class 1 rates for contracted-out rise by 0.6 per cent (employees) and 0.65 per cent (employers); thus increasing rates from 6.25 per cent to 6.85 per cent (employees) and from 5.7 per cent to 6.35 per cent (employers).) Lower Earnings Limit rises from £29.50 to £32.50 and Upper Earnings Limit from £220 to £235. Change in the rate of National Insurance Surcharge also affects employers' total payments, see P1-3.]

1. Why increase employees' contributions?

Recognise employees hard hit recently (increase of 2.5 per cent overall since Government came to power). Some increase necessary because of rise in cost of benefits paid from NI Fund. But, to protect contributors, increase is less than needed to balance Fund (in consequence, Fund will be in deficit in 1983-84 by £262 million).

2. Very large increase for contracted-out?

Change in contracting-out terms announced last March - following report by Government Actuary - and not part of this year's review. Reduction in rebate reflects Government Actuary's assessment of fall in cost to contracted-out schemes of providing guaranteed minimum pensions.

BENEFITS

[Benefits being uprated by 11 per cent later this month (22 November 1982). Includes 9 per cent to take account of inflation. 9 per cent clearly too high hence announcement in Autumn Statement that uprating in November 1983 will be adjusted to have regard to this].

3. Government reneging on pledge to maintain value of pensions?

On contrary, pensioners will be better off during next year by extent of the overshoot. Only question how much of this real increase will continue beyond November 1983. Maintaining real value bound to mean adjustments from year to year; nothing extraordinary about this.

4. Level of overshoot?

Cannot say exactly until December, when November RPI available. Industry Act forecast is 6 per cent inflation for fourth quarter 1982. So overshoot of 2½-3 per cent reasonable estimate. Reflects Government success in reducing inflation.

5. Public expenditure saving?

Recovery of a 2½ per cent overshoot would save £250 million in 1983-84; more in a full year. But social security programme has been reduced by £180 million in 1983-84. This reflects Government's judgement of appropriate level of expenditure. Exact level of November 1983 uprating will be settled at Budget time, when Government will, as usual, take wide range of factors into account.

6. Improvements in benefits?

[Ie, using difference between reduction of £180 million and full saving of £250 million if overshoot is £250 million.]

There is constant pressure from both sides of House for whole variety of improvements. Government will have to determine priorities, eg between change in individual benefits and adjustment to next year's uprating. Decisions will, as usual, be taken at Budget time.

7. Uprate pension by pensioners' price index?

[Two RPI's for one and two person households; both exclude housing costs. Both indices have moved less than RPI between fourth quarter 1978 Q4 and third quarter 1982 Q3. The gap has, however, been narrowing in recent times. Moreover, comparison with the full RPI, ie including housing costs, shows that over time they produce very similar results.]

Pensioner's price index is not necessarily representative of pattern of pensioners' spending, and is constructed on limited information on a very small sample of pensioners. We consider RPI to be best measure of general level of prices, and appropriate for uprating of pensions. In any case, pensioners would not have done any better had we used the PPI to uprate pensions since we came into office.

8. Burden of State pension too high?

[Articles by G Hill in The Times 18 and 19 November discussing whether burden of pensions in future could become too great - especially with high unemployment.]

First Quinquennial Review by Government Actuary on long-term financial estimates for the NI fund (published last July) considered the burden of the State scheme over next 40 years. Clearly, conclusions of such a review must depend on assumptions made about earnings, prices and unemployment, which - on such an extended timescale - cannot but be stylised. We shall be considering GA's report carefully before reaching any conclusions. In meantime, DHSS consulting widely with interested organisations; would welcome comments by end-1982.

9. Occupational pensions - increase supervision?

[Recent report by Occupational Pensions Board recommending, inter alia, disclosure of information to pension fund members; end to 'franking' (whereby schemes implement requirement to maintain value of guaranteed minimum pension only by eroding accumulated pension rights above that minimum).]

Government welcome recommendations of OPB. Accept in principle need for legislation on disclosure of information to members of pension funds. Social Services Secretary will be consulting interested parties about content. He also hopes to bring forward in first half of next year regulations to prohibit practice of 'franking'.

10. Restore abatement of unemployment benefit?

[NB subject of Supply Debate Monday 22 November]

[Uprating November 1980 abated by 5 per cent; foreshadowed in Budget Speech announcing plans to bring UB into tax.]

Position on this has been made clear. Reviewed possibility of restoring abatement when UB brought into tax (in July 1982) but concluded could not afford to do so. Matter being kept under review.

11. Death grant - increase to realistic level?

[Consultative document about death grant published 3 March, deadline for comments 30 July.]

Social Services Secretary grateful for comments received on consultative document on death grant published in spring and is considering them carefully.

ALTERNATIVE PROPOSALS BY OTHER PARTIES

12. Cost of social security proposals in 'Labour's Programme 1982'?

[Proposals include raising single/married pension to one-third/half of average earnings; reducing pension age to 60; increasing Child Benefit to £7.75; paying unemployment benefit for men, without limiting duration, at rate equal to RP.]

Cost of implementing Labour's proposals in full probably over £20 billion in full year - an increase of over 60 per cent in social security programme. Labour proposes revenue increases to finance changes of less than £4 billion (abolition of married man's tax allowance and of upper earnings limit of contributions). To raise remainder would require, for example, rise in employee's NIC from current 8.75 per cent to around 22 per cent; or rise in basic rate income tax to 46p in £.

13. SDP proposals?

See D6-7.

H FISCAL POLICY AND THE PSBR

1. Progress on fiscal policy?

[Aim is to achieve reduction in PSBR as percentage of GDP over run of years, so as to achieve lower inflation and interest rates.]

Have made progress; Government has succeeded in reducing PSBR as percentage of GDP, and further reduction is projected. Inflation has fallen fast and is expected to fall further (see K2-3). Long term interest rates now lower than at any time in last 9 years. Benefits seen in recovery of debenture market. [IF PRESSED: Government would like to see rates lower still, so long as further reductions not likely to endanger progress or inflation.]

2. How does UK fiscal stance compare with other countries?

[IMF Annual Report noted that among major industrial countries by far the largest 'restrictive shift' over past two years, equivalent to more than 3½ per cent, was that of UK.]

Many countries reducing borrowing; UK budget deficit now well below average of OECD countries. France demonstrates problems with reflation option and US experience shows that fiscal and monetary policy must be broadly consistent.

3. PSBR for 1982-83 now expected to be lower than FSBR forecast?

[1982-83 FSBR forecast £9½ billion. New Industry Act Forecast (IAF) £9 billion.]

Change is small (and insignificant compared with forecast errors of plus or minus £2 billion at this stage in year). Outturns for PSBR and CGBR so far consistent with PSBR of £9 billion this year.

4. How can Industry Act forecast of £9 billion PSBR in 1982-83 be reconciled with seasonally adjusted outturn for first half of year?

[Seasonally adjusted, PSBR April-September £3.0 billion.]

Wrong to multiply seasonally adjusted half-yearly outturn by two to get PSBR for 1982-83. Many erratic and irregular influences which seasonal adjustment does not pick up (nor is it meant to). Examples: public corporations expected to borrow more in rest of year than first half; outstanding pay awards (eg nurses); National Insurance benefits up-rating of 11 per cent.]

5. PSBR seriously undershooting and Government has been forced to inflate the economy?

Government does not control the PSBR out of a wish to wear a hair shirt. Chancellor said in Mansion House speech [22 October] that PSBR seemed to be undershooting; in light of this

Government has decided to take further worthwhile measures to help industry and in other ways, e.g housing announcements by Environment Secretary.

6. Why then hasn't Government acted to get PSBR back to £9½ billion?

PSBR forecasts not precise targets - would not make practical sense to fine tune in that way. Must also remember margins of error in forecasting PSBR (see Q3).

7. Why has Government cut PSBR for 1983-84?

[IAF figure of £8 billion for 1983-84 compares with £8½ billion in this year's MTFS.]

PSBR figures in IAF and MTFS for 1983-84 are not targets. The actual plan will depend on judgement taken in next Budget. Both PSBR figures are same percentage (2¾ per cent) of money GDP. Reduction in money GDP forecast since March merely means that this implies £8 billion rather than £8½ billion.

8. More than £1 billion available for tax cuts next year?

[IAF showed £1 billion 'fiscal adjustment' 1983-84; Press suggest scope for more].

PSBR figures in Industry Act forecast illustrative, not targets. Final decisions about PSBR and tax cuts planned for 1983-84 will be made at Budget time, not before.

9. Cyclically adjusted PSBR better guide to policy?

Government fiscal policy has taken account of recession. Acid test of PSBR is level of interest rates at which it can be financed, not its value at some hypothetical cyclically adjusted level of output.

10. Inflation-adjusted or 'real' PSBR in surplus - isn't fiscal policy too tight?

['Real' PSBR subtracts from actual PSBR erosion by inflation of real value of Government debt. Calculations by Bank of England and others produce a surplus 'real' PSBR in most years since the 60's.]

No. Fall in inflation has raised the 'real' PSBR (because the 'inflation tax' is reduced). Real PSBR is interesting indicator but poor guide to setting policy e.g. suggests raising PSBR when inflation accelerates.

J MONETARY AND FINANCIAL POLICY

1. Monetary growth in 1982-83 on target

[(Full) money and banking figures for October published 18 November heavily distorted upwards by oversubscription for STC. Bank gave more prominence to their estimates of underlying increases. Target aggregates M1 £M3 and PSL 2, adjusted for STC distortion, grew by ½ - 1¼, ¾ - 1¼ and ¾ - 1¼ per cent respectively in banking October. Implied rates of growth in 1982-83 target period were 9-10½, 11¾-12¾ and 8¾-9½ per cent per annum respectively, compared with target range of 8-12 per cent (all figures seasonally adjusted).]

Estimated rates of growth in target period are within Government's 8-12 per cent range for M1 and PSL 2 and at top end of range for £M 3. But looking also at behaviour of exchange rate and progress in reducing inflation, overall picture is of sound domestic monetary conditions.

2. Adjustment for STC attempts to cover up large October increases?

Distortion to recorded October money figures by STC effect was widely anticipated in the City. The clearing banks' own statement consistent with that of Bank of England. Nothing to be gained by covering up as distortion will correct itself in figures for later months.

3. Benefit of interest rate falls to home buyers

[Mortgage rates have fallen 5 percentage points since this year's peak in March. Latest cut to 10 per cent comes into effect for all home buyers on 1 December.]

Mortgage rate falls including latest cut mean for average couple buying first home net saving of over £50 a month since March.

4. Effect of US developments?

[US interest rates fell substantially during July/August, and again in October.]

The falls in US interest rates were helpful and facilitated reductions in our own. But of course US rates are not sole determinant of UK's, and this spring progress was made in reducing ours at a time when US rates were rising. UK rates are determined in the light of domestic monetary conditions generally, including the behaviour of the exchange rate. Effect of high US money supply figures and delay in cutting Federal discount rate combined (½ percentage point cut in rate finally announced 19 November), weakened gilts market and sterling in last week or so.

5. Will slide in sterling affect monetary conditions?

Exchange rate is one of several important factors taken into account in judging domestic monetary conditions. Government has no intention of allowing lax financial conditions to jeopardise progress in defeating inflation.

6. Prospects for further reductions in interest rates?

[Last reduction in bank base rates made on 4 November - to 9 per cent. Have come down by 7 points since peak in October 1981. Long term interest rates also reduced significantly -by one point in October alone - 6 points since peak last year.]

Substantial interest rate reductions this year reflect sound monetary conditions, and good inflation prospects. Impulse also from earlier US developments. Any further reductions will only be made if will not weaken financial discipline or endanger progress on inflation.

7. Monetary conditions too tight - stifling recovery?

No. Behaviour of exchange rate and money supply suggest financial conditions moderately restrictive, as intended. Interest rates reductions have cut companies' costs and should promote climate for investment. Have given boost to corporate bond market - reducing companies' dependence on banks and easing pressure on monetary growth.

8. Bank lending growing too fast?

[Lower growth rate in May/June not maintained. Increased by (seasonally adjusted) £1.3 billion in banking August, £2 billion in September , and £1.8 billion in October. (October figure distorted upwards by sale of STC.).]

Reasons for growth of bank lending to companies not entirely clear. Companies may have been trying to build up gross liquidity levels which fell back in spring. Strong growth in personal lending is partly result of structural changes, such as move by banks into home loans market, replacing lending by building societies; ending of HP controls in July does not appear to have had a large effect. To the extent that increases in bank lending are additional, ie not just in substitution for lending by eg building societies, do represent potential cause for concern, as add to monetary growth. To be taken into account in interest rate policy.

9. Why has Bank of England been providing such large-scale money market assistance?

The rapid growth of bank lending has caused problems for conduct of monetary policy. By selling long-term Government debt on a larger scale outside the banking system, it has been possible to contain the rapid growth in money which could otherwise have taken place. This in turn has created shortages of liquidity in money markets. If Bank had not intervened, short-term interest rates would have been forced up to unnecessarily high levels.

K PRICES AND EARNINGS

PRICES

1. October RPI

[Year on year increase in RPI 6.8 per cent in October, compared with 7.3 per cent in September].

Annual rate of inflation again fell sharply in October to 6.8 per cent, its lowest level for 10 years (compared 6.6 per cent in October 1972).

2. Further falls likely in 1983?

We expect inflation to be down to 5 per cent early next year.

3. Inflation turning up again next year?

[S Times: D Lipsey article 21 November alleges 10 per cent depreciation in £ could add 2½ per cent to RPI by spring 1984.]

We have forecast a figure of 5 per cent for price increase over the year to next autumn (fourth quarter 1983). This still holds. Further falls in wage settlements this pay round and continued productivity growth should enable low rates of price increase to be maintained during 1983, even with some rebuilding of profit margins.

4. No decline in inflation between spring and autumn 1983?

[Mansion House speech: 5 per cent by spring. Industry Act forecast: 5 per cent in fourth quarter 1983.]

Obviously we cannot expect to maintain the very rapid progress on inflation which is now being made. What we will maintain are the policies which have given us this success; confident that they will keep inflation down.

5. Inflation lower than under previous Government?

[Average year-on-year rate of inflation between February 1974 and May 1979 was 15.4 per cent; average level of inflation since May 1979 has been 12.7 per cent.]

Year-on-year rate of inflation was 10.3 per cent and rising when previous Government left office in May 1979. Now (October 1982) 6.8 per cent and falling. We will be first Government for quarter of a century to achieve a lower average rate of inflation during its term of office than the previous Administration.

6. Inflation still not as low as competitors?

[September figures UK inflation 7.3 per cent compared with 5.0 per cent in US, 4.9 per cent in West Germany, and 3.2 per cent in Japan.]

UK inflation now lower than Western European (OECD Europe) average, and well below many countries - such as France and Italy. Still some way to go to match US, West Germany and Japan, but good progress being made in right direction.

7. Long term inflation objective?

Recent developments encouraging. But inflation rate still higher than some competitors e.g Germany. Must not let up. Have always made it clear that price stability not unattainable.

8. TPI now shows pay increases need to be ½ per cent higher than RPI to maintain living standards?

[Increase in TPI over 12 months to October 7.4 per cent, compared with RPI increase of 6.8 per cent].

The gap between the RPI and the TPI (now 0.6 percentage points) widened in July when benefits paid to the unemployed became taxable. Pay increases go to people in work, who will not pay any more tax as result of the change - except for the minority who have a spell of unemployment during the year.

9. Nationalised industry prices

[Increase over 12 months to October 15.1 per cent, compared RPI increase of 6.8 per cent].

Increases regrettable, but holding prices down artificially would distort market forces and add to burden on taxpayer. But sustained improvement only possible if industries succeed in holding down current costs, particularly pay. (See also R1).

PAY

[NB: GAD Report published 8 November includes assumption that average earnings in 1983-84 6½ per cent higher than in 1982-83.]

10. What pay settlements does Government now want?

Low enough to be consistent with improved job prospects in the industry concerned. The lower the better. Certainly lower than in the past year.

11. 5-5½ per cent settlements in year ahead?

[5-5½ per cent settlements quoted by T Burns to TCSC 16 November as consistent with 6½ per cent assumption given to Government Actury.]

True that settlements around 5 per cent would be consistent with Government Actuary assumption. But so would lower figures. If 'drift' was 2 per cent - as last year - 6½ per cent earnings would imply 4½ per cent settlements. But important point is not the assumptions used but the need to get settlements as low as possible.

12. What has been average over past year/pay round?

[CBI Databank suggests 7 per cent average for manufacturing in last (1981-82) pay round.]

Average has been in single figures, and moving downwards, in each of past two years. We need a substantial further reduction, with really low settlements, and thus a better outlook for jobs, in the year ahead.

13. Pay settlements failing to come down?

[FT article (1 November) and November Incomes Data Services Report suggest pay settlements still averaging 7% in spite of falling inflation.]

Too early to say. Few settlements so far this autumn. But in everyone's interest that pay settlements should come down, and come down sharply.

~~14. A 3½ per cent~~ pay policy?

The 3½ per cent pay assumption [announced 1 October for calculating the pay element in cash expenditure plans for 1983-84] does not represent a 'norm', still less an 'incomes policy'. Nor is it a decision on the offer to be made in any individual case. Settlements higher or lower than the assumption are not ruled out. Each case will be considered on merits.

15. Government exhortations on pay imply aiming to cut living standards?

[Real earnings show little variation over past two years; August 1982 broadly similar to August 1981 and about 1 per cent higher than August 1980.]

Low pay increases do not necessarily mean a reduction in living standards. But whether they do or not, they are essential if we are to create a competitive and profitable productive sector, and thus secure the conditions for sustained improvement in living standards.

16. 1982 New Earnings Survey shows public services falling behind?

Taking account of the effect of overtime on those working in the private sector, and public service settlements which were delayed beyond the Survey date, difference shown between public services and private sector pay movements over period covered by April 1981 and 1982 Surveys no more than 2 per cent.

17. Average earnings index

[Year on year growth 6.8 per cent in September compared with 7.8 per cent in August. Underlying increase about 8¾ per cent in September.]

Encouraging that underlying rate of growth continues to fall. Further moderation in settlements can only be helpful in maintaining jobs and getting inflation down.

18. Incomes Policy

Proposals for incomes policies, including recent refinements, do not avoid many of the familiar problems of norms, administrative costs, and interference with market forces. Experience gives no encouragement to the idea that incomes policy can be made to work on a permanent basis. They always succumb to the distortions they create.

19. Top Salaries Review Body increases too large?

[Government announced on 12 May increases of 14.3 per cent for senior civil servants and senior members of armed forces, and 18.6 per cent for judiciary.]

Government believes these increases are fully justified. Essential to ensure adequate supply of candidates of sufficient calibre for the Bench, and to provide adequate career structure and differentials in higher levels of civil service and armed forces. Before the increases, TSRB were the only group whose salaries were below those recommended for April 1980.

20. Performance-related pay for nationalised industry board members?

This is an attractive concept. Practicalities and implications of it are being studied jointly with representatives of the Nationalised Industries' Chairmen's Group, at Government's initiative. Individual boards are free to make proposals of this kind for their own circumstances.

21. Pay increase for nationalised industries' boards this year?

[S Times: article 21 November: 'State bosses to get 15 per cent']

No general level of increases for board members this year. Proposals for each board are being considered individually on their merits, in light of circumstances of the board. When relatively large increases have been approved by Ministers responsible (in consultation with Chancellor) it is because these have been justified by such factors as the need to recruit people of ability, inadequate differentials with senior staff and the performance of the industry. Because board pay has been held back in previous years, many salaries are now seriously out of line with market rates.

22. Index-linked pensions and Scott report?

Question debated in House of Commons 22 October, when Government announced they favoured Megaw Committee suggestion that civil service pension scheme be made contributory. Reduction in inflation has greatly eased disparity between private and public sector pensions; Government's main aim at present is to ensure appropriate contributions are paid for index-linked benefits.

L BALANCE OF PAYMENTS

1. Trade figures and current account

[October trade figures show trade account in broad balance though non-oil trade remains in deficit; invisibles surplus of £260 million a month in Q2 and projected £200 million a month from Q3 onwards. Cumulative current account surplus of £3.0 billion in ten months to October. IAF shows zero current account balance in 1983.]

Current account remains in substantial surplus, albeit reduced from last year's levels - current account surplus for 1981 was £6 billion.

2. Export trends - recent

Month-to-month movements in exports during 1982 have been very erratic. There was a sharp recovery in exports in September and October from the erratically low August level but underlying level of non-oil exports has probably fallen since the spring. To a large extent this appears due to world recession; world trade in manufactures has probably fallen in 1982-83 - first year-on-year fall since 1975.

3. Export trends last few years?

Growth in UK exports of manufactures significantly below world trade growth over 1977 to early 1981, when competitiveness worsening, but with improvement in competitiveness since then, our share appears to have stabilised.

4. Import trends

Manufactured imports fell ½ per cent in 3 months to October: there has been little, if any, growth in underlying level of manufacturing imports since end-1981. Manufacturing output has fallen back a little this year, so there has probably been some continued growth in import penetration, although not at anything like same rate as in 1981.

5. New import controls on way?

[Continuing Press speculation].

We are concerned at the extent of unfair trading practices and the damaging effect of very high tariffs and quotas in some other countries. Pressing for positive European Community action to remedy this. But wish to make clear, as Chancellor said recently [Caterham 22 October] that 'we will be continuing to defend the open trading system'. A free and fair trading system is in the interest of all trading nations.

6. <u>Overseas investment takes jobs away from UK?</u>

30 per cent of UK exports are bought by overseas firms connected with UK companies. By increasing links between UK and overseas companies, overseas investment helps UK exports and production, so producing more jobs. If UK does not take profitable opportunities to invest overseas, others will.

M EXCHANGE RATE AND THE RESERVES

1. Policy towards the exchange rate/falling £?

[£ fell sharply between Monday 15 and Wednesday 17 November, then, following brief recovery, fell further on Monday 22 November. Course of exchange rate in recent days has been:

	12 Nov close	22 Nov low points	22 Nov close	12-22 Nov % change
$/£	1.6512	1.5815	1.5918	-3.6
DM/£	4.2783	4.0150	4.0352	-5.7
£ effective	91.3	86.2	86.5	-5.3

Previous lows for sterling were $1.5675 (28.10.76), and effective of 85.7 (24.9.81). Fall on 22 November largely a reaction to S.Times story suggesting Government looking for further 7 per cent fall beyond previous Friday's rate - based on misconception of remark by T Burns to TCSC on 16 November about the exchange rate assumption in November Industry Act forecast.]

Government has no target for the exchange rate. Policy is for rate to be determined largely by market forces with intervention limited to that required to seek to moderate excessive fluctuati~~ons and~~ maintain orderly markets. Exchange rate only one factors taken into account in interpreting domestic monetary conditions and taking decisions on policy. Despite its recent fall sterling's effective rate remains within levels seen over last year. [NB: Avoid any mention, if possible, of particular rates of changes.]

2. Should not Government welcome fall in pound?

A lower exchange rate means higher costs to industry and the consumer: no-one should welcome that. Of course, recent fall in pound may bring some relief to British firms that are facing difficult competitive pressures in home and overseas markets, particularly from Europe and the Far East - but they must contain their costs rigorously in order to retain that benefit. We cannot solve our basic problems of competitiveness by depreciation, and no-one should doubt our determination to adhere to our counter-inflation policies. Sound money remains at the heart of the Government's economic strategy.

3. Why not improve UK competitiveness directly by bringing exchange rate down further?

First of all, Government's ability to influence exchange rate very limited; developments in other countries critically important; domestic rate decisions must reflect overall judgement about monetary conditions, in which exchange rate only one element. Industry itself has mixed views about desirability of bringing the rate down (illustrated at CBI Conference in October). Moreover, exchange rate depreciation only offers at best a breathing space. UK's problems caused by failure to contain costs (effective rate only 5-6 per cent above level in May 1979 but cost competitiveness some 26 per cent worse). Only long term solution is lower costs (via lower wages/higher productivity).

4. Influence rate differentially as against DM/yen and dollar?

Could only do so by depressing value of dollar against DM/yen. Over recent months both German and Japanese authorities have indicated that a desirable end but one which they are powerless to achieve. Dollar/DM and dollar/yen exchange rates are even less within power of UK authorities to influence.

5. Bank of England intervention?

Policy is unchanged. Bank intervene to smooth excessive fluctuations and preserve orderly markets particularly when conditions unsettled. But Bank do not attempt to resist underlying trend of rate. Not practice of Government to comment in detail on intervention undertaken.

6. Debt repayments

We have made excellent progress with our plans to reduce the burden of external debt substantially during this Parliament. We aimed to reduce official external debt to $14 billion by end of 1981. This has been more than achieved - external debt is now around $13 billion, compared with over $22 billion when the Government took office.

N EUROPEAN MATTERS

MEMBERSHIP OF EUROPEAN COMMUNITY

1. UK budget settlement

Foreign Ministers agreed on 25 May to a settlement for the UK budget contribution for 1982 which provides for a basic refund of about £470 million with provision for change if our unadjusted net contribution varies from the Commission estimate of £880 million. Final agreement on implementation on the settlement was reached by Foreign Ministers on 25/26 October. Although UK will only be compensated for 75 per cent of our contribution to German refunds, we shall receive our 1982 refund of 1092 million ecus, about £600 million gross, much earlier than originally envisaged.

2. Progress in implementing 1982 Budget Agreement

Commission has submitted draft implementing Regulation which is now being considered by the Council and the European Parliament. The Parliament is also considering draft supplementary and amending budget which Council established on 8 November to provide necessary budgetary provision for our refunds payments. [IF PRESSED ON consequences of Parliament blocking either the Regulation or the Amending Budget: cannot speculate on hypothetical question].

3. Refunds for 1983 and later

On 17 November Commission produced its proposals for dealing with UK budget problem in 1983 and later. Commission communication does not suggest what size of our refunds or our net contribution after refunds should be. We think it provides a suitable framework for discussion of problem within the Community. However, we recognise with regret that end-November deadline for decisions on 1983 and later will not now be met: hope nevertheless that progress will be made quickly.

4. UK objectives for longer-term negotiations?

Government has made it clear that, in spite of our relative economic position, UK is prepared to remain a net contributor - but only on a very modest scale.

5. Will Government withhold contributions?

We hope very much that the issue of our Budget contributions can be satisfactorily settled without the need for recourse to such a step.

6. 15/16 November ECOFIN/'Jumbo Council' discussions on economic policy

All member states agreed to conclusions of the Joint Council which stress need to control level of public borrowing and inflation as precondition for lasting reduction in unemployment.

7. Commission's ideas for changes to 'own resources' system

Understand that Commission are considering measures to diversify Community's revenue sources. If they put forward proposals we will consider them. Our opposition to any increase in the 1 per cent VAT ceiling is well known.

8. Policy for CAP reform

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

9. Costs of CAP to UK consumers

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

10. 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.

11. Join the EMS for exchange rate stability?

There is no reason to suppose that by the simple act of joining the EMS exchange rate mechanism we would guarantee exchange rate stability. This has not been the experience of the current participants. Genuine stability requires a return to low inflation rates throughout the Community.

P INDUSTRY

1. Effect of NIC and NIS changes on private sector employers?

[Chancellor announced further reduction of 1 percentage point in National Insurance surcharge for 1983-84, cutting the rate to 1½ per cent; also half of the 1 percentage point reduction in the rate next year will be brought forward into the current financial year. Effect will be as if private sector had paid at 2 per cent rather than 2½ per cent (rate announced in 1982 Budget) during 1982-83. Small increase in employer's NIC as from April 1983 also announced on 8 November (see G: NI contributions.]

The special reduction in NIS is worth about £350 million to private sector employers this year, and the announced NIC and NIS changes taken together will benefit them by over £400 million next year. Constitute a substantial reduction in the costs faced by private sector commerce and industry.

2. How does this compare with burden as at May 1979?

Private employers will pay around £1 billion less next year than they would have done under the rate of NIS and employers' NIC inherited from the previous Administration.

3. Won't contracted-out employers be worse off?

No; their combined rate of NIC and NIS falls by 0.35 per cent next year. [Reduction of contracted-out rebate was announced last March, so not part of Autumn Statement, but included in this calculation.]

4. Prospects for industry-recovery?

See A2-4 and Section B.

5. Prospects for construction industry?

[Construction employers still looking for more public investment FT 22 November.]

Current picture for industry rather mixed (construction orders falling off recently, private housing starts showing little increase recently, though more than 20 per cent higher than last year) but Government has been doing a good deal to help. Lower inflation and above all lower interest rates - including mortgage rate down 5 percentage points from autumn 1981 peak - especially valuable to construction industry. Decisions announced 8 November - additional capital allocations to local authorities and increased spending provisions for the Housing Corporation - could give an extra £¼ billion of work to the industry in 1982-83. And Autumn Statement plans for 1983-84 include provision for a one third increase over 1982-83 (to £4 billion) in LA capital spending; a substantial increse in capital spending on urban and derelict land programmes; and a £350 million increase in housing investment.

6. Companies' financial position?

[£bn

	1979	1980	1981 Year	H1	H2	1982 H1
Net borrowing requirement (+)/repayments (-)	+6.3	+6.5	+5.1	-1.5	+6.6	+5.6
Financial surplus (+)/deficit (-)	-2.9	-1.4	+1.8	+1.0	+0.8	-1.3]

Financial position of industrial and commercial companies (excluding North Sea) improved last year, relative to 1979 and 1980. Improvement in part reflected companies' efforts to cut costs, for example by de-stocking. Some apparent deterioration in second half 1981 financial position due to slowdown in de-stocking and unwinding of delays in tax payments because of the civil service dispute. Figures for H1 1982 suggest reduction in companies' borrowing requirements relative to H2 1981; but borrowing needs still high.

7. Profits rate of return still too low?

[Gross trading profits of industrial and commercial companies (ICCs) (net of stock appreciation) rose 18 per cent to 1982 H1; but increase was from a very low base ICC's real pre-tax rate of return (except North Sea was just over 3 per cent in 1981, and only 2 per cent in manufacturing - half previous cyclical low figure in 1975.]

Government can help best by getting inflation down and setting sound basis for sustained recovery. Fundamental improvement in ICC's rates of return depend on better performance by companies. Some encouragement from recent productivity gains and trend towards moderate pay settlements.

8. Real rates of return on capital lower in UK than elsewhere?

[OECD statistics comparing UK, Japan, France and UK show net rates of return to fixed capital in non-financial corporations in 195-80 lowest in UK - though all on a downward trend. 1980 figures: US 13 per cent, Japan 15 per cent, France 9 per cent, UK 5 per cent.]

Figures show how policies of earlier administrations have allowed profitability to slide in UK. Sound basis for sustained recovery rests on reducing inflation, increased productivity gains, and moderation in pay settlements which creates conditions for better performance by companies.

9. High interest rates damaging for industry and investment?

Banks' base rates have fallen 7½ percentage points since last October, and 3½ points over last three months. Outside analysis suggests that a 1 per cent reduction in interest rates improves the net financial position of the company sector by about £250 million over a full year. Lower interest rates reflect Government's firm fiscal and monetary stance and will help industry and investment.

10. Lower rates for industry?

De-rating one of a number of possible ways of assisting industry and business, but in last Budget preference given to other forms of relief, notably reductions in NIS. De-rating would be expensive, though less so if applied to industry alone - even so, 10 per cent de-rating would cost about £140 million per annum. Legislation would be required.

11. Lower energy prices

See R2-3.

12. Government help for small firms

Budget provided further help for small businesses, increasing the number of measures taken so far to over 100. Enterprise package included further reduction in weight of corporation tax; further increases in VAT registration limits; increase in global amount available for loans under Loan Guarantee Scheme (see below); and doubling of investment limit under Business Start-Up Scheme to £20,000 a year. New measures will encourage start-ups and existing firms.

13. How many new firms starting up?

[Correspondence in progress between Treasury and D Industry about value of giving 'net' figures of 'birth' of minus 'deaths' of companies based on VAT registrations.]

On a very rough average some 10,000 new companies come into being every month.

14. Response to Loan Guarantee Scheme?

[Over 6,400 guarantees already issued - about half to new businesses. Total lending under scheme around £215 million. Budget provided for lending ceiling in first year (to May 1982) to be raised from £100 million to £150 million and for further £150 million to be available in second year (to May 1983). Thirty financial institutions now participating.]

Scheme operating successfully. Too early to assess overall cost . After first year, out of over 6000 guarantees issued, only 150 have so far been 'called'. Cost has been covered by the premium income received over the period. Scheme is kept under continuous review.

15. New enterprise zones

Proposed sites for new zones in England announced by Environment Secretary 15 November; sites for two new zones for Scotland, one for Northern Ireland and one (possibly for more) for Wales have also been announced. Total (12 or 13 in all) slightly more than the eleven new zones announced by Chancellor (27 July); this reflects number and quality of applications received from local authorities.

16. First group of enterprise zones

All first eleven zones now in operation. 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.

R NATIONALISED INDUSTRIES

NATIONALISED INDUSTRY PAY AND PRICES

1. Nationalised industries' prices

[Having risen approximately in line with retail prices for several months, the latest figures show bigger 12 months increase in nationalised industry prices, water charges and London Transport fares than all items RPI (15.1 per cent in October compared 6.8 per cent). This differential reflects March increase in LT fares. Removal of these temporary distortions confirms that nationalised industry prices are still increasing somewhat faster than RPI, largely because of increases in energy sector.]

Gap between nationalised industry price increases and RPI has been due in large measure to cumulative effect of years of artificial price restraint. World oil price rises of 1979 and 1980 have also played an important part. We greatly regret the need for these increases, but holding prices down artificially would distort market forces and add to burden on taxpayer. Differential between RPI (all items) and NI prices (including water charges and London Transport fares) now currently about 8 per cent compared with 14 per cent in January 1982. But sustained improvement will only be possible if the industries succeed in holding down their current costs, particularly pay.

2. Freeze on industrial gas prices?

[BGC announced 8 November that freeze on renewal prices for contract gas due to expire at end of year would be extended for further nine months].

Government welcomes BGC's decision to freeze industrial gas prices for a further nine months from the end of this year. Decision was taken on purely commercial grounds - BGC judge that they can accommodate the freeze within their present EFL.

3. Electricity prices?

As announced by the Secretary of State (for Energy and for Scotland) on 12 November, electricity prices will not, on average, be increased at all in 1983. This is consistent with the EFLs announced 8 November. The standstill follows the recent review of the bulk supply tariffs.

4. What is Government doing to improve nationalised industries' efficiency?

We continue to press for greater efficiency within NIs. We are setting realistic financial targets and performance aims. A rolling programme of Monopolies and Mergers Commission investigations has been set up. The introduction of market forces provides greatest incentive to efficiency.

5. Nationalised industry board's pay?

See K 20-21.

INVESTMENT

6. Nationalised industries' investment should be stepped up to/improve infrastructure/provide orders to private sector/as boost to economy

Government has not prevented the industries from carrying forward a large number of profitable investment programmes. Wasteful to provide funds for public sector projects with lower returns than those in private sector. Unfortunately, pre-tax rate of return on nationalised industries' capital (including subsidies) in 1980 (latest available figures) was minus one per cent, compared with 3 per cent for industrial and commercial companies.

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

As in private sector, moderate pay settlements and control of other costs are essential. Ability to finance new investment in nationalised industries bound to diminish if excessive pay settlements agreed. Each 1 per cent off wages saves about £140 million this year; and each 1 per cent off total costs saves £330 million this year.

8. Take nationalised industry investment out of PSBR?

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

9. Private finance for NI investment?

In discussions in NEDC and elsewhere, we have indicated our willingness to consider new financing proposals, provided they can be structured so as to induce improvements in efficiency at least sufficient to offset the extra cost, and provided the finance is raised in fair competition with the private sector.

10. Investment plans unlikely to be attained?

[PM has stressed to chairman of NI Chairmen's Group importance of maintaining NI investment programme: £900 million underspend 1981-82, £500 million expected underspend 1982-83.]

No Government can unconditionally guarantee a particular level of investment by the nationalised industries. NI planned investment for 1982-83 26 per cent higher than estimated outturn 1981-82. Some signs plans may not be fulfilled. Events outside industries' control may cause investment plans to be revised downwards. PM has made it clear that industries should make full and proper use of their allocation.

EXTERNAL FINANCING LIMITS

11. EFLs for 1982-83

Nationalised industries' total external finance increased by £1.3 billion in 1982-83 (£1.2 billion after allowing for NIS cut and other changes). Increase in 1982-83 was roughly half what the industries bid for. Government has given full recognition to problems faced by the industries in a period of recession.

12. EFLs for 1983-84?

Nationalised industries EFLs for 1983-84 announced in Autumn Statement. Overall, external finance in line with previous plans. £2.7 billion being made available to nationalised industries in 1983-84.

PRIVATISATION

13. Special asset sales in 1981-82

Gross sales in 1981-82 totalled £481 million, so target published in 1981 Public Expenditure White Paper of £500 million nearly met. Pleasing result - included two large sales - Cable and Wireless (£182 million) and Amersham International (£64 million). True that delivery of BNOC oil in 1981-82 paid for in 1980-81 and taken into account in special disposals figure for that year reduced 1981-82 receipts by £573 million to total of -£92 million. But it is gross figure which is true measure of success of Government's privatisation programme. As Chancellor said in Cambridge 3 July, 'Public utilities and the so-called "natural monopolies" cannot be allowed permanently and without challenge to remain within State ownership'.

14. What further sales expected?

Special sales of assets in 1982-83 forecast at around £600 million and expected to increase in subsequent years. This year's and next year's involve primarily very large sales of energy assets - Britoil and the British Gas Corporation's major offshore oil assets - made possible by Oil and Gas (Enterprise) Act (which received Royal Assent in June). Industry Secretary announced 19 July plans to sell 51 per cent of British Telecom - but not before next Election.

15. Why sell Britoil?

[In 10 November statement Energy Secretary announced offer for sale by tender of 51 per cent of Britoil shares. Special arrangements made to encourage small investors and employees to apply. Shares underwritten at minimum tender prices of 215p per share.

Government thereby guaranteed over £548 million from sale of shares plus £88 million from debenture which will be repaid by Britoil - giving total proceeds of over £636 million.]

Sale will create an independent British oil company free to seize opportunities. Will substantially reduce size of public sector in area where State ownership has no justification whatever. Will allow public to take direct personal stake in North Sea.

16. Wrong time to sell Britoil?

Absolutely no reason to believe that could have obtained a better price by delaying sale. FT actuaries oil share index 17 per cent higher at time offer announced than when decision to sell announced last year.

17. Why a tender?

Choice between tender and fixed price offer considered carefully. Right in these particular circumstances for price to be tested by market. And tender allows price to take into account upward movements in market during period of offer for sale. A novel approach for sale of this size. But objective is to get fair price for taxpayer.

18. Will poor reception for shares prevent privatisation?

No. Although market has moved adversely during period of offer for sale, any shares not applied for have to be taken by the sub-underwriters.

19. Government has sold assets too cheap?

[Heavy oversubscription for British Aerospace, Cable and Wireless, Amersham International, followed by large increases in prices when shares first traded.]

Not in Government's interest to see shares underpriced, given the loss to the PSBR, but also risks in pitching price too high. Getting balance right not easy - especially when company's shares have not previously been traded. Government will continue to consider alternative forms of sale eg tender, but critics should note that sale by tender could make it harder for small investor to buy shares.

20. Contribution to giving people satisfaction of property ownership?

Exercise of returning enterprises from State ownership to ownership by the public has included measures to promote employee share ownership in the enterprise they work for; for example free offers of shares (British Aerospace, Cable and Wireless, Amersham); preference in allocation of shares (B Ae, C & W, Amersham, BP); provision for matching shares - one for each share subscribed for - (B Ae, Amersham, BP). Most radical initiative taken by consortium of managers and employees who bought National Freight Company.

S NORTH SEA AND UK ECONOMY

1. New forecast of North Sea revenues?

[Autumn Statement (Industry Act forecast) projections (in money of the day) of Government revenues from North Sea: £6½ billion in 1981-82, £7 billion in 1982-83, £7½ billion in 1983-84. Higher than 1982 FSBR projections, partly because of higher production, partly higher oil prices].

Must remember that oil revenue projections are crucially dependent on inherently uncertain cost, price and production assumptions. Prospects for North Sea tax receipts have improved since 1982 FSBR published because of higher than assumed oil prices and production. New projections assume oil prices do not change much from present levels.

2. Onerous tax system damaging future field developments?

[Shell/ESSO have shelved plans for Tern partly because of tax system; Phillips postponing T-block complex and BP their Andrew field; BP statement issued with their interim results criticised fiscal regime.].

Other adverse factors - falling oil prices earlier this year; high development costs - much more important. Detailed study has shown that under new tax structure, levels of profitability should still be sufficient to make exploration and development attractive. Hope that present structure will provide more secure and stable tax regime. Aberdeen University study shows UK taxation on marginal fields to be one of world's 'more lenient'.

3. Government about to relax North Sea fiscal regime?

No decisions have been taken, but fact-finding discussions taking place with UKOOA and individual oil companies. Government wishes to give oil companies every opportunity to present their evidence about profitability in the North Sea. The regime is kept under review.

4. Taxation of petrochemical feedstocks

[Government has announced that new rules on valuation of ethane for petrochemical use in interaffiliate transfers (Finance Act Section 134) should be extended to mixed streams of gas with a large ethane component. ICI complain that the extension and the rules themselves give unfair advantage to their integrated oil company competitors and have taken out writ against the Government.]

Government convinced that new formula will give fair valuation. New valuation will not have effect of providing subsidy to ICI's competitors. Have done best to reassure ICI. Will resist ICI's legal action.

5. Government should do more to promote UK Continental Shelf oil production in 1990's?

[Select Committee on Energy's Report on Depletion Policy published 18 May: emphasised development of fields entering production in 1990s by increasing pace of licensing rounds

and overhauling fiscal regime. Recommended reserve powers to impose production cuts. Energy Secretary and Chancellor replied in joint memorandum on 29 July].

HMG agrees with general conclusions encouraging North Sea exploration and development, thereby maximising economic oil production over time; eg decision recently announced not to impose production cuts before 1985. Agree uncertainties in oil markets too great to justify deferring new field developments in foreseeable future. Cannot accept Committee's criticism of North Sea fiscal regime - opposed to another fundamental review; industry does not want a structural upheaval.

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

[Contribution of North Sea to GNP estimated at 4 per cent of GNP in 1981. Not projected to rise significantly before 1985.]

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 lower level of interest rates to benefit of industry and economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Less than 6 per cent of total General Government receipts in 1981-82.

7. North Sea revenues should be channelled into special fund?

North Sea revenues are already committed. Setting up special Fund would make no difference. More money would not magically become available.

8. Future North Sea oil prices?

A matter for commercial negotiation between oil companies and BNOC.

9. Are we really any better off for our North Sea oil?

We are better off with oil - at current oil prices - than we would have been without it. We have been spared fall in real national income that other industrial countries have suffered following oil price rises. But North Sea oil costly to produce, so we are not necessarily any better off than we would have been had oil prices not risen. No need therefore for possession of oil to require a contraction in our industrial base.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Prospects for world recovery?

[IMF, London Business School and Bank of England Quarterly Bulletin all gloomy about immediate prospects. No overall growth seen in major countries in 1982, and only weak recovery next year. Press reports suggest OECD will also revise its previous forecasts downwards this autumn.]

Output in the major economies appears to have recovered slightly in the spring after the downturn last winter. Output flat in US in Q3 after small rise in Q2. The major European economies, remain depressed. Too early to say that a broad upturn has started. Lower inflation and interest rates however offer prospects for better growth next year.

2. Why don't major industrial countries together expand demand?

Widespread agreement among leaders of the major countries expressed at the OECD, Summit and IMF and, most recently, 'jumbo council' meetings on the need to continue the fight against inflation. As the OECD's Economic Outlook explains, Governments are convinced 'a significant part of any stimulus to demand would increase public sector deficits, and dissipate itself rather quickly as an increase in inflation'.

3. Anti-inflation policies are working

[Consumer price inflation down from a year ago in all 7 major economies on latest available figures: US (from 11.0 to 5.0 per cent), UK (11.7 to 6.8 per cent), Japan (3.9 to 3.2 per cent), Italy (18.3 to 17.2 per cent), Canada (12.5 to 10.4 per cent) France (13.9 to 10.1 per cent), Germany (6.5 to 4.9 per cent).]

Inflation has fallen in all major countries in the past year. Firm fiscal and monetary responses to 1979-80 oil price rise vindicated. UK close behind US and Germany in bringing down inflation, and ahead of some other European countries. Realism in wage settlements is growing; US, Germany and Japan all have wage settlements in single figures.

4. Cuts in public expenditure in other countries?

[Many countries seeking economies. Countries planning to curb public sector pay and costs include Germany, France, Japan, Canada, Belgium and Denmark. Also Germany, France, Canada, Belgium all plan to make economies in welfare programmes.]

UK not alone in facing up to hard decisions. Coming to power of goverments committed to curbing public spending in UK, US, Norway, Denmark and now Germany suggests increasing awareness of need to reduce it.

5. International financial collapse?

Concern about effects of over-borrowing noted at Toronto IMF meeting. But should not exaggerate alarm. Important of course to sustain system's stability. Lower interest rates should help, as should IMF programmes to restore countries' credit-worthiness. Further progress needed on banking supervision including risk assessment and prudential standards; also watertight allocation of supervisory responsibilities.

6. US economy?

[Revised figures show that US GNP was flat in Q3 instead of small rise previously indicated through GNP rose ½ per cent in Q2. Interest rates have fallen 4 points since July while inflation has fallen to 5 per cent. Press reports suggest that Administration now admit Federal deficit likely to rise over next few years, instead of declining as previously forecast.]

US output flat in Q3 after small rise in Q2. Still too early to say that a strong recovery is under way, but falls in interest rates and inflation hold out better prospects for next year. However, important that US Administration curb budget deficit if progress in reducing inflation and interest rates is to be maintained.

7. US monetary policy

[US interest rates have fallen and Federal Reserve last Friday reduced discount rate from 9½ to 9 per cent. Chairman Volcker has said US authorities will be attaching much less than usual weight to M1 over period ahead. Press reports suggest that Federal Reserve has suspended M1 target and intends to allow M2 growth above long term ceiling set in February.]

Accept that monetary indicators in US must be interpreted flexibly in light of financial innovations. Federal Reserve Chairman, Mr Volcker, has made clear that reduction of inflation remains a priority and that monetary targets have not been abandoned. Mr Feldstein, chairman of Council of Economic Advisers, has commented: 'no reason to be concerned about the fed's policy being to expansionary'

8. Gloomy prospects for Europe?

[EC Commission Annual Report predicts only 1.2 per cent growth in Europe next year and 10.3 per cent unemployment. Medium-term forecast gives gloomy picture of 1983-87 with growth in EC averaging only 2½ per cent and inflation of nearly 8 per cent.]

Short-term prospects for recovery in Europe weaker than in US or Japan. But budget deficits higher and inflation rapid in many European countries. Note that EC Commission draws attention to need to curb budget deficits and reduce labour costs. Always difficult to see into medium run but improvements in competitiveness, lower inflation and interest rates all offer better prospects.

9. Competitive devaluations

[Recent devaluation of Swedish krona by 16 per cent widely criticised by other Governments. Finnish marka subsequently devalued by 6 per cent. Independent 'wise men's' report on Danish economy suggests withdrawing from EMS temporarily in order to allow 20 per cent devaluation].

IMF rules forbid countries to manipulate exchange rates to gain unfair competitive advantage. Authorities in Sweden will have noted strong objections from her major trading partners. Recent 'jumbo' council re-affirmed Community's determination to combat protection and in particular competition devaluations. Prosperity of world economy depends on maintaining open and fair trading system. Large devaluations may hinder this, and risk encouraging competitive devaluations by others. [IF PRESSED: IMF is examining Swedish action.]

COMMENTARY ON RECENT ECONOMIC DEVELOPMENTS AND STATISTICS 22 NOVEMBER 1982

Summary comment

Recent financial developments favourable - inflation and interest rates falling - but activity remains flat.

World Economy: expectations held by most forecasters for an upturn in activity of 1 per cent this year unfulfilled. IAF expects 2% increase in GNP of major 6 in 1983.

- world commodity prices are at their lowest level in real terms for thirty years;

- oil prices are weak and likely to remain so for the near future;

- consumer price inflation (OECD major 7) around 6½ per cent in September ranging from 17 per cent in Italy to 5 per cent in Germany and 3 per cent in Japan;

- average world 3-month interest rates 10 per cent at 1 November a fall of 4 points since October 1981; US 3 month rate stood at 9 per cent on 1 November; real interest rates remain clearly positive;

- world trade volume has been more or less flat since the middle of last year;

- total industrial production for the OECD Major 7 fell 5 per cent in the twelve months to Aug; in the US it fell by 9½ per cent in the 12 months to September;

- unemployment (major 7) now 8½ per cent, compared with 6½ per cent in mid-1981.

UK Balance of Payments: non-oil trade balance has deteriorated quite sharply but current account remains in strong surplus this year. But both the loss of competitiveness during 1979 and 1980 and a smaller world market are affecting our non-oil trade at home and abroad.

- OPEC and Third World countries are cutting back on imports because of low commodity prices, high interest rates and debt problems in some countries. UK exports in 1981 Q3 4 per cent down on 1981 H2.

. import volume rose sharply as activity recovered last year and import penetration rose too; imports broadly flat this year.

. the effective exchange rate fell 5 per cent last week as sterling depreciated against the dollar; currently at 86.6. The pound has now fallen below the range 87-93 that it occupied for the last year.

Financial Developments

.M1, PSL2 within target range for 1982-83, £M3 towards top of range;

.short term interest rates down 7 points since last October; base-rates down 7 points;

.mortgage interest rates down to 10 per cent, first time since 1978;

.real interest rates have fallen but remain clearly positive (higher real rates are being experienced in the US and Japan);

.CGBR £6.5 billion in 7 months to October, consistent with IAF assessment of £9 billion PSBR for 1982-83.

Inflation

.retail price inflation, 6.8 per cent in year to October. Forecast 6½ per cent before Xmas, with prospect of 5 per cent by spring 1983 and at Q4 1983;

.TPI increase in 12 months to October was 7.4 per cent;

.Wholesale price inflation also moderating; input prices up almost 3½ per cent in year to September; output prices 7½ per cent;

GDP and industrial production

.GDP rose slightly in Q3 1982 for second successive quarter but remains at Q4 1981 level. Underlying level of industrial production also remains broadly flat but is 1½-2 per cent above spring 1981 trough largely due to increased oil and gas production; the underlying level of manufacturing output only slightly above its trough level.

Demand Components

.consumer spending has remained broadly unchanged since 1979, over period when other components of final demand fell some 4-5 per cent. Some fall in RPDI (see below) offset by lower savings ratio. Retail sales in July -September 2 per cent higher than in spring, partly reflecting abolition of HP controls.

.gross fixed investment fell back by 4 per cent in 1982 Q2 - from a strong first quarter - to a level similar to that in 1981 H1 and 10 per cent below the level in 1979. Manufacturing investment has been weak. Plant and machinery investment, however, has held up.

.destocking of £420 million occured in 1982 Q3. The CBI's October Survey suggested there was some scope for further destocking but stock figures are volatile and too much should not be made of one quarter's figures;

.government consumption in 1982 H1 was 2 per cent above its level in the same period last year. 1982 Q2 data suggests that the upward trend in volume may be flattening out;

.there has been some fall in the volume of exports in recent months reflecting both loss of competitiveness and the flatness in world trade;

.imports rose very sharply between the two halves of 1981, reflecting both the increase in activity and increased import penetration, before stabilising.

Productivity and Competitiveness

.manufacturing productivity continues to rise strongly - at 6½ per cent annual rate so far this year, following 8½-8¾ per cent last year;

.manufacturers' unit wage/salary costs up less than 6 per cent in 3 months to August on a year earlier;

.during 1981 external price and cost competitiveness improved around 15 per cent but less than 1½ per cent improvement during 1982 H1.

Company Sector

.ICCs pre-tax real rates of return on capital in 1981 were very low; only 2 per cent in the manufacturing sector. Some slight improvement likely this year.

.after falling in first quarter of 1982 gross trading profits (net of stock appreciation) of ICCs rose in the second quarter by 5 per cent; this follows the strong recovery in 1981;

.non-North Sea profits in 1982 H1 were 22 per cent above their level in 1981 H1;

.gross profits of North Sea oil companies rose 10 per cent over the same period;

.ICCs financial deficit was £1.3 billion in 1982 H1, following £0.8 billion surplus in 1981 H2, partly reflecting less destocking. Over same period net borrowing requirement fell from £6½ billion to £5½ billion.

Personal Sector

.wage settlements in 1981-82 were on average around 7 per cent, 2 per cent lower than in the previous round;

.underlying rate of increase in average earnings in year to September 1982 was about 8¾ per cent;

.real earnings broadly flat in last 12 months but RPDI is about 1½ per cent lower than the average for 1981.

Labour Market

.UK employment fell 2.4 million (10½ per cent) between 1979 Q2 and 1982 Q2 (two-thirds concentrated in manufacturing); between 1981 Q2 and 1982 Q2 employment fell by 670,000;

.Total employment fell more in the second quarter of 1982 (189 thousand) than in the previous quarter (94,000);

.total registered unemployment fell by 48,000 to 3.3 million (13.8 per cent) in October reflecting seasonal falls in school leavers which more than offset the underlying upward trend (which itself slowed to 23,000); on the new basis the headline total for October was 246,000 lower at 3.1 million (13.1 per cent);

.UK adult unemployment rose by (only) 23,000 to 3.1 million (12.8 per cent) in October; previously the trend (since June) was accelerating. On the new basis unemployment in October at 2.9 million (12.4 per cent) was 173,000 lower than on the old basis;

.vacancies have not altered much in recent months;

.other labour market indicators - short time, overtime working, etc - continue to suggest some flattening out following last year's improvements.

Forward Indicators

.car production (seasonally adjusted) recovered to 79,000 in October from 60,000 in September;

.steel production (not seasonally adjusted) fell from 230,000 tonnes per week in September to 228,000 tonnes per week in October;

.the volume of new construction orders, which remained broadly flat since the first half of 1981, fell 6 per cent in the 3 months to August. Within the total, orders for new housing, particularly in the private sector, remain slightly below their level last spring. Engineering orders also disappointing with a 12 per cent fall in the lastest 3 months.

.total manufacturing order books, as monitored in the CBI's monthly industrial trends enquiry, after strengthening last year, have shown some decline; and export order books have weakened.

.total housing starts, having increased from an average 40,000 a quarter in 1980 to 53,000 in 1982 Q1, fell back in the spring, but average for the first nine months is over 25 per cent up on the same period a year ago. Total completion have remained fairly flat during 1981 Q2 and Q3 having previously drifted slowly downwards.

.seasonal falls in school leavers registrations continue into November and December but a sharp seasonal rise in unemployment occurs in January;

.CSO's index of longer leading indicators rose between July and October reflecting lower interest rates and higher share prices, following 3 months of little change.

CBI's October Trends Survey suggests a further decline in business confidence, further slight falls in total new orders and output. Stock reductions are continuing and investment intentions have weakened again. The survey suggests no recovery in new export orders and deliveries over the next four months. Cost pressures are expected to slow further and a slight improvement in firms liquidity is in prospect. Consumer goods industries are benefiting slightly from some improvement in demand.

Outside forecasts

.Outside forecasting groups are now less optimistic about recovery in 1982, suggesting that growth this year will be ½-1 per cent - about ½ per cent less than expected at Budget time; for 1983 consensus of outside forecasts around 2 per cent, assuming some recovery in world economy, with inflation/interest rates continuing to fall at least for some time into next year.

.New Treasury forecast published November 8th assumes a modest (2 per cent) world recovery in 1983. Forecast includes a £1 billion fiscal adjustment in 1983-84 within a fiscal/monetary stance broadly in line with 1982 MTFS. Between 1982 and 1983 GDP grows by 1½ per cent and manufacturing output by ½ per cent. Principal demand increases are from consumers expenditure (2½ per cent) and capital investment (5 per cent). Reflecting strong import growth balance of payments current account goes to zero in 1983. RPI inflation is about 5 per cent in early 1983 and 1983 Q4. Government Actuary assumes unemployment (old basis) averages 2.9 million (GB, ex school leaver) in 1982-83 and 3.2 million in 1983-84. On new basis figures could be up to 200,000 lower.

Key Statistics Week-Ending Friday 26 November

Wed 24	:	Construction new orders (Sept)
Thurs 25	:	Employment (Sept)
	:	Short-time and overtime (Sept)
	:	Industrial Stoppages (Oct)
Fri 26	:	Vehicle production (Oct)

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Econ Pol

PPS/CHANCELLOR

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copied to:

Mr Salveson (for transmission to No.10)
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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 BRIEF

I attach the latest version of this Brief. (Changes from the previous Brief, of 8 November, are sidelined.) This incorporates general coverage of the Autumn Statement made on 8 November. More detailed briefing has been supplied as well to No.10, Treasury Ministers and others with specific needs.

M M Deyes

M M DEYES

RA

R I G ALLEN

15 November 1982

EB Division
H M Treasury
01-233-5503

ECONOMIC BRIEF: CONTENTS

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 maintaining steady but not excessive downward pressure on monetary variables, and complementary fiscal policies. Improvement of supply side depends on restoration of flexible and competitive market economy and better incentives.

2. Significance of Autumn Statement?

This first Autumn Statement. It explains autumn announcements in more complete and accessible way than in earlier years. Can expect the publication to evolve.

3. A S represents shift in policy?

No. Autumn Statement not a mini-Budget; brings together number of annoucements about decisions - on public expenditure, NIC and Industry Act Forecast - which have to be made at this time of year. Though announcements affect scope for fiscal action in next Budget, they are fully consistent with MTFS.

4. AS reflationary/deflationary?

There is no change of policy compared with 1982 MTFS. PSBR as percentage of GDP in 1983-84 unchanged; as is public expenditure planning total.

5. What help for indsutry?

Measures announced in AS themselves have benefits for industry-NIS (see P1-3), NIC (see P1-3), public expenditure decisions. Other announcements made around time of AS - energy (see R2-3), ending of RDG deferment (Industry Secretary 9 November), local authority capital spending initiative (see E13-14) - all helpful. Also keep in mind wider benefits of lower inflation and interest rates.

6. Effect on employees?

N.I contributions go to fund benefits which command wide support e.g retirement pensions. Increase less than full amount required to balance Fund. Decisions must not be seen in isolation from decisions on taxation to be taken at Budget time.

7. Clobbering pensioners in 1983?

No. See G4-8.

8. Recovery over/Activity flat?

Delayed but not over. Activity still 1 per cent above trough in Spring 1981. Pause this year partly reflects external developments. Expected recovery in world trade and output expected at Budget time has not materialised. Progress on inflation and interest rates more rapid than expected and, together with continued rapid improvements in productivity argues well for future.

9. Recovery next year?

Although recovery has been hesitant this year renewed modest recovery expected in 1983. Expectation supported by upturn in cyclical indicators and by most outside forecasts. [For Industry Act forecast See B7.]

10. Where will growth come from?

Sources of growth are expected to be: some modest recovery in world activity; improved confidence as inflation comes down, encouraging more investment and risk-taking; lower interest rates improving companies' financial position and encouraging more fixed investment and stockbuilding; increased consumers' expenditure, partly reflecting lower inflation. But prospects depend critically on containing costs.

11. Policy far too tight, given world recession? Below FSBR forecast growth in output, prices and money GDP clear sign of deficient demand?

Government cannot fine-tune either money or real GDP. Domestic demand is recovering - much as expected. Problem is external demand and UK's falling share of home and foreign markets (reflecting weak competitiveness). Need improvements to supply as much as demand. Without better supply performance, a boost to demand may be largely wasted, even in the short term.

12. PSBR undershooting/fiscal policy too tight?

See H7.

13. Room for tax cuts in 1983 Budget?

Chancellor has effectively 'spent' nearly £1 billion by reducing NIS and holding down NIC increases. Scope for further worthwhile tax cuts for 1983-4 - the so-called fiscal adjustment - now estimated at about £1 billion. But figures very uncertain at this stage. Decisions taken in next Budget will depend on prospects as then seen for PSBR and economy. These factors will also affect choices of taxes to be modified.

14. Public spending decisions?

Planning total for 1983-84 held at level envisaged in the 1982 Budget - some £120 billion. Most welcome achievement - first time has happened since 1977. Unlike in 1977, Government not forced to hold to plans by outside intervention of IMF.

15. Monetary framework?

As Chancellor again made clear in Statement 8 November, Government's role is to maintain firm, consistent, financial framework, in line with major economic objectives (see 1 above) as set out in Government will continue to interpret monthly developments flexibly. With inflation coming down, should be ample scope within target ranges for rising activity.

16. To increase competitiveness, cannot rely on pay settlements alone; should devalue?

See M 2-3.

13. Unemployment prospect?

See C10.

2.29

BULL POINTS As at 15.11.82

(i) Activity. Underlying level of output broadly flat since last Autumn but industrial and manufacturing output above levels spring 1981. Most recent major independent forecasts see prospect of modest recovery later this year and next.

(ii) Interest rates. Bank base rates have fallen 7 points since last autumn (now 9 per cent). Lowest level for almost four years. Recent falls reflect several factors:- singel figure inflation M1, £M3 and PSL2 developing favourably in relation to 8-12 per cent target, Government borrowing under control, exchange rate firm.

(iii) Inflation. The increase in the RPI over the 12 months to October was 6.8 per cent. For the first time in 10 years the rate is below 7 per cent and is the lowest since August 1972. Forecast of annual rate RPI inflation 6½ per cent by end of 1982 and prospect of 5 per cent by Spring of 1983. Manufacturers' output prices up 7½ per cent in year to October.

(v) Costs.

- Increase in average earnings halved in 1980-81 pay round. Public sector pay in line. Further moderation in average level of settlements in 1981-82 round. CBI pay databank for manufacturing settlements suggests average around 7 per cent compared with 9 per cent in 1980-81 round.

- Manufacturers' unit wae and salary costs up less than 6 per cent in 3 months to August over a year earlier-below average of major competitors.

- Manufacturers' input prices up almost 3½ per cent in year to October.

- CBI October survey still shows lowest degree of unit cost pressures for 15 years.

(v) Manufacturing productivity. Output per head has risen about 13 per cent since end 1980. Output per head and output per hour now about 6 and 9 per cent higher than previous peak in 1H 1979.

(vi) Competitiveness. Cost competitiveness improved by about 15 per cent during 1091 reflecting pay moderation, higher productivity and exchange rate fall, but less than 1½ per cent improvement during 1982 H1 and position remains ⅓ worse than in 1975.

(vii) Profits: Industrial and commercial companies' gross trading profits (net of stock appreciation, exluding North Sea) risen 16 per cent in 1H 1982 compared with 1H 1981. Recovery in profits from very low base: pre-tax real rate of return of ICC's (excluding North Sea) only 3 per cent in 1981.

(viii) Housing starts (total) - up over a quarter in first nine months of 1982 compared with same period 1981.

(ix) Exports (non oil, exluding erratics) only 2 per cent lower in 12 months to Septembr 1982 than in 1980, despite earlier substantial loss of competitiveness.

(x) Special employment measures. Total provision for special employment schemes planned to reach £1½ billion in 1982-83. Further measures announced end-July - new community work programme (started October), job splitting subsidy schemes (from January 1983).

(xi) Overseas investment in UK: US direct investment in Britain amounted to stock of over $14 billion in 1980. Nearly 60 per cent of all US outward non-oil direct investment now takes place in EC - over half of that in UK. Half of all Japanese investment in the EC also comes to Britain. Investment intentions survey of 231 German owned companies in the UK shows great majority intend to expand here in the near future.

(xii) Overseas debt repayments. Officials external debt reduced from over $22 billion in May 1979 to around $12½ billion at end-September 1982.

Economic Briefing Division, HM Treasury, 01-233 5514/5503

Retail sales

B ECONOMIC ACTIVITY AND PROSPECTS

Housing
Restaurants
Theatres
consumer
incl service
not retail sales

1. Prospects for UK economy

[Industry Act Forecast Tables reproduced in Commentary at end of Brief.]

- Although recovery has been hesitant this year, partly reflecting depressed world activity it should gather pace in 1983: about 1½ per cent growth of GDP 1983 on 1982. All outside forecasts (some rather dated) expect recovery to continue in 1983; consensus has been for year-on-year growth around 2 per cent.

- Inflation has come down much faster than expected. Now forecast to be 6 per cent in 1982 Q4 (9 per cent in Budget forecast) and 5 per cent next year (7½ per cent in 1983 Q2 in Budget).

- Wage settlements are expected to decline further over next 12 months. [No forecast ~~given in IAF~~ but GAD Report assumes 6½ per cent earnings growth between 1982-83 and 1983-84, against 9 per cent in previous year.] Productivity growth still fast (level of output per head in manufacturing now 13 per cent above end-1980).

- Consumers' expenditure (particularly retail sales) now increasing again after three flat years - up 1½ per cent in 1982 Q3, compared Q2, and forecast to rise 2½ per cent 1983 on 1982.

- Current account of balance of payments expected to decline to zero in 1983.

2. Recent output figures

[Latest GDP figures (all three measures) suggest any growth in economic activity in 1982 H1 over 1981 H2 was slight, but output about 1 per cent higher than in 1981 Q2. Industrial production in 1982 Q3 unchanged from previous quarter, though underlying level of industrial output 1½-2 per cent above 1981 Q2 trough - largely attributable to North Sea oil. Trend in manufacturing activity at best flat, though IAF expects 1 per cent increase in year to 1983 H2.]

Output remains disappointingly flat - partly due to depressed world economic activity. But expected higher world output should encourage some modest recovery in 1983, while lower interest rates and inflation, coupled with improved productivity and competitiveness, provide a sounder base for expansion in the medium term.

3. Other evidence of improvement in economy?

See Bull Points (following Section A).

4. Latest CBI assessments/Business confidence collapsed?

[CBI October Trends Enquiry shows less optimism on general business outlook and export prospects over next 12 months (optimism net balance fell from minus 22 in July to minus 28 in October). Orders and output have fallen and most (94 per cent of participants) see orders constraining future output. Stock reductions continue and investment intentions have weakened again. Most exporters expect prices to limit new orders. Cost and price pressure remain low, and company liquidity may inprove slightly in next six months. CBI <u>August forecast</u> suggested GDP growth next year of 1-1½ per cent; more recently, CBI emphasising lower end of range.]

Results of October Survey certainly disappointing. But deterioration in optimism, and immediate outlook (next four months), not unexpected and probably reflect in part very depressed level of activity, at home and overseas, this year. Survey not entirely gloomy - favourable developments continue in unit costs and price expectations; firms' liquidity also expected to improve. As witnessed by surveys from Times Business Forum in October and November, great majority of businessmen support Government's basic economic strategy and are optimistic about prospects for company growth/profits over next two years. Decisions announced 8 November aimed to reduce business and industry's costs and should boost confidence.

5. <u>New orders figures depressing</u>?

[New <u>construction</u> orders in August fell by 22 per cent from around £450 million to £350 million (at 1975 prices) compared previous month. In <u>three</u> months to August, orders fell 6 per cent compared previous three. Volume of new orders in <u>engineering</u> industries fell 9 per cent in three months to July compared previous three.]

Figures manifest depressed economic activity which itself partly reflects flatness in world trade.

6. <u>Fall in investment and reduction in stocks?</u>

[Capital expenditure by the manufacturing, distributive and service industries in Q2 1982 4 per cent lower than level in previous quarter. Investment in manufacturing in H1 1982 was 3 per cent lower than in Q4 1981. Stocks fell by £30 million ('75 prices) in Q2; but in the first half of 1982 stocks increased by £100 million compared with destocking of £520 million in second half of 1981. CBI October survey shows for second successive survey, decline in investment intentions. IAF projects 3 per cent growth in fixed investment in 1982, 5 per cent in 1983.]

Figures another manifestation of hesitation in economic activity. Despite this, some categories of investment, notably plant and machinery, have held up quite well. [<u>IF PRESSED</u>: latest DOI investment intentions survey shows slight fall in manufacturing investment between 1981 and 1982; Q2 figure not inconsistent with this.]

7. <u>Stock levels a threat to recovery</u>?

Falling interest rates (nominal rates lowest for four years) have eased cash pressures and should assist recovery in stock cycle.

8. Competitiveness not improved this year?

Cost competitiveness has improved about 15 per cent since 1981 Q1 [but virtually no change during 1982 H1: position remains about one quarter worse than when Government took office]. Further improvements, which are essential to regain markets and create new ones, depend above all on substantially lower wage settlements in this pay round than in the last one. Lower exchange rate not the answer (see M2-3).

9. Productivity growth falling off?

No; productivity growth in manufacturing up 4½ per cent over last year, and 13 per cent up on end-1980, is well above UK historical average.

10. CSO's index of leading cyclical indicators?

[NB October cyclical indices to be published Friday 19 November: longer leading index expected to show further rise.]

Longer leading index rose again in September reflecting further falls in interest rates and an increase in share prices. Shorter leading index also rose in July and August. Taken with other indicators - including lower inflation and interest rates - these changes are encouraging pointers to future recovery.

11. Outside forecasts

[GDP profile in recent major assessments:

Per cent change

	LBS (Nov)	Phillips & Drew (Nov)	Simon & Coates (Oct)	CBI (Aug)	St James (Aug)	OECD (July)	NIESR (May)	IAF (Nov)
1982 on 1981	+¼	+½	+½	+½	+1¼	+1¼	+1	+½
1983 on 1982	+3	+¾	+2½	+1½	+2½	+1¾	+1	+1½]

Nearly all see prospect of continued recovery and lower inflation.

C LABOUR MARKET

1. Government concerned over unemployment?

Of course Government concerned; so pursuing balanced fiscal and monetary policies to curb inflation and creating conditions for enterprise - only measures that will ensure sustainable increase in employment. Nevertheless has substantially increased spending on schemes to alleviate impact on especially vulnerable groups. Most crucial factor in influencing unemployment is level of pay settlements (See also Section K).

2. Extent of help?

Government plan to spend £1½ billion in cash in 1982-83 (40 per cent more than in 1981-82) on special employment and training measures (including new Youth Training Scheme costing £1 billion a year from 1982-83); new community programme, designed to provide up to 130,000 places for long term unemployed; and new Job Splitting Subsidy (open on 1 January next year) to encourage extension of part time work and provide additional opportunities for productive jobs for unemployed people.

3. Recent unemployment figures and other labour market indicators?

[Underlying trend in unemployment has deteriorated since Q2, but October figures a little more favourable than of late. Because of seasonal factors, no further sharp rise in 'headline total' expected till January. Recent unemployment/vacancy figures shown below:

	1980 Q4	1981 Q1	Q2	Q3	Q4	1982 Q1	Q2	Q3	Oct
'Total' unemployment	2.16	2.46	2.59	2.93	2.96	3.04	3.01	3.28	3.30 (13.8% rate)
UK adult sa unemployment (millions)	2.02	2.28	2.48	2.64	2.75	2.82	2.88	2.98	3.06 (12.8% rate)
increase in period (000's)	+105	+77	+62	+51	+33*	+21*	+30*	+42	+23*
Vacancies (000's)	99	98	89	96	104	112	107	111.0	112

*After allowing for over 60's transferring to supplementary benefit.

Other labour market indicators (e.g overtime, short-time) roughly flat for last 6 months.]

October figures cannot provide indication of future trends but are nonetheless welcome. Level of unemployment still tragic but problems took a long time to build up will also take a long time to check or reverse. Recent figures reflect levelling out in activity since last autumn. Looking further ahead, lower inflation and interest rates, and lower pay settlements and hence improved industrial competitiveness should help promote economic recovery and create climate for sustainable jobs.

4. CBI's ideas for reducing unemployment?

[Report of Cave Committee presented to CBI Conference proposes strategy based on increasing economic growth; encouraging efficient labour-intensive sectors e.g. construction, tourism; increasing work opportunities e.g. by job splitting, phased retirement, short-time; reducing size of labour force e.g. voluntary early retirement, youth training. Claims to reduce unemployment by 1-1½ million.]

Interesting contribution - will stimulate public debate. Group has more work to demonstrate how this package relates to CBI's other policy recommendations. 1-1½ million reduction in unemployed very optimistic; almost half estimated effect attributable to measures already announced.

5. Unemployment in UK higher than in other countries?

[On standardised definitions in Q2 1982 UK unemployment was 12.7 per cent compared with 8.1 per cent OECD rate; little over doubling for UK compared with OECD rise of over one half since 1979.]

Unemployment now rising sharply in many industrialised countries - in last three months number unemployed (on national definitions - not strictly comparable) rose much more in Canada (up by over 20 per cent), Holland (9 per cent), Ireland (8 per cent), Germany (7 per cent) than in UK (4 per cent).

6. UK's true unemployment figures really much higher?

[TUC say 'true' figure just under 4½ million The Times 11 November.]

No one seeks to deny there are unregistered unemployed but reliable estimates of their numbers are difficult to obtain. Available estimates vary quite widely. Figures of registered unemployed are based on accurate counts, have been accepted by successive administrations and provide reasonable estimates of trend.

7. Cost of unemployment/Effect on PSBR?

There can be no single estimate of 'the cost of unemployment'. Only costs that can be at all readily identified are additional expenditure on unemployment benefit, supplementary benefit, rent and rate rebates and administration. (Even these dependent on characteristics of those becoming unemployed - family status, resources etc). These could average £1800 in 1982-83 for each additional registered unemployed person. (NB This cannot be multiplied out by the total number unemployed.)

[IF PRESSED: Estimates of effect of other influences on PSBR directly or indirectly associated with unemployment vary widely depending on large number of highly debatable assumptions. And a major change in the level of unemployment would have impact on other economic indicators effective in the calculation of PSBR.]

8. Fiddling the statistics?

[Rayner cost-saving exercise means that from November onwards method of measuring unemployed will change. November count will be some 100,000 lower than on traditional measure. Even further reduced in summer when school leavers register. NB October figures on revised basis to be published 18 November; November figures 2 December.]

No question of a fiddle. Detailed and considered study revealed substantial savings on collecting statistics for registered non-claimants. D.Employment will be providing estimates of effect on past statistics, and will provide similar information for up to a year from the change.

9. What is Government's own forecast of unemployment?

[Government Actuary was instructed to assume that number of unemployed in Great Britain, excluding school leavers etc, would average 2.9 million in 1982-83 and 3.2 million in 1983-84, (or just under 3.4 million including school leavers). Assumption for 1982-83 same as in 1982 PEWP but for 1983-84 3000,000 higher than in 1982 PEWP.]

GA's ~~assumptions~~ are not predictions or forecasts. [IF PRESSED they provide reasonable assessment of prospect but any forecast of unemployment must be highly conditional.]

10. Employment continuing to fall?

[Total employment declined 2.4 million (10½ per cent) between mid 1979 and Q2 1982. Decline of 94,000 in 1982 Q1 increased to 189,000 in 1982 Q2. Manufacturing employment in August fell 35,000 to 5,531,000 (compared 5,871,000 in August 1981).]

Only way to achieve permanent jobs is sustainable recovery, based on improved industrial competitiveness lower inflation and lower interest rates. Substantial provision (£1½ billion) being made to help most vulnerable groups (see C1 above).

11. Recent productivity gains inimical to higher employment/lower unemployment?

[Output per head in manufacturing up 12 per cent since end-1980.]

This may be true in the short run. But in the longer term, as experience in UK, Japan and many other countries clearly demonstrates, higher productivity essential for growth and employment opportunities.

D TAXATION

1. Burden of taxation

[Total taxation (including NIC) as proportion of GDP was 34½ per cent in 1978-79 and is forecast to be 39¾ per cent in 1982-83. Corresponding figures excluding NIC are 28½ per cent and 33 per cent].

Burden has inevitably risen because of upward pressures on public expenditure caused by the recession. Increases in taxation are better - and more honest - means of financing this than borrowing, because of adverse effects borrowing has on interest rates and inflation.

2. British tax burden high by international standards?

Not so. Accurate comparisons difficult, but UK burden about average for OECD countries [1981 data from Lloyds Bank Economic Bulletin, October 1982]. Similarly, UK taxes on household income and employees' social security contributions about average for EC countries and lower than Japan and USA [1980 provisional OECD data].

3. Autumn Statement

Chancellor on 8 November announced proposals for further reductions in NIS which should be welcomed by industry: another ½ per cent for 1982-83 and 1 per cent for 1983-84 to bring the rate down to 1½ per cent. Less than half the 3½ percent level inherited from Labour. Each 1 per cent reduction worth some £800 million pa (full year) to private sector.

4. NIC announcement

NICs not taxation but contributions giving entitlement to specific benefits. Holding down the increase below what would have been required fully to balance the National Insurance Fund.

5. Combined effect on taxpayer/contributors?

Effect on living standards and tax burden will also depend on income tax decisions to be taken in 1983 Budget.

6. Prospects for cuts in taxation in 1983 Budget?

NIS and NIC decisions do, of course, reduce scope for tax reductions in next Budget though sticking to public expenditure totals helps. Decisions for 1983 Budget, both in PSBR and particular tax changes, will not be made for several months yet.

7. Future of married man's personal allowance?

[Labour party commitment to phase out in favour of increased child benefit etc; SDP proposals to abolish as part of new scheme to assist lower paid.]

Government launched debate with December 1980 Green Paper on Taxation of Husband and Wife. Very wide range of views received, which government is considering. Abolition of married man's allowance advocated in some quarters would affect many millions of taxpayers and by itself leave a basic rate taxpayer £5 a week worse off. Abolition makes the poverty and unemployment traps worse for some people. (See also G11 on Labour's proposals.)

8. SDP plan to abolish poverty trap?

['Attacking Poverty', published 11 November.]

Their scheme costs £4½ billion and still leaves marginal tax rates, for people in the poverty trap, of 80-85 per cent. What is more, they extend the trap both up and down the income scale. Claims to have eliminated the trap are based on artificially restricted definitions.

9. SDP re-distributing to the poor?

SDP plan involves massive re-distribution. But it is not redistribution from rich to poor in any accepted sense. On SDP's own figures single people worse off on anything over half average earnings; married couple without children worse off if have income of more than ¾ average earnings; married couple with children worse off if have average earnings or even a bit less unless they have 3 children or more.

10. Government unconcerned about poverty and unemployment traps

[Incidence of 40-50 per cent marginal tax rates given in reply to PQ 25 October to 315. IEA document reported in Press 1 November 'The Moral Hazards of Social Benefit' claims 5½ million adults at risk from the traps.]

Government concerned about poverty and unemployment traps, in context of incentives as a whole. Traps caused by attempts of successive Governments to alleviate poverty and hardship while keeping costs in bounds. Alternatives are to give less support for the poor and unemployed or to let costs rip. SDP proposals far from a complete solution (see D8). [IF PRESSED: IEA paper exaggerates numbers affected and offers few concrete proposals.] A necessary step in the right direction is to reduce burden of income tax by restraining public expenditure - which is Government policy. Long-term solution is increased wages resulting from sustained improvement in productivity and economic performance: this too a goal of Government policy.

11. Burden of taxation risen most for the poor?

Proportion of income paid in income tax and NICs has fallen in 1982-83 for lowest paid taxpayers. Low paid with children are also entitled to benefits such as FIS.

12. Previous reductions in personal taxation favour the rich?

1979 Budget cut absurdly high top rates of income tax to European levels, as part of package which also involved substantial increase in thresholds. Such action was essential to restore incentives. No 'pot of gold' in higher rate tax; restoration of 83 per cent top rate would finance a cut of under ½p in the basic rate.

E PUBLIC EXPENDITURE AND FINANCE

[Total spending of £120.1 billion in revised plans for 1983-84 announced 8 November. Compares with total of £120.7 billion in 1983-84 in Cmnd 8494 published 9 March, adjusted for Budget (and other minor changes). Revised plans for 1984-85 and 1985-86 will be published in next Public Expenditure White Paper in late January/early February 1983. Plans now announced are firm. Precise figures may change slightly between now and White Paper in light of more detailed calculations. Contingency Reserve will also be reviewed before White Paper finalised.]

PUBLIC EXPENDITURE 1982-83 AND AUTUMN STATEMENT

1. How do revised plans for 1983-84 compare with those previously announced?

[PM on 3 November referred to holding to the total of £120.5 billion announced of time of last Budget].

Outcome of annual review of public expenditure plans has been to hold planning total within previously ~~announced~~ plans. First time this has happened since 1977. Unlike 1977, Government not forced to hold to plans by outside intervention of IMF.

2. What is change in real terms?

Small fall in expenditure in 'real' (cost) terms now planned for 1983-84 compared with 1982-83 plans. [NB cost terms means cash adjusted for general level of inflation as measured by GDP deflator]. No 'volume' (constant price) figures available.

3. Cuts in services?

Decision to contain expenditure has inevitably meant reductions in some programmes to compensate for increases in others. But Government's success in reducing inflation and interest rates has made it possible to accommodate such changes without major cuts in services.

4. Hasn't Government gone too far in reducing public expenditure?

Still planning for an increase (£5½ billion) between plans for 1982-83 and 1983-84. Reduction below Budget-time plans largely accounted for by two factors: £400 million benefit from NIS clawback: revised forecasts of receipts from special sales of assets. When effect of these discounted, Government has held closely to its previous plans.

PUBLIC EXPENDITURE - GENERAL

5. Ratio of public spending to GDP

Ratios in 1980-81 (43 per cent) and 1981-82 (44½ per cent estimated) remain below level of 1974-75 and 1975-76 (46 per cent in both years). Rise in ratio in 1981-82 compared 1980-81 mainly reflected higher expenditure on social security at a time when real GDP falling. Ratio expected to fall in next few years. Autumn Statement gives figures of 45 per cent in 1982-83 and 44 per cent in 1983-84.

6. Figures quoted in Weekend World programme 10 October?

[Ratio of public expenditure planned for 1982-83 to GDP in that year given in Weekend World programme was 46.8 per cent. Apparently derived (incorrectly) by someone at ITV taking from the FSBR the wrong numerator for the ratio. They took it from Table 8. The correct figures were given in the FSBR at para 2.21, and a reconciliation set out in Table 6.]

Figure of 46.8 per cent shown on Weekend World for 1982-83 based by them on incorrect calculation. At Budget time, the estimated ratio of public expenditure to GDP in 1982-83 was 44.5 per cent.

7. Increase spending in recession?

No good trying to spend way out of recession. Any benefits would be short-term. If increased spending not financed responsibly, would soon lead to more inflation. If financed prudently, would lead to higher interest rates and/or higher taxes. We are responding, within limits of prudence, to needs of current circumstances.

8. Capital spending in public sector?

Government's policy is that provision made for capital expenditure both in central government and local authorities, should be fully spent, subject to the normal prudential margin. (Of course always necessary to take account of implications for future current running costs - and interest). In nationalised industries, criterion is that capital expenditure should show an adequate return. (See also E13-14 and R9).

9. Cut public sector pay bill/administrative costs of central government?

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. Provision for public service pay increases 1982-83 limited to 4 per cent. Administrative costs are not far short of 10 per cent of total public expenditure. We are determined to reduce that proportion, and to maintain drive for more efficient management throughout public sector.

10. Cost of pay rises for public servants - equivalents in public spending programmes?

Every 1 per cent extra on pay for public servants (excluding Nationalised Industries) costs £335 million - the approximate equivalent of two frigates, 50 Harriers or about 70 miles of motorway.

11. What allowance will Government make for pay increase in public services next year?

Government attaches great importance to realistic wage settlements next year, in both public and private sectors. Provision for public service pay will be made from within cash plans.

12. 3½ per cent pay assumption for 1983-84

Assumption is not a 'norm'. Nor is it a decision on the offer to be made in any particular case. Each will be considered on its merits. It concerns the provision in public expenditure plans for next year for those groups for which Government is directly responsible, other than NHS. It does not directly cover local authorities, or nationalised industries, which are not within Government's direct control. But they will be controlled by the rate support grant and the external financing limits.

LOCAL GOVERNMENT

13. LA capital underspending and measures to prevent recurrence in 1983-84

Following underspend of £¾ billion in 1981-82, local authorities seem set to underspend their capital cash limits for 1982-83 by between £1 and £1½ billion (GB figures). Some steps in hand to reduce the underspend: Prime Minister has written to local authority associations, and extra allocations will be given to authorities who can use them, especially for improvement grants.

14. LAs cannot increase capital spend because of revenue consequences?

Plans for relevant LA current expenditure allow for financing costs of full planned capital programme. Many capital projects have no immediate running costs eg roads, reclamation of derelict land. Others will reduce running costs by rationalisation. LAs would be able to afford running costs of worthwhile investments if curbed wasteful expenditure and held down pay settlements.

15. LA current overspending in 1982-83

Budget returns from LAs indicate overspend of over £1 billion on current expenditure is under way. Secretaries of State have announced intentions to abate rate support grant to overspenders in response. (For details, refer to statements in Parliament 27/28 July by Secretaries of State.)

16. Local government finance 1983-84?

[Announcements in Autumn Statement.]

Plans for LA current spending have been increased by over £1 billion to ensure that they are realistic. Only some £270 million of this increase will be allocated to service programmes the rest will be included in expenditure targets as it represents an extra provision which the Government does not consider desirable, but which has been included to make plans realistic in relation to this year's overspend.

17. Rate increases implied by plans?

What happens next year depends on what LAs decide to spend. If LAs comply with their expenditure targets, rate increases need only be very modest overall, and in some areas will be no need for any increase. Of course, if LAs decide to overspend, the rate burden they have to impose will be higher, and they may lose rate support grant if they exceed targets.

18. Holdback of RSG in 1983-84?

Refer Written Answer from Environment Secretary (Hansard 4 November) announcing options for holdbacks in England. Consultation with LAs underway (also in Scotland and Wales). Schemes adopted will depend on outcome of consultations.

19 Higher council house rents?

[85p assumption referred to in Autumn Statement].

In Government's view, LAs should not need to increase rents in real terms in 1983-84. For them to decide. Government decision is about provision for housing subsidy - Environment Secretary will be consulting LA associations on basis of figure of 85p per week per dwelling. ~~per week~~. If that figure confirmed, will be possible to provide for real increase in capital investment in housing next year.

20. Green Paper on Domestic Rating System: Government response?

Carefully considering representations. Need scheme to run that will remedy shortcomings of present rating system which will command widespread support. Taking account of pleas from industry, business, etc. (See also P 9.)

FALKLANDS EXPENDITURE

21. Falklands defence costs?

[Answers given by PM 26 October OR cols 885-6; Defence Secretary 28 October OR cols W 453-4.]

Latest assessment of costs of operation, and of replacing equipment lost during the conflict, is about £700 million in current year; over next three years the cost will be £200 million, £350 million and £320 million respectively. Decisions have yet to be taken on size (and thus cost) of garrison.

22. Equipment replacement costs

Defence budget will be compensated in full for Falklands costs. This will include full replacement costs of new - and usually better - ships, aircraft and other equipment. In some cases (eg the four new frigates) Ministry of Defence are considering detailed design requirements before going out to tender.

23. How will the various costs be met?

Extra costs in current year will be met from Contingency Reserve. The block defence cash limit for 1982-83 has been increased by £371 million on account of operations in the South Atlantic. (Hansard col W 108 9 November 1982) For 1983-84, an increase to the Defence Budget of just over £620 million has been announced. Future years' provision will be announced in the 1983 Public Expenditure White Paper. Extra defence costs will be met out of monies additional to path of annual real growth of 3 per cent.

24. What will be costs of repairing damage and reconstructing the Islands' economy?

Too soon to say what these costs will be. Work has begun on restoration of essential services and on implementing Civil Commissioner's recommendations for priority action (accommodation, inter-Islands air service, education). Up to £10 million is being made available for this. Not yet able to say whether these costs will require additions to existing FCO and ODA funds and how far additional sums will be needed. Ministers studying Shackleton Report proposals for long term development of Islands; in advance of decisions, impossible to say what costs will be.

[BACKGROUND WHICH CAN BE DRAWN UPON: Estimates of cost given in the Report are £31-36 million for new development aid; £40 million for offshore fishing; up to £12 million for additional housing/infrastructure. Total estimate of £83-89 million (at 1982 prices) excludes aid for rehabilitation and compensation for war damage already being made available.]

25. Cost of paying compensation for war damage?

Too soon to say what total will be. Claims are being processed, and further claims may be received. About £1 million has so far been paid out, but this is no guide to what the final total might be. Not yet clear whether the compensation scheme will require an addition to existing FCO programme.

F CIVIL SERVICE STAFFING AND PAY

1. Civil service too big/does too much/is over staffed?

Since Government came to office, Civil Service has been reduced by 10 per cent to 659,300. Results from reduction in functions, privatisation and improvements in efficiency. On course to achieve aim of having Civil Service of 630,000 by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean smallest Civil Service since end of Second World war.

2. Civil service efficiency?

[Government reply to TCSC was published 28 September entitled 'Efficiency and Effectiveness in the Civil Service Government Observations on TCSC Report Cmnd 8616].

Measures to increase efficiency in civil service set out in Government's recent White Paper welcoming Report from TSCS, and accepting (totally or with reservations) no less than 20 of the Committee's 26 recommendations. White Paper gives details of new financial management initiative, and responds to Committee recommendations on management information systems, training in management and financial management, and the filling of senior posts.

3. Civil service pay in 1983?

Unions have asked Government, in light of 3½ per cent planning assumption announced 1 October ~~(see~~ E 12), whether Government intend to have genuine negotiations, and whether arbitration will be available. They believe arbitration should be unconditionally binding ie not subject to Parliamentary over-ride.

4. Megaw Report

Report of Megaw Inquiry into arrangements for deciding civil service pay in future (Cmnd 8590) contained number of important recommendations which are now being considered. Government pleased with widespread support that has emerged for the general approaches which the Inquiry endorsed. Preliminary 'ground-clearing' discussions with unions have commenced. A new system will not be agreed in time for 1983 pay.

5. Scott Report/Public sector pensions?

See K 20.

G SOCIAL SECURITY

NATIONAL INSURANCE CONTRIBUTIONS

[National Insurance contribution rates for employees and employers to be increased by 0.25 per cent from next April, giving contracted-in rates for Class 1 of 9 per cent (employees) and 10.45 per cent (employers). (Because of reduction in rebate on contracted-out rates - announced last March and not part of the annual contributions review - of 0.35 per cent for employees and 0.4 per cent for employers, Class 1 rates for contracted-out rise by 0.6 per cent (employees) and 0.65 per cent (employers); giving rates of 6.85 per cent (employees) and 6.35 per cent (employers).) Lower Earnings Limit rises from £29.50 to £32.50 and Upper Earnings Limit from £220 to £235. Change in the rate of National Insurance Surcharge also affects employers' total payments, see P1-3 for burden on employers.]

1. Why increase employees' contributions?

Recognise that employees have been hard hit recently (increase of 2.5 per cent overall since Government came to power). Some increase necessary because of the rise in the cost of benefits paid from the Fund. But in order to protect contributors the increase is less than is needed to balance the Fund, and in consequence, Fund will be in deficit in 1983-84 by £262 million.

2. Very large increase for contracted-out?

The change in contracting-out terms was announced last March, following a report by the Government Actuary, and is not part of this review. This reduction in the rebate reflects the Government Actuary's assessment of the fall in the cost to contracted-out schemes of providing guaranteed minimum pensions.

3. Effects of 8 November decisions on employers?

See P1-3.

BENEFITS

[Benefits being uprated by 11 per cent later this month (22 November 1982). Includes 9 per cent to take account of inflation. 9 per cent clearly too high hence announcement in Autumn Statement that uprating in November 1983 will be adjusted to have regard to this fact].

4. Government reneging on pledge to maintain value of pensions?

On the contrary, pensioners will be better off during the next year by the extent of the overshoot. Only question is how much of this real increase will continue beyond November 1983. Maintaining real value bound to mean adjustments from year to year; nothing extraordinary about this.

5. Level of overshoot?

Cannot say exactly until December, when November RPI available. Industry Act forecast is 6 per cent inflation for fourth quarter 1982. So overshoot of 2½-3 per cent reasonable estimate. Reflects Government success in reducing inflation.

6. Public expenditure saving?

Recovery of a 2½ per cent overshoot would save £250 million in 1983-84; more in a full year. But social security programme has been reduced by £180 million in 1983-84. This reflects Government's judgement of appropriate level of expenditure. Exact level of November 1983 uprating will be settled at Budget time, when Government will, as usual, take wide range of factors into account.

7. Improvements in benefits?

[ie, using difference between reduction of £180 million and full saving of £250 million if overshoot is £250 million.]

There is constant pressure from both sides of House for whole variety of improvements. Government will have to determine priorities, eg between change in individual benefits and adjustment to next year's uprating. Decisions will, as usual, be taken at Budget time.

8. Uprate pension by pensioners' price index?

[Two PPI's for one and two person households; both exclude housing costs. Both indices have moved less than both RPI (all items), and RPI excluding housing costs, between fourth quarter 1978 Q4 and third quarter 1982 Q3. The gap has, however been narrowing in recent times. Moreover, comparison with the full RPI, ie including housing costs, shows that over time they produce very similar results.]

Pensioner's price index is not necessarily representative of pattern of pensioners' spending, and is constructed on limited information on a very small sample of pensioners. We consider RPI to be best measure of general level of prices, and appropriate for uprating of pensions. In any case, pensioners would not have done any better had we used the PPI to uprate pensions since we came into office.

9. Occupational pensions - increase supervision?

[Recent report by Occupational Pensions Board recommending, inter alia, disclosure of information to pension fund members; end to 'franking' (whereby schemes implement requirement to maintain value of guaranteed minimum pension only by eroding accumulated pension rights above that minimum).]

Government welcome recommendations of OPB. Accept in principle need for legislation on disclosure of information to members of pension funds. Social Services Secretary will be consulting interested parties about content. He also hopes to bring forward in first half of next year regulations to prohibit practice of 'franking'.

10. Death grant - increase to realistic level?

[Consultative document about death grant published 3 March, deadline for comments 30 July.]

Social Services Secretary grateful for comments received on consultative document on death grant published in spring and is considering them carefully.

ALTERNATIVE PROPOSALS BY OTHER PARTIES

11. Cost of social security proposals in 'Labour's Programme 1982'?

[Proposals include raising single/married pension to one-third/half of average earnings; reducing pension age to 60; increasing Child Benefit to £7.75; paying unemployment benefit for men, without limiting duration, at rate equal to RP.]

Cost of implementing Labour's proposals in full probably over £20 billion in full year - an increase of over 60 per cent in social security programme. Labour proposes revenue increases to finance changes of less than £4 billion (abolition of married man's tax allowance and of upper earnings limit of contributions). To raise remainder would require, for example, rise in employee's NIC from 8.75 per cent to around 22 per cent; or rise in basic rate income tax to 46p in £.

12. SDP proposals?

See D8-9.

H FISCAL POLICY AND THE PSBR

1. Progress on fiscal policy?

[Aim is to achieve reduction in PSBR as percentage of GDP over run of years, so as to achieve lower inflation and interest rates.]

Have made progress; Government has succeeded in reducing PSBR as percentage of GDP, and further reduction is projected. Inflation has fallen fast and is expected to fall further (see K2-3). Long term interest rates now lower than at any time in last 9 years. Benefits seen in recovery of debenture market. [IF PRESSED: Government would like to see rates lower still, so long as further reductions not likely to endanger progress or inflation.]

2. How does UK fiscal stance compare with other countries?

[IMF Annual Report noted that among major industrial countries by far the largest 'restrictive shift' over past two years, equivalent to more than 3½ per cent, was that of UK.]

Many countries reducing borrowing; UK budget deficit now well below average of OECD countries. France demonstrates problems with reflation option and US experience shows that fiscal and monetary policy must be broadly consistent.

3. CGBR in October?

[CGBR in October published 9 November, was £0.9 billion: CGBR April - October £6.5 billion].

CGBR outturn to end-October consistent with IAF PSBR for 1982-83 of £9 billion.

4. Why 1982-83 PSBR now expected to be lower than FSBR forecast?

[1982-83 FSBR forecast £9.5 billion. Industry Act Forecast (IAF) published 8 November £9.0 billion.]

It is only slightly lower, particularly in context of plus or minus £2 billion forecasting errors at this time of year. North Sea tax receipts are now higher and local authorities' capital expenditure lower than thought at time of FSBR. Some factors went other way: e.g. local authorities' over-spend on current expenditure.

5. How can Industry Act forecast of £9 billion PSBR in 1982-83 be reconciled with seasonally adjusted outturn for first half of year?

[Seasonally adjusted, PSBR April-September £3.0 billion. Commentators may multiply this by two to get £6 billion as PSBR figure for year as whole.]

It would be wrong to multiply seasonally adjusted half-yearly outturn by two as there are many erratic and irregular influences in the underlying data which seasonal adjustment does not pick up (nor is it meant to).

[IF PRESSED: what factors will increase PSBR in rest of year?

Public corporations expected to borrow more in second half of year than their £0.4 billion to end-September; there are a number of outstanding public sector pay awards which have not been implemented (eg nurses); National Insurance up-rating of 11 per cent, higher than present rate of inflation, will affect second half of year.]

6. Why treat PSBR as crucial statistic when prone to very substantial forecasting error?

[Margins of error are wide: plus or minus £4 billion.]

Although forecasting PSBR is hazardous, this in no way diminishes importance of achieving better balance between Government spending and income. Recognised by all Governments, whatever the difficulties of forecasting.

[CONFIDENTIAL NOT FOR USE: recently-decided measures on revenue and expenditure are intended to make PSBR £1¼ billion higher than it would have been otherwise. IAF allows for this.]

7. PSBR seriously undershooting and Government has been forced to inflate the economy?

Government does not control the PSBR out of a wish to wear a hair shirt. Chancellor said in Mansion House speech [22 October] that PSBR seemed to be undershooting; in light of this Government has decided to take further worthwhile measures to help industry and in other ways, e.g recent housing announcements by Environment Secretary.

8. Why then hasn't Government acted to get PSBR back to £9½ billion?

PSBR forecasts not precise targets - would not make practical sense to fine tune in that way. Must also remember margins of error in forecasting PSBR (see Q6).

9. Why has Government cut PSBR for 1983-84?

[IAF figure of £8 billion for 1983-84 compares with £8½ billion in this year's MTFS.]

PSBR figures in IAF and MTFS for 1983-84 are not targets. The actual plan will depend on judgement taken in next Budget. Both PSBR figures are same percentage (2¾ per cent) of money GDP. Reduction in money GDP forecast since March merely means that this implies £8 billion rather than £8½ billion.

10. More than £1 billion available for tax cuts next year?

[IAF showed fiscal adjustment of £1 billion for 1983-84, subsequent Press speculation has suggested more scope for tax cuts].

PSBR figures in Industry Act forecast illustrative, not targets. Final decisions about PSBR and tax cuts planned for 1983-84 will be made at Budget time, not before.

11. Cyclically adjusted PSBR better guide to policy?

Government fiscal policy has taken account of recession. Acid test of PSBR is level of interest rates at which it can be financed, not its value at some hypothetical cyclically adjusted level of output.

12. Inflation-adjusted or 'real' PSBR in surplus - isn't fiscal policy too tight?

['Real' PSBR subtracts from actual PSBR erosion by inflation of real value of Government debt. Calculations by Bank of England and others produce a surplus 'real' PSBR in most years since the 60's].

No. Fall in inflation has raised the 'real' PSBR (because the 'inflation tax' is reduced). Real PSBR is interesting indicator but poor guide to setting policy e.g. suggests raising PSBR when inflation accelerates.

J MONETARY AND FINANCIAL POLICY

1. Monetary growth in 1982-83 on target

[Provisional money figures for October published 9 November heavily distorted upwards by oversubscription for STC. Bank gave more prominence to their estimates of underlying increases. Target aggregates M1 £M3 and PSL 2, adjusted for STC distortion, grew by ½ - 1¼, ¾ - 1¼ and ¾ - 1¼ per cent respectively in banking October. Implied rates of growth in 1982-83 target period were 9-10½, 11¼ and 8¾-9¾ per cent per annum respectively, compared with target range of 8-12 per cent (all figures seasonally adjusted).]

Estimated rates of growth in target period are within Government's 8-12 per cent range for M1 and PSL 2 and at top end of range for £M 3. But looking also at behaviour of exchange rate and progress in reducing inflation, overall picture is of sound domestic monetary conditions.

2. Adjustment for STC attempts to cover up large October increases?

Distortion to recorded October money figures by STC effect was widely anticipated in the City. The clearing banks' own statement consistent with that of Bank of England. Nothing to be gained by covering up as distortion will correct itself in figures for later months.

3. Prospects for further reductions in interest rates?

[Last reduction in bank base rates made on 4 November - to 9 per cent. Have come down by 7 points since peak in October 1981. Long term interest rates also reduced significantly -by one point in October alone - 6 points since peak last year.]

Substantial interest rate reductions this year reflect sound monetary conditions, and good inflation prospects. Impulse also from US developments. Government would like to see rates lower still, so long as further reductions do not seem likely to endanger progress on inflation.

4. Benefit of interest rate falls to home buyers

[Mortgage rates have fallen 5 percentage points since this year's peak in March. Latest cut to 10 per cent comes into effect for all home buyers on 1 December.]

Mortgage rate falls including latest cut mean for average couple buying first home net saving of over £50 a month since March.

5. Effect of US interest rates on ours?

[US rates fell substantially during July/August, and again in October.]

The falls in US rates were helpful and facilitated reductions in our own. But of course US rates are not sole determinant of UK's, and this spring progress was made in reducing ours at a time when US rates were rising. UK rates are determined in the light of domestic monetary conditions generally, including the behaviour of the exchange rate.

6. Monetary conditions too tight - stifling recovery?

No. Behaviour of exchange rate and money supply suggest financial conditions moderately restrictive, as intended. Interest rates reductions have cut companies' costs and should promote climate for investment. Have given boost to corporate bond market - reducing companies' dependence on banks and easing pressure on monetary growth.

6. Bank lending growing too fast?

[Lower growth rate in May/June not maintained. Increased by £1.3 billion in banking August and £2 billion in September (seasonally adjusted).]

Reasons for growth of bank lending to companies not entirely clear. Companies may be trying to build up gross liquidity levels which fell back in spring. Strong growth in personal lending is partly result of structural changes, such as move by banks into home loans market, replacing lending by building societies; ending of HP controls in July does not appear to have had a large effect. To the extent that increases in bank lending are additional, ie not just in substitution for lending by eg building societies, do represent potential cause for concern, as add to monetary growth. To be taken into account in interest rate policy.

7. Prospects for reactivation of corporate bond market?

[Tax treatment of 'zero coupon' and 'deep discount' stocks and removal of embargo on company issues of this type of stock announced 25 June. BOC announced issue of £100 million conventional bond 10 September, followed by other companies.]

Zeros broaden options available to companies, though not expected to transform capital market. Best hopes for resurgence of market provided by lower interest rates and inflation, for which we are on course.

8. Why has Bank of England been providing such large-scale money market assistance?

The rapid growth of bank lending has caused problems for conduct of monetary policy. By selling long-term Government debt on a larger scale outside the banking system, it has been possible to contain the rapid growth in money which could otherwise have taken place. This in turn has created shortages of liquidity in money markets. If Bank had not intervened, short-term interest rates would have been forced up to unnecessarily high levels.

9. <u>What is significance of National Loans Funds surplus with Banking Department in week ended 29 October? Result of over-funding?</u>

[A balance is accumulated at the Banking Department of the Bank of England when flows into NLF exceed flows out and there are no further Ways and Means Advances borrowed from the Issue Department to be repaid]

Need for a balance reflects many factors. Major ones have been low Government borrowing requirements earlier in year together with continuing sales of Government debt, and underlying decline in the reserves (recently reversed in part). Flow of debt sales of all kinds have been high in recent months but by no means exceptional, having regard to level of bank lending..

K PRICES AND EARNINGS

PRICES

1. October RPI

[Year on year increase in RPI 6.8 per cent in October, compared with 7.3 per cent in September].

Annual rate of inflation again fell sharply in October to 6.8 per cent, its lowest level for 10 years (compared 6.6 per cent in October 1972).

2. How low inflation by end 1982?

We expect inflation to be at or below 6½ per cent by end 1982.

3. Further falls likely in 1983?

We expect inflation to be down to 5 per cent by next spring.

4. Inflation turning up again next year?

We have forecast a figure of 5 per cent for price increase over the year to next autumn (fourth quarter 1983). Further falls in wage settlements this pay round and continued productivity growth should enable low rates of price increase to be maintained during 1983, even with some rebuilding of profit margins.

5. No decline in inflation between spring and autumn 1983?

[Mansion House speech: 5 per cent by spring. Industry Act forecast: 5 per cent in fourth quarter 1983.]

Obviously we cannot expect to maintain the very rapid progress on inflation which is now being made. What we will maintain are the policies which have given us this success; confident that they will keep inflation down.

6. Inflation lower than under previous Government?

[Average year-on-year rate of inflation between February 1974 and May 1979 was 15.4 per cent; average level of inflation since May 1979 has been 12.7 per cent.]

Year-on-year rate of inflation was 10.3 per cent and rising when previous Government left office in May 1979. Now (October 1982) 6.8 per cent and falling. We will be first Government for quarter of a century to achieve a lower average rate of inflation during its term of office than the previous Administration.

7. Inflation still not as low as competitors?

[September figures UK inflation 7.3 per cent compared with 5.0 per cent in US, 4.9 per cent in West Germany, and 3.2 per cent in Japan.]

UK inflation now lower than Western European (OECD Europe) average, and well below many countries - such as France and Italy. Still some way to go to match US, West Germany and Japan, but good progress being made in right direction.

8. Long term inflation objective?

Recent developments encouraging. But inflation rate still higher than some competitors e.g Germany. Must not let up. Have always made it clear that price stability not unattainable.

9. TPI now shows pay increases need to be ½ per cent higher than RPI to maintain living standards?

[Increase in TPI over 12 months to October 7.4 per cent, compared with RPI increase of 6.8 per cent].

The gap between the RPI and the TPI (now 0.6 percentage points) widened in July when benefits paid to the unemployed became taxable. Pay increases go to people in work, who will not pay any more tax as result of the change - except for the minority who have a spell of unemployment during the year.

10. Nationalised industry prices

[Increase over 12 months to October 15.1 per cent, compared RPI increase of 6.8 per cent].

Increases regrettable, but holding prices down artificially would distort market forces and add to burden on taxpayer. Underlying position has been improving steadily for past year or so. But sustained improvement only possible if industries succeed in holding down current costs, particularly pay. (See also Section R).

PAY

[NB: GAD Report published 8 November includes assumption that average earnings in 1983-84 6½ per cent higher than in 1982-83.]

11. What pay settlements does Government now want?

Low enough to be consistent with improved job prospects in the industry concerned. The lower the better. Certainly lower than in the past year.

12. What has been average over past year/pay round?

[CBI Databank suggests 7 per cent average for manufacturing in last (1981-82) pay round.]

Average has been in single figures, and moving downwards, in each of past two years. We need a substantial further reduction, with really low settlements, and thus a better outlook for jobs, in the year ahead.

13. Pay settlements failing to come down?

[FT article (1 November) and November Incomes Data Services Report suggest pay settlements still averaging 7% in spite of falling inflation.]

Too early to say. Few settlements so far this autumn. But in everyone's interest that pay settlements should come down, and come down sharply.

14. A 3½ per cent pay policy?

The 3½ per cent pay assumption [announced 1 October for calculating the pay element in cash expenditure plans for 1983-84] does not represent a 'norm', still less an 'incomes policy'. Nor is it a decision on the offer to be made in any individual case. Settlements higher or lower than the assumption are not ruled out. Each case will be considered on merits.

15. Government exhortations on pay imply aiming to cut living standards?

[Real earnings show little variation over past two years; August 1982 broadly similar to August 1981 and about 1 per cent higher than August 1980.]

Low pay increases do not necessarily mean a reduction in living standards. But whether they do or not, they are essential if we are to create a competitive and profitable productive sector, and thus secure the conditions for sustained improvement in living standards.

16. 1982 New Earnings Survey shows public services falling behind?

Taking account of the effect of overtime on those working in the private sector, and public service settlements which were delayed beyond the Survey date, difference shown between public services and private sector pay movements over period covered by April 1981 and 1982 Surveys no more than 2 per cent.

17. Average earnings index

[Year on year growth 7.8 per cent in August compared with 10.9 per cent in July, but August index artificially low because of large amount of civil service back pay paid in August 1981. Underlying increase about 9 per cent in both July and August.]

Encouraging that underlying rate of growth continues to fall. Further moderation in settlements can only be helpful in maintaining jobs and getting inflation down.

18. Incomes Policy

Proposals for incomes policies, including recent refinements, do not avoid many of the familiar problems of norms, administrative costs, and interference with market forces. Experience gives no encouragement to the idea that incomes policy can be made to work on a permanent basis. They always succumb to the distortions they create.

19. Top Salaries Review Body increases too large?

[Government announced on 12 May increases of 14.3 per cent for senior civil servants and senior members of armed forces, and 18.6 per cent for judiciary.]

Government believes these increases are fully justified. Essential to ensure adequate supply of candidates of sufficient calibre for the Bench, and to provide adequate career structure and differentials in higher levels of civil service and armed forces. Before the increases, TSRB were the only group whose salaries were below those recommended for April 1980.

20. Performance-related pay for nationalised industry board members?

This is an attractive concept. Practicalities and implications of it are being studied jointly with representatives of the Nationalised Industries' Chairmen's Group, at Government's initiative. Individual boards are free to make proposals of this kind for their own circumstances.

21. Pay increase for nationalised industries' boards this year?

No general level of increases for board members this year. Proposals for each board are being considered individually on their merits, in light of circumstances of the board.

22. Index-linked pensions and Scott report?

Question debated in House of Commons 22 October, when Government announced they favoured Megaw Committee suggestion that civil service pension scheme be made contributory. Reduction in inflation has greatly eased disparity between private and public sector pensions; Government's main aim at present is to ensure appropriate contributions are paid for index-linked benefits.

L BALANCE OF PAYMENTS

1. Trade figures and current account

[September trade figures show trade account in broad balance though non-oil trade remains in deficit; invisibles surplus of £260 million a month in Q2 and projected £200 million a month in Q3. Cumulative current account surplus of £2.6 billion in nine months to September. IAF shows zero current account balance in 1983.]

Current account remains in substantial surplus, albeit reduced from last year's levels - current account surplus for 1981 was £6 billion.

2. Export trends - recent

Month-to-month movements in exports during 1982 have been very erratic. There was a sharp recovery in exports in September from the erratically low August level but underlying level of non-oil exports has probably fallen since the spring. To a large extent this appears due to world recession; world trade in manufactures has probably fallen in 1982-83 - first year-on-year fall since 1975.

3. Export trends last few years?

Growth in UK exports of manufactures significantly below world trade growth over 1977 to early 1981, when competitiveness worsening, but with improvement in competitiveness since then, our share appears to have stabilised.

4. Import trends

Manufactured imports increased in September but there has been little, if any, growth in underlying level of manufacturing imports since end-1981. Manufacturing output has fallen back a little this year, so there has probably been some continued growth in import penetration, although not at anything like same rate as in 1981.

5. New import controls on way?

[Continuing Press speculation].

We are concerned at the extent of unfair trading practices and the damaging effect of very high tarriffs and quotas in some other countries. But wish to make clear, as Chancellor said recently [Caterham 22 October] that 'we will be continuing to defend the open trading system'. A free and fair trading system is in the interest of all trading nations.

6. Overseas investment takes jobs away from UK?

30 per cent of UK exports are bought by overseas firms connected with UK companies. By increasing links between UK and overseas companies, overseas investment helps UK exports

and production, so producing more jobs. If UK does not take profitable opportunities to invest overseas, others will.

M EXCHANGE RATE AND THE RESERVES

1. Policy towards the exchange rate/falling £?

[The average £ effective rate in Q3 1982 was nearly 10 per cent lower than in Q1 1981. In last few months £ has remained broadly stable. Lately £ has been strong in effective terms although it has lost ground against the stronger dollar. Rates at noon on 12 November were $1.6530 DM 4.786 and an effective of 91.3. Previous lows were $1.6476 on 29 November 1976, DM 4.098 on 21 May 1982. Highs were $1.97 on 30 November 1981, DM 4.407 on 9 February 1982. Reserves at end October stood at $18.5 billion, compared with $18.3 billion at end September.]

Government has no target for exchange rate. The exchange rate is only one of the factors taken into account in interpreting domestic monetary conditions and taking decisions on policy. Sterling's effective exchange rate has continued to show the broadly stable pattern of recent months. This stability reflects the continuing international confidence in this Government's economic policies.

2. Why not improve UK competitiveness directly by bringing exchange rate down?

First of all, Government's ability to influence exchange rate very limited; developments in other countries critically important; domestic rate decisions must reflect overall judgement about monetary conditions, in which exchange rate only one element. Industry itself has mixed views about desirability of bringing the rate down (Illustrated at CBI Conference in October). Moreover, exchange rate depreciation only offers at best a breathing space. UK's problems caused by failure to contain costs (effective rate only 5-6 per cent above level in May 1979 but cost competitiveness some 26 per cent worse). Only long term solution is lower costs (via lower wages/higher productivity).

3. Influence rate differentially as against DM/yen and dollar?

Could only do so by depressing value of dollar against DM/yen. Over recent months both German and Japanese authorities have indicated that a desirable end but one which they are powerless to achieve. Dollar/DM and dollar/yen exchange rates are even less within power of UK authorities to influence.

4. Bank of England intervention?

Policy is unchanged. Bank do intervene to smooth excessive fluctuations and preserve orderly markets particularly when conditions unsettled. But, as Chancellor has already stated, we have no target - undisclosed, secret or otherwise - for the exchange rate. Most recent reserves figures confirm that policy is unchanged.

5. Debt repayments

We have made excellent progress with our plans to reduce the burden of external debt substantially during this Parliament. We aimed to reduce official external debt to \$14 billion by end of 1981. This has been more than achieved - external debt is now around \$13 billion, compared with over \$22 billion when the Government took office.

N EUROPEAN MATTERS

MEMBERSHIP OF EUROPEAN COMMUNITY

1. UK budget settlement

Foreign Ministers agreed on 25 May to a settlement for the UK budget contribution for 1982. The settlement provides for a basic refund of about £470 million in respect of 1982, with provision for changes to this figure if our unadjusted net contribution varies from the Commission estimate of £880 million. It was also agreed that the problem for the longer term would be settled by the end of November.

2. Implementation of budget settlement

Final agreement was reached by Foreign Ministers on 25/26 October. Although the UK will not now be fully compensated for our contribution to German refunds, we shall receive our 1982 refunds of 1,092 millionecus, about £600 million gross, much earlier than originally envisaged. Payment will now be made before the end of December this year rather than in March next year or later - a significant improvement for the UK.

3. UK objectives for longer-term negotiations?

Government has made it clear that, in spite of our relative economic position, UK is prepared to remain a net contributor - but only on a very modest scale.

4. Will Government withhold contributions?

We hope very much that the issue of our Budget contributions can be satisfactorily settled without the need for recourse to such a step.

5. Commission's ideas for changes to 'own resources' system

Understand that Commission are considering measures to diversify Community's revenue sources. If they put forward proposals we will consider them. Our opposition to any increase in the 1 per cent VAT ceiling is well known.

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

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. <u>What is the current attitude of the UK Government</u>?

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.

9. <u>Join the EMS for exchange rate stability</u>?

There is no reason to suppose that by the simple act of joining the EMS exchange rate mechanism we would guarantee exchange rate stability. This has not been the experience of the current participants. Genuine stability requires a return to low inflation rates throughout the Community.

P INDUSTRY

1. Effect of NIC and NIS changes on private sector employers?

[Chancellor announced further reduction of 1 percentage point in National Insurance surcharge for 1983-84, cutting the rate to 1½ per cent; also half of the 1 percentage point reduction in the rate next year will be brought forward into the current financial year. Effect will be as if private sector had paid at 2 per cent rather than 2½ per cent (rate announced in 1982 Budget) during 1982-83. Small increase in employer's NIC as from April 1983 also announced on 8 November (see G: NI contributions.]

The special reduction in NIS is worth about £350 million to private sector employers this year, and the announced NIC and NIS changes taken together will benefit them by over £400 million next year. Constitute a substantial reduction in the costs faced by private sector commerce and industry.

2. How does this compare with burden as at May 1979?

Private employers will pay around £1 billion less next year than they would have done under the rate of NIS and employers' NIC inherited from the previous Administration.

3. Won't contracted-out employers be worse off?

No; their combined rate of NIC and NIS falls by 0.35 per cent next year. [Reduction of contracted-out rebate was announced last March, so not part of Autumn Statement, but included in this calculation.]

4. Prospects for industry-recovery?

See A2-4 and Section B.

5. Companies' financial position?

[£bn

	1979	1980	1981 Year	H1	H2	1982 H1
Net borrowing requirement (+)/repayments (-)	+6.3	+6.5	+5.1	-1.5	+6.6	+5.6
Financial surplus (+)/deficit (-)	-2.9	-1.4	+1.8	+1.0	+0.8	-1.3]

Financial position of industrial and commercial companies (excluding North Sea) improved last year, relative to 1979 and 1980. Improvement in part reflected companies' efforts to cut costs, for example by de-stocking. Some apparent deterioration in second half 1981 financial position due to slowdown in de-stocking and unwinding of delays in tax payments because of the civil service dispute. Figures for H1 1982 suggest reduction in companies' borrowing requirements relative to H2 1981; but borrowing needs still high.

6. Profits rate of return still too low?

[Gross trading profits of industrial and commercial companies (ICCs) (net of stock appreciation) rose 18 per cent to 1982 H1; but increase was from a very low base ICC's real pre-tax rate of return (except North Sea was just over 3 per cent in 1981, and only 2 per cent in manufacturing - half previous cyclical low figure in 1975.]

Government can help best by getting inflation down and setting sound basis for sustained recovery. Fundamental improvement in ICC's rates of return depend on better performance by companies. Some encouragement from recent productivity gains and trend towards moderate pay settlements.

7. Real rates of return on capital lower in UK than elsewhere?

[OECD statistics comparing UK, Japan, France and UK show net rates of return to fixed capital in non-financial corporations in 195-80 lowest in UK - though all on a downward trend. 1980 figures: US 13 per cent, Japan 15 per cent, France 9 per cent, UK 5 per cent.]

Figures show how policies of earlier administrations have allowed profitability to slide in UK. Sound basis for sustained recovery rests on reducing inflation, increased productivity gains, and moderation in pay settlements which creates conditions for better performance by companies.

8. High interest rates damaging for industry and investment?

Banks' base rates have fallen 7½ percentage points since last October, and 3½ points over last three months. Outside analysis suggests that a 1 per cent reduction in interest rates improves the net financial position of the company sector by about £250 million over a full year. Lower interest rates reflect Government's firm fiscal and monetary stance and will help industry and investment.

9. Lower rates for industry?

De-rating one of a number of possible ways of assisting industry and business, but in last Budget preference given to other forms of relief, notably reductions in NIS. De-rating would be expensive, though less so if applied to industry alone - even so, 10 per cent de-rating would cost about £140 million per annum. Legislation would be required.

10. Lower energy prices

See R2-3.

11. Government help for small firms

Budget provided further help for small businesses, increasing the number of measures taken so far to over 100. Enterprise package included further reduction in weight of corporation tax; further increases in VAT registration limits; increase in global amount available for loans under Loan Guarantee Scheme (see below); and doubling of investment limit under Business Start-Up Scheme to £20,000 a year. New measures will encourage start-ups and existing firms.

12. How many new firms starting up?

[Correspondence in progress between Treasury and D Industry about value of giving 'net' figures of 'birth' of minus 'deaths' of companies based on VAT registrations.]

On a very rough average some 10,000 new companies come into being every month.

13. Response to Loan Guarantee Scheme?

[Over 6,400 guarantees already issued - about half to new businesses. Total lending under scheme around £215 million. Budget provided for lending ceiling in first year (to May 1982) to be raised from £100 million to £150 million and for further £150 million to be available in second year (to May 1983). Thirty financial institutions now participating.]

Scheme operating successfully. Too early to assess overall cost . After first year, out of over 6000 guarantees issued, only 150 have so far been 'called'. Cost has been covered by the premium income received over the period. Scheme is kept under continuous review.

14. New enterprise zones

Chancellor announced Tuesday 27 July eleven new Enterprise Zones to be created: 7 in England; two in Scotland; one each in Wales and Northern Ireland. Applications from local authorities in all four countries for sites in their areas to be designated now being considered. (53 applications in England).

15. First group of enterprise zones

All first eleven zones now in operation. 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.

16. Is is true that a committee has been set up to consider changing basis of regional assistance?

[Report in FT 25 October.]

Regional policy is, like other Government policies, continually open to scrutiny in case improvements can be made. [IF PRESSED: But cannot comment on precise details of official committees.]

R NATIONALISED INDUSTRIES

NATIONALISED INDUSTRY PAY AND PRICES

1. Nationalised industries' prices

[Having risen approximately in line with retail prices for several months, the latest figures show bigger 12 months increase in nationalised industry prices, water charges and London Transport fares than all items RPI (15.1 per cent in October compared 6.8 per cent). This differential reflects March increase in LT fares. Removal of these temporary distortions confirms that nationalised industry prices are still increasing somewhat faster than RPI, largely because of increases in energy sector.]

Gap between nationalised industry price increases and RPI has been due in large measure to cumulative effect of years of artificial price restraint. World oil price rises of 1979 and 1980 have also played an important part. We greatly regret the need for these increases, but holding prices down artificially would distort market forces and add to burden on taxpayer. Underlying position better than it was. The differential between RPI (all items) and NI prices (including water charges and London Transport fares) is now currently about 8 per cent compared with 14 per cent in January 1982. But sustained improvement will only be possible if the industries succeed in holding down their current costs, particularly pay.

2. Freeze on industrial gas prices?

[BGC announced 8 Nomvber that freeze on renewal prices for contract gas due to expire at end of year would be extended for further nine months].

Government welcomes BGC's decision to freeze industrial gas prices for a further nine months from the end of this year. Decision was taken on purely commercial grounds - BGC judge that they can accommodate the freeze within their present EFL.

3. Electricity prices?

As announced by the Secretary of State (for Energy and for Scotland) on 12 November, electricity prices will not, on average, be increased at all in 1983. This is consistent with the EFLs announced 8 November. The standstill follows the recent review of the bulk supply tariffs.

4. What is Government doing to improve nationalised industries' efficiency?

We continue to press for greater efficiency within NIs. We are setting realistic financial targets and performance aims. A rolling programme of Monopolies and Mergers Commission investigations has been set up. The introduction of market forces provides greatest incentive to efficiency.

5. Nationalised industry board s' pay?

See K 20-21.

INVESTMENT

6. Nationalised industries' investment should be stepped up to/improve infrastructure/provide orders to private sector/as boost to economy

Government has not prevented the industries from carrying forward a large number of profitable investment programmes. It would be wasteful to provide funds for public sector projects with lower returns than those in the private sector. Unfortunately, the pre-tax rate of return on nationalised industries' capital (including subsidies) in 1980 (latest available figures) was minus one per cent, compared with 3 per cent for industrial and commercial companies.

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

As in private sector, moderate pay settlements and control of other costs are essential. Ability to finance new investment in nationalised industries bound to diminish if excessive pay ~~settlements~~ agreed. Each 1 per cent off wages saves about £140 million this year; and each 1 per cent off total costs saves £330 million this year.

8. Take nationalised industry investment out of PSBR?

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

9. Private finance for NI investment?

In discussions in NEDC and elsewhere, we have indicated our willingness to consider new financing proposals, provided they can be structured so as to induce improvements in efficiency at least sufficient to offset the extra cost, and provided the finance is raised in fair competition with the private sector.

10. Investment plans unlikely to be attained?

[Letter has been sent by PM to chairman of Nationalised Industries' Chairman's Group stressing importance of maintaining NI investment programme: £900 million underspend 1981-82, £500 million expected underspend 1982-83.]

No Government can unconditionally guarantee a particular level of investment by the nationalised industries. NI planned investment for 1982-83 26 per cent higher than estimated outturn 1981-82. Some signs plans may not be fulfilled. Events outside industries' control may cause investment plans to be revised downwards. PM has made it clear that industries should make full and proper use of their allocation.

EXTERNAL FINANCING LIMITS

11. EFLs for 1982-83

Nationalised industries' total external finance increased by £1.3 billion in 1982-83 (£1.2 billion after allowing for NIS cut and other changes). Increase in 1982-83 was roughly half what the industries bid for. Government has given full recognition to problems faced by the industries in a period of recession.

12. EFLs for 1983-84?

Nationalised industries EFLs for 1983-84 announced in Autumn Statement. Overall, external finance in line with previous plans. £2.7 billion being made available to nationalised industries in 1983-84.

PRIVATISATION

13. Special asset sales in 1981-82

Gross sales in 1981-82 totalled £481 million, so target published in 1981 Public Expenditure White Paper of £500 million nearly met. Pleasing result - included two large sales - Cable and Wireless (£182 million) and Amersham International (£64 million). True that delivery of BNOC oil in 1981-82 paid for in 1980-81 and taken into account in special disposals figure for that year reduced 1981-82 receipts by £573 million to total of -£92 million. But it is gross figure which is true measure of success of Government's privatisation programme. As Chancellor said in Cambridge 3 July, 'Public utilities and the so-called "natural monopolies" cannot be allowed permanently and without challenge to remain within State ownership'.

14. What further sales expected?

Special sales of assets in 1982-83 forecast at around £600 million and expected to increase in subsequent years. This year's and next year's involve primarily very large sales of energy assets - Britoil and the British Gas Corporation's major offshore oil assets - made possible by Oil and Gas (Enterprise) Act (which received Royal Assent in June). Industry Secretary announced 19 July plans to sell 51 per cent of British Telecom - but not before next Election.

15. Why sell Britoil?

[In 10 November statement Energy Secretary announced offer for sale by tender of 51 per cent of Britoil shares. Special arrangements made to encourage small investors and employees to apply. Shares underwritten at minimum tender prices of 215p per share. Payment in two instalments: first instalment of £1, with balance next April].

Sale will create an independent British oil company free to seize opportunities. Will substantially reduce size of public sector in area where State ownership has no justification whatever. Will allow public to take direct personal stake in North Sea.

16. Wrong time to sell Britoil?

[Slump in Shell profits and cut in prices by Indonesia reported 12 November].

Absolutely no reason to believe that could have obtained a better price by delaying sale. FT actuaries oil share index 17 per cent higher at time offer announced than when decision to sell announced last year.

17. Why a tender?

Choice between tender and fixed price offer considered carefully. Right in these particular circumstances for price to be tested by market. And a tender allows price to take into account movements in market during period of offer for sale. A novel approach for sale of this size. But objective is to get fair price for taxpayer.

18. Government has sold assets too cheap?

[Heavy oversubscription for British Aerospace, Cable and Wireless, Amersham International, followed by large increases in prices when shares first traded.]

Not in Government's interest to see shares underpriced, given the loss to the PSBR, but also risks in pitching price too high. Getting balance right not easy - especially when company's shares have not previously been traded. Government will continue to consider alternative forms of sale eg tender, but critics should note that sale by tender could make it harder for small investor to buy shares.

19. Contribution to giving people satisfaction of property ownership?

Exercise of returning enterprises from State ownership to ownership by the public has included measures to promote employee share ownership in the enterprise they work for; for example free offers of shares (British Aerospace, Cable and Wireless, Amersham); preference in allocation of shares (B Ae, C & W, Amersham, BP); provision for matching shares - one for each share subscribed for - (B Ae, Amersham, BP). Most radical initiative taken by consortium of managers and employees who bought National Freight Company.

S NORTH SEA AND UK ECONOMY

1. New forecast of North Sea revenues?

[Autumn Statement (Industry Act forecast) projections (in money of the day) of Government revenues from North Sea: £6½ billion in 1981-82, £7 billion in 1982-83, £7½ billion in 1983-84. Higher than 1982 FSBR projections, partly because of higher production, partly higher oil prices].

Must remember that oil revenue projections are crucially dependent on inherently uncertain cost, price and production assumptions. Prospects for North Sea tax receipts have improved since 1982 FSBR published because of higher than assumed oil prices and production. New projections assume oil prices do not change much from present levels.

2. Onerous tax system damaging future field developments?

[Shell/ESSO have shelved plans for Tern partly because of tax system; Phillips postponing T-block complex and BP their Andrew field; BP statement issued with their interim results criticised fiscal regime.].

Other adverse factors - falling oil prices earlier this year; high development costs - much more important. Detailed study has shown that under new tax structure, levels of profitability should still be sufficient to make exploration and development attractive. Hope that present structure will provide more secure and stable tax regime.

3. Government about to relax North Sea fiscal regime?

No decisions have been taken, but fact-finding discussions taking place with UKOOA and individual oil companies. Government wishes to give oil companies every opportunity to present their evidence about profitability in the North Sea. The regime is kept under review.

4. Taxation of petrochemical feedstocks

[Government has announced that new rules on valuation of ethane for petrochemical use in interaffiliate transfers (Finance Act Section 134) should be extended to mixed streams of gas with a large ethane component. ICI complain that the extension and the rules themselves give unfair advantage to their integrated oil company competitors and have taken out writ against the Government.]

Government convinced that new formula will give fair valuation. New valuation will not have effect of providing subsidy to ICI's competitors. Have done best to reassure ICI. Will resist ICI's legal action.

5. Government should do more to promote UK Continental Shelf oil production in 1990's?

[Select Committee on Energy's Report on Depletion Policy published 18 May: emphasised development of fields entering production in 1990s by increasing pace of licensing rounds

and overhauling fiscal regime. Recommended reserve powers to impose production cuts. Energy Secretary and Chancellor replied in joint memorandum on 29 July].

HMG agrees with general conclusions encouraging North Sea exploration and development, thereby maximising economic oil production over time; eg decision recently announced not to impose production cuts before 1985. Agree uncertainties in oil markets too great to justify deferring new field developments in foreseeable future. Cannot accept Committee's criticism of North Sea fiscal regime - opposed to another fundamental review; industry does not want a structural upheaval.

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

[Contribution of North Sea to GNP estimated at 4 per cent of GNP in 1981. Not projected to rise significantly before 1985.]

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 lower level of interest rates to benefit of industry and economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Less than 6 per cent of total General Government receipts in 1981-82.

7. North Sea revenues should be channelled into special fund?

North Sea revenues are already committed. Setting up special Fund would make no difference. More money would not magically become available.

8. Future North Sea oil prices?

A matter for commercial negotiation between oil companies and BNOC.

9. Are we really any better off for our North Sea oil?

We are better off with oil - at current oil prices - than we would have been without it. We have been spared fall in real national income that other industrial countries have suffered following oil price rises. But North Sea oil costly to produce, so we are not necessarily any better off than we would have been had oil prices not risen. No need therefore for possession of oil to require a contraction in our industrial base.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Prospects for world recovery?

[IMF, London Business School and Bank of England Quarterly Bulletin all gloomy about immediate prospects. No overall growth seen in major countries in 1982, and only weak recovery next year. Press reports suggest OECD will also revise its previous forecasts downwards this autumn.]

Output in the major economies appears to have recovered slightly in the spring after the downturn last winter. US economy grew slightly in both Q2 and Q3. The major European economies, however, remain depressed, and it is too early to say that a broad upturn has started. Lower inflation and interest rates however offer prospects for better growth next year.

2. Why don't major industrial countries together expand demand?

Leaders of the major countries agreed at the OECD, Summit and IMF meetings on the need to continue the fight against inflation. As the OECD's Economic Outlook explains, Governments are convinced 'a significant part of any stimulus to demand would increase public sector deficits, and dissipate itself rather quickly as an increase in inflation'.

3. Anti-inflation policies are working

[Consumer price inflation down from a year ago in all 7 major economies on latest available figures: US (from 11.0 to 5.0 per cent), UK (11.7 to 6.8 per cent), Japan (3.8 to 3.1 per cent), Italy (18.3 to 17.2 per cent), Canada (12.5 to 10.4 per cent) France (13.9 to 10.1 per cent), Germany (6.5 to 4.9 per cent).]

Inflation has fallen in all major countries in the past year. Firm fiscal and monetary responses to 1979-80 oil price rise vindicated. UK close behind US and Germany in bringing down inflation, and ahead of some other European countries. Realism in wage settlements is growing; US, Germany and Japan all have wage settlements in single figures.

4. Cuts in public expenditure in other countries?

[Many countries seeking economies. Countries planning to curb public sector pay and costs include Germany, France, Japan, Canada, Belgium and Denmark. Also Germany, France, Canada, Belgium all plan to make economies in welfare programmes.]

UK not alone in facing up to hard decisions. Coming to power of goverments committed to curbing public spending in UK, US, Norway, Denmark and now Germany suggests increasing awareness of need to reduce it.

5. International financial collapse?

Concern about effects of over-borrowing noted at Toronto IMF meeting. But should not exaggerate alarm. Important of course to sustain system's stability. Lower interest rates should help, as should IMF programmes to restore countries' credit-worthiness. Further progress needed on banking supervision including risk assessment and prudential standards; also watertight allocation of supervisory responsibilities.

6. What about US ideas for emergency IMF assistance to countries heavily indebted to the international banking system?

The IMF must certainly be endowed with the resources it needs to carry out its present role. There is widespread agreement that a substantial increase in its quotas is necessary. Its resources may need to be supplemented even further. The US ideas are only among a number which need to be studied carefully.

7. Another oil energy crisis looming?

[Latest World Energy Outlook from International Energy Agency raises possibility that tight oil market could reappear in late 1980's].

Always difficult to foresee future oil prices. But they are weak at present and likely to remain so in near future. In longer term, energy conservation should permanently reduce countries' dependence on oil.

8. US economy?

[US GNP rose only slightly in Q3 after ½ per cent rise in Q2. Unemployment has risen above 10 per cent. Consumer price inflation has fallen to 5 per cent. Interest rates have fallen 4 per cent since July. Press reports suggest that Federal Reserve only expects growth of 2 per cent next year - lower than forecasts by US Administration and other forecasters].

US output rose slightly in Q3 after small rise in Q2. Still too early to say that a strong recovery is under way, but falls in interest rates and inflation hold out better prospects for growth over the next year.

9. US monetary policy

[US interest rates have fallen and Federal Reserve has reduced its discount rate from 9½ to 9 per cent. Chairman Volcker has said US authorities will be attaching much less than usual weight to M1 over period ahead].

Accept that monetary indicators in US must be interpreted flexibly in light of financial innovations. Federal Reserve Chairman, Mr Volcker has made clear that reduction of inflation remains a priority and that monetary targets have not been abandoned.

10. Gloomy prospects for Europe?

[EC Commission Annual Report predicts only 1.2 per cent growth in Europe next year and 10.3 per cent unemployment. Medium-term forecast gives gloomy picture of 1983-87 with growth in EC averaging only 2½ per cent and inflation of nearly 8 per cent.]

Short-term prospects for recovery in Europe weaker than in US or Japan. But budget deficits higher and inflation rapid in many European countries. Note that EC Commission draws attention to need to curb budget deficits and reduce labour costs. Always difficult to see into medium run but improvements in competitiveness, lower inflation and interest rates all offer better prospects.

11. Competitive devaluations

[Recent devaluation of Swedish krona by 16 per cent widely criticised by other Governments. Finnish marka subsequently devalued by 6 per cent. Independent 'wise men's' report on Danish economy suggests withdrawing from EMS temporarily in order to allow 20 per cent deyaluation].

IMF rules forbid countries to manipulate exchange rates to gain unfair competitive advantage. Authorities in Sweden will have noted strong objections from her major trading partners. Prosperity of world economy depends on maintaining open and fair trading system. Large devaluations may hinder this, and risk encouraging competitive devaluations by others. [IF PRESSED: IMF is examining Swedish action.]

COMMENTARY ON RECENT ECONOMIC DEVELOPMENTS AND STATISTICS 15 NOVEMBER 1982

Summary comment

Recent financial developments favourable - inflation and interest rates falling - but activity remains flat.

World Economy: expectations held by most forecasters for an upturn in activity of 1 per cent this year unfulfilled. Outside forecasters expect only a weak recovery next year.

. world commodity prices are at their lowest level in real terms for thirty years;

. oil prices are weak and likely to remain so for the near future;

. consumer price inflation (OECD major 7) around 6½ per cent in September ranging from 17 per cent in Italy to 5 per cent in Germany and 3 per cent in Japan;

. average world 3-month interest rates 10 per cent at 1 Novmber a fall of 4 points since October 1981; US 3 month rate stood at 9 per cent on 1 November; real interest rates remain clearly positive;

. world trade volume has been more or less flat since the middle of last year;

. total industrial production for the OECD Major 7 fell 6 per cent in the twelve months to July; in the US it fell by 9½ per cent in the 12 months to September;

. unemployment (major 7) now 8½ per cent, compared with 6½ per cent in mid-1981.

UK Balance of Payments: non-oil trade balance has deteriorated quite sharply but current account remains in strong surplus this year. But both the loss of competitiveness during 1979 and 1980 and a smaller world market are affecting our non-oil trade at home and abroad.

. OPEC and Third World countries are cutting back on imports because of low commodity prices, high interest rates and debt problems in some countries. UK exports in 1981 Q3 4 per cent down on 1981 H2.

. import volume rose sharply as activity recovered last year and import penetration rose too; imports broadly flat this year.

. the effective exchange rate has been broadly stable since summer 1981; currently 92.0.

Financial Developments

.M1, PSL2 within target range for 1982-83, £M3 towards top of range;

.short term interest rates down 7 points since last October; base-rates down 7 points;

.mortgage interest rates down to 10 per cent, first time since 1978;

.real interest rates have fallen but remain clearly positive (higher real rates are being experienced in the US and Japan);

.CGBR £6.5 billion in 7 months to October, consistent with IAF assessment of £9 billion PSBR for 1982-83.

Inflation

.retail price inflation, 6.8 per cent in year to October. Forecast 6½ per cent before Xmas, with prospect of 5 per cent by spring 1983 and at Q4 1983;

.TPI increase in 12 months to October was 7.4 per cent;

.Wholesale price inflation also moderating; input prices up almost 3½ per cent in year to September; output prices 7½ per cent;

GDP and industrial production

.GDP has been broadly flat since 1981 Q4, as has the underlying level of industrial production; but latter 1½ to 2 per cent above spring 1981 trough largely due to increased oil and gas production; the underlying level of manufacturing ouput only slightly above its trough level.

Demand Components

.consumer spending has remained broadly unchanged since 1979, over period when other components of final demand fell some 4-5 per cent. Some fall in RPDI (see below) offset by lower savings ratio. Retail sales in July -September 2 per cent higher than in spring, partly reflecting abolition of HP controls.

.gross fixed investment fell back by 4 per cent in 1982 Q2 - from a strong first quarter - to a level similar to that in 1981 H1 and 10 per cent below the level in 1979. Manufacturing investment has been weak. Plant and machinery investment, however, has held up.

.the massive destocking of 1980 H2 and 1981 is over but the 1982 Q2 figures show no return to positive stockbuilding. October CBI survey suggests some further scope for destocking in manufacturing;

.government consumption in 1982 H1 was 2 per cent above its level in the same period last year. 1982 Q2 data suggests that the upward trend in volume may be flattening out.

.there has been some fall in the volume of exports in recent months reflecting both loss of competitiveness and the flatness in world trade;

.imports rose very sharply between the two halves of 1981, reflecting both the increase in activity and increased import penetration, before stabilising.

Productivity and Competitiveness

.manufacturing productivity continues to rise strongly - at 6½ per cent annual rate so far this year, following 8½-8¾ per cent last year;

.manufacturers' unit wage/salary costs up less than 6 per cnet in 3 months to August on a year earlier;

.during 1981 external price and cost competitiveness improved around 15 per cent but less than 1½ per cent improvement during 1982 H1.

Company Sector

.ICCs pre-tax real rates of return on capital in 1981 were very low; only 2 per cent in the manufacturing sector. Some slight improvement likely this year.

.after falling in first quarter of 1982 gross trading profits (net of stock appreciation) of ICCs rose in the second quarter by 5 per cent; this follows the strong recovery in 1981;

.non-North Sea profits in 1982 H1 were 22 per cent above their level in 1981 H1;

.gross profits of North Sea oil companies rose 10 per cent over the same period;

.ICCs financial deficit was £1.3 billion in 1982 H1, following £0.8 billion surplus in 1981 H2, partly reflecting less destocking. Over same period net borrowing requirement fell from £6½ billion to £5½ billion.

Personal Sector

.wage settlements in 1981-82 were on average around 7 per cent, 2 per cent lower than in the previous round;

.underlying rate of increase in average earnings in year to July 1982 was about 9-9½ per cent;

.real earnings broadly flat in last 12 months but RPDI is about 1½ per cent lower than the average for 1981.

Labour Market

.UK employment fell 2.4 million (10½ per cent) between 1979 Q2 and 1982 Q2 (two-thirds concentrated in manufacturing); between 1981 Q2 and 1982 Q2 employment fell by 670,000;

.Total employment fell more in the second quarter of 1982 (189 thousand) than in the previous quarter (94,000);

.total registered unemployment fell by 48,000 to 3.3 million (13.8 per cent) in October reflecting seasonal falls in school leavers which more than offset the underlying upward trend (which itself slowed to 23,000);

.UK adult unemployment rose by (only) 23,000 to 3.1 million (12.8 per cent) in October; previously the trend (since June) was accelerating;

.vacancies have not altered much in recent months;

.other labour market indicators - short time, overtime working, etc - continue to suggest sóme flattening out following last year's improvements.

Forward Indicators

.car production (seasonally adjusted) recovered to 79,000 in October from 60,000 in September;

.steel production (seasonally not adjusted) fell from 230,000 tonnes per week in September to 228,000 tonnes er week in October;

.the volume of new construction orders, which remained broadly flat since the first half of 1981, fell 6 per cent in the 3 months to August. Within the total, orders for new housing, particularly in the private sector, remain slightly below their level last spring. Engineering orders also disappointing with a 9 per cent fall in the lastest 3 months.

.total manufacturing order books, as monitored in the CBI's monthly industrial trends enquiry, after strengthening last year, have shown some decline; and export order books have weakened.

.total housing starts, having increased from an average 40,000 a quarter in 1980 to 53,000 in 1982 Q1, fell back in the spring, but average for the first nine months is over 25 per cent up on the same period a year ago. Total completion have remained fairly flat during 1981 Q2 and Q3 having previously drifted slowly downwards.

.seasonal falls in school leavers registrations continue into November and December but a sharp seasonal rise in unemployment occurs in January;

.CSO's index of longer leading indicators rose in August and September reflecting lower interest rates and higher share prices, following a fall from April to July.

CBI's October Trends Survey suggests a further decline in business confidence, further slight falls in total new orders and output. Stock reductions are continuing and investment intentions have weakened again. The survey suggests no recovery in new export orders and deliveries over the next four months. Cost pressures are expected to slow further and a slight improvement in firms liquidity is in prospect. Consumer goods industries are benefiting slightly from some improvement in demand.

Outside forecasts

.Outside forecasting groups are now less optimistic about recovery in 1982, suggesting that growth this year will be ½-1 per cent - about ½ per cent less than expected at Budget time; for 1983 consensus of outside forecasts around 2 per cent, assuming some recovery in world economy, with inflation/interest rates continuing to fall at least for some time into next year.

.New Treasury forecast published November 8th - see summary table attached.

Key Statistics Week-Ending Friday 19 November

Mon 15	:	Retail Sales (Oct - provisional)
Wed 17	:	Average earnings (Sept) and wage rates (Oct)
Thurs 18	:	Monetary aggregates (Oct - final)
	:	GDP output (3rd qtr)
	:	Capital expenditure by manufacturing, distributive and service industries (3rd qtr - prov)
	:	Manufacturers' and distributors' stocks (3rd qtr - prov)
Fri 19	:	Cyclical indicators (Oct)
	:	Sales and orders in engineering industries (Oct).

Reproduced from November 1982 Autumn Statement

Table 1.9 below presents a summary of the economic prospects.

Economic Prospects

		Percentage changes		
		1981 to 1982	1982 to 1983	Average errors from forecasts, relevant for 1983
A	*Output and expenditure at constant 1975 prices*			per cent
	Gross domestic product (at factor cost)	½	1½	1
	Consumers' expenditure	½	2½	1½
	General government current expenditure	2	1	1½
	Fixed investment	3	5	2½
	Exports of goods and services	−1	0	3
	Change in rate of stock-building as a percentage of the level of GDP	2	½	1
	Imports of goods and services	4½	5	3
		1982	1983	
B	*Balance of payments on current account* (£ billion)	3½	0	3
C	*Retail prices index* (4th quarter to 4th quarter)	6	5	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 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 1980. For the current balance and the retail prices index, forecasts made between June 1970 and October 1980 are used. The errors are after adjustment for the effects of major changes in fiscal policy, where excluded from the forecast. Quarterly forecasts are grouped so as to be comparable with 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 1.10

Table 1.10 Constant price forecasts of expenditure, imports and gross domestic product*

£ million at 1975 prices, seasonally adjusted

	Consumers' expenditure	General government consumption	Total 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	Gross domestic product at factor cost	GDP index 1975=100
1980	71 550	24 300	20 450	33 100	−1 550	147 850	34 150	12 200	200	101 700	108·0
1981	71 750	24 450	18 750	32 400	−1 900	145 450	34 100	12 100	0	99 250	105·4
1982	72 150	24 900	19 350	32 150	−150	148 400	35 650	12 150	−600	100 000	106·2
1983	73 800	25 100	20 300	32 200	300	151 700	37 450	12 500	−500	101 250	107·6
1981 H1	35 900	12 150	9 350	15 850	−1 350	71 900	15 950	6 100	−250	49 600	105·4
H2	35 850	12 300	9 400	16 550	−550	73 550	18 150	6 000	250	49 650	105·5
1982 H1	35 750	12 400	9 650	16 300	0	74 100	17 750	6 000	−350	50 000	106·2
H2	36 400	12 500	9 700	15 850	−150	74 300	17 900	6 150	−250	50 000	106·2
1983 H1	36 650	12 500	10 050	15 950	100	75 250	18 500	6 200	−250	50 300	106·9
H2	37 150	12 600	10 250	16 250	200	76 450	18 950	6 300	−250	50 950	108·2
% changes:											
1980 to 1981	½	½	−8	−2		−1½	0	−½		−2½	
1981 to 1982	½	2	3	−1		2	4½	½		½	
1982 to 1983	2½	1	5	0		2½	5	3		1½	

*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 half per cent. The GDP index in the final column is calculated from unrounded numbers.

1/1

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PPS/CHANCELLOR

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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 BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 1 November, are sidelined. Fuller briefing on the Autumn Statement has already been supplied to No.10, Treasury Ministers and others with specific needs.

M. M. Deyes

M M DEYES

RIA

R I G ALLEN

8 November 1982

EB Division
H M Treasury
01-233-5503

ECONOMIC BRIEF: CONTENTS

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 maintaining steady but not excessive downward pressure on monetary variables, and complementary fiscal policies. Improvement of supply side depends on restoration of flexible and competitive market economy and better incentives.

2. Recovery over/Activity flat?

Delayed but not over. Activity still 1 per cent above trough in Spring 1981. Pause this year partly reflects external developments. Expected recovery in world trade and output expected at Budget time has not materialised. Progress on inflation and interest rates more rapid than expected and, together with continued rapid improvements in productivity argues well for future.

3. Recovery next year?

Although recovery has been hesitant this year renewed modest recovery expected in 1983. Expectation supported by upturn in cyclical indicators and by most outside forecasts. [For Industry Act forecast see B .]

4. Where will growth come from?

Sources of growth are expected to be: some modest recovery in world activity; improved confidence as inflation comes down, encouraging more investment and risk-taking; lower interest rates improving companies' financial position and encouraging more fixed investment and stockbuilding; increased consumers' expenditure, partly reflecting lower inflation. But prospects depend critically on containing costs.

5. Government policies have caused recession by deflating demand?

No. Output had fallen more strongly than demand during the current recession; and in year to 1982 Q2 real demand rose by 3 per cent, real output by only 1 per cent. Import penetration higher than in first half of last year. Essential problems of economy lie on 'supply side' -lack of competitiveness etc. Government policies aimed at helping industry to redress these problems by : deregulating, restoring incentives and implementing a financial strategy under which inflation and interest rates can fall over the medium term.

6. What factors have caused flattening out in recovery this year?

Two main contributory factors appear to have been world output lower than expected plus worse UK performance both at home and abroad. Domestic demand quite buoyant (see 5 above).

7. PSBR undershooting/fiscal policy too tight?

This year's apparent undershoot estimated at nearly £½ billion and also bear in mind rapid fall in inflation. Also look at Government's fiscal strategy as a whole: firm control of Government borrowing one factor in interest rate falls. Aim is to achieve lasting interest rate reductions: real interest rates still uncomfortably high.

8. Room for tax cuts? Fiscal boost?

Chancellor has effectively 'spent' nearly £1 billion by reducing NIS and holding down NIC increases. Scope for further worthwhile tax cuts for 1982-3 - the so-called fiscal adjustment - now estimated at about £1 billion. But figures very uncertain at this stage. Decisions taken in next Budget will depend on prospects as then seen for PSBR and economy. These factors will also affect choices of taxes to be modified.

9. Public spending decisions?

Planning total for 1982-83 held at level envisaged in the 1982 Budget - some £120 billion. Most welcome achievement - first time has happened since 1977. Unlike in 1977, Government not forced to hold to plans by outside intervention of IMF.

10. Business confidence collapsed?

[October CBI survey published 28 October. Times Business forum results published 1 November show generally greater confidence than CBI respondents.]

Recognise that business confidence is weak, reflecting depressed trading conditions at home and worldwide. But, as witnessed by surveys from Times Business Forum in October and November, great majority of businessmen support Government's basic economic strategy and are optimistic about prospects for company growth/profits over next two years. (See also B4). Decisions announced 8 November aimed to reduce business and industry's costs and should boost confidence.

11. Monetary framework?

Government's role is to maintain firm, consistent, financial framework, in line with major economic objectives (see 1 above) as set out in Medium Term Financial Strategy. Monetary ranges in MTFS interpreted flexibly. Government takes account of all available evidence, including exchange rate, interest rates and money GDP, as well as behaviour of broad and narrow measures of money. Monetary conditions much as intended this year. With inflation coming down, should be ample scope within target ranges for rising activity.

12. Pressure for action on imports?

See L4 and 5.

13. Unemployment?

No miracle cures. Unemployment rising throughout world. Defeating unemployment means creating a dynamic economy, for which defeating inflation a precondition.

14. Autumn Statement

Presented Monday 8 November.

15. Autumn Statement left out tax proposals/information about public expenditure decisions for later years ahead, and ready reckoners of economic effects?

Government explained, in reply to TSCS, November too early for detailed tax proposals. Have included estimates of revenue effects of possible changes. Omission of later public spending information partly function of celerity in bringing out first Autumn Statement. Can be expected to evolve and develop over future years. Statement already offers much fuller picture than in past.

BULL POINTS As at 8.11.82

(i) Activity. Underlying level of output broadly flat since last Autumn but industrial and manufacturing output above levels spring 1981. Most recent major independent forecasts see prospect of modest recovery later this year and next.

(ii) Interest rates. Bank base rates have fallen 7 points since last autumn (now 9 per cent). Lowest level for almost four years. Recent falls reflect several factors:- single figure inflation, M1, £M3 and PSL2 developing favourably in relation to 8-12 per cent target, Government borrowing under control, exchange rate firm.

(iii) Inflation. The increase in the RPI over the 12 Months to September was 7.3 per cent. This is the lowest since September 1972 and about a third of the peak in May 1980. The September level of prices is no higher than June and actually below the August level - the first fall since August 1970. Forecast of annual rate RPI inflation 6½ per cent by end of 1982 and prospect of 5 per cent by Spring of 1983. Manufacturers' output prices up 7½ per cent in year to October.

(v) Costs.

- Increase in average earnings halved in 1980-81 pay round. Public sector pay in line. Further moderation in average level of settlements in 1981-82 round. CBI pay databank for manufacturing settlements suggests average around 7 per cent compared with 9 per cent in 1980-81 round.
- Manufacturers' unit wage and salary costs up only 4 per cent up in year to Q3, below average of major competitors.
- Manufacturers' input prices up almost 3½ per cent in year to October.
- CBI October survey still shows lowest degree of unit cost pressures for 15 years.

(v) Manufacturing productivity. Output per head has risen about 13 per cent since end 1980. Output per head and output per hour now about 6 and 9 per cent higher than previous peak in 1H 1979.

(vi) Competitiveness. Cost competitiveness improved by 10-15 per cent during 1981 reflecting pay moderation, higher productivity and exchange rate fall, but remains $^1/_3$ worse than in 1975.

(vii) Profits: Industrial and commercial companies' gross trading profits (net of stock appreciation, excluding North Sea) risen 16 per cent in 1H 1982 compared with 1H 1981. Recovery in profits from very low base: pre-tax real rate of return of ICC's (excluding North Sea) only 3 per cent in 1981.

(viii) Housing starts (total) - up over a quarter in first nine months of 1982 compared with same period 1981.

(ix) Exports (non oil, excluding erratics) only 2 per cent lower in 12 months to September 1982 than in 1980, despite earlier substantial loss of competitiveness.

(x) Special employment measures. Total provision for special employment schemes planned to reach £1½ billion in 1982-83. Further measures announced end-July - new community work programme (started October), job splitting subsidy schemes (from January 1983).

(xi) Overseas investment in UK: US direct investment in Britain amounted to stock of over $14 billion in 1980. Nearly 60 per cent of all US outward non-oil direct investment now takes place in EC - over half of that in UK. Half of all Japanese investment in the EC also comes to Britain. Investment intentions survey of 231 German owned companies in the UK shows great majority intend to expand here in the near future.

(xii) Overseas debt repayments. Official external debt reduced from over $22 billion in May 1979 to around $12½ billion at end-September 1982.

Economic Briefing Division, HM Treasury, 01-233 5514/5503

B ECONOMIC ACTIVITY AND PROSPECTS

1. Industry Act Forecast in Autumn Statement

[See Table at Annex]

Although recovery has been hesitant this year it should gather pace in 1983: about 2 per cent growth through the year. All outside forecasts (some rather dated) expect recovery to continue in 1983; consensus has been for year-on-year growth over 2 per cent. Domestic activity this year held back by stalling in world recovery; improvement generally expected for 1983, particularly in US. Inflation has come down much faster than expected. Now confidently predicted to be 6 per cent in Q4 (9 per cent in Budget forecast) and 5 per cent next year (7½ per cent in mid-year in Budget). Wage settlements are expected to decline further over next 12 months. [No forecast given but GAD Report assumes 6½ per cent earnings growth between 1982-83 and 1983-84, against 9 per cent in previous year.] Productivity growth still fast (level of output per head in manufacturing now 13 per cent above end-1980). Consumers' expenditure (particularly retail sales) now increasing again after three flat years - up 1½ per cent in Q3. With falling inflation, lower interest rates and possible fiscal adjustment, expect 2½ per cent growth 1982 to 1983.

2. Recent output figures

[Latest GDP figures (all three measures) suggest any growth in economic activity in H1 1982 over H2 1981 was slight, but output about 1 per cent higher than in Q2 1981. Industrial production in three months to July unchanged compared with previous three months once adjustments made for holidays in May and June. Underlying level of industrial output 1½ per cent above 1981 Q2 trough - largely attributable to North Sea oil. Trend in manufacturing activity at best flat and may be deteriorating.]

Prospects for recovery this year undoubtedly receded since Budget partly because world recovery has not materialised. But rapid progress on inflation and interest rates, and productivity is higher. Beginnings of recovery in industrial competitiveness must not be undetermined. Industry's contribution to sustaining recovery is decisive; must be ready to meet (modest) recovery in world activity expected next year (see T1).

3. Other evidence of improvement in economy?

See Bull Points (following Section A).

4. Latest CBI assessments?

[CBI October Trends Enquiry shows less optimism on general business outlook and export prospects over next 12 months (optimism net balance fell from minus 22 in July to minus 28 in October). Orders and output have fallen and most (94 per cent of participants) see orders constraining future output. Stock reductions continue and investment intentions have weakened again. Most exporters expect prices to limit new orders. Cost and price pressure remain low, and company liquidity may inprove slightly in next six months. CBI August forecast suggested GDP growth next year of 1-1½ per cent; more recently, CBI emphasising lower end of range.]

Results of October Survey certainly disappointing. But deterioration in optimism, and immediate outlook (next four months), not unexpected and probably reflect in part very depressed level of activity, at home and overseas, this year - much more depressed than expected in spring. Survey not entirely gloomy - favourable developments continue in unit costs and price expectations; firms' liquidity also expected to improve. Prospect remains for renewed modest recovery next year.

5. New orders figures depressing?

[New construction orders in August fell by 22 per cent from around £450 million to £350 million (at 1975 prices) compared previous month. In three months to August, orders fell 6 per cent compared previous three. Volume of new orders in engineering industries fell 9 per cent in three months to July compared previous three.]

Figures manifest depressed economic activity which itself partly reflects flatness in world trade.

6. 80 per cent of extra consumer spending going on imports?

[S Brittan FT 28 October]

This greatly exaggerates the position. May be true for (some) manufactured goods, but for many items of consumer spending - eg housing, services - import content very low.

7. Fall in investment and reduction in stocks?

[Capital expenditure by the manufacturing, distributive and service industries in Q2 1982 4 per cent lower than level in previous quarter. Investment in manufacturing in H1 1982 was 3 per cent lower than in Q4 1981. Stocks fell by £30 million ('75 prices) in Q2; but in the first half of 1982 stocks increased by £100 million compared with destocking of £520 million in second half of 1981. CBI October survey shows for second successive survey, decline in investment intentions.]

Figures another manifestation of hesitation in economic activity. Despite this, some categories of investment, notably plant and machinery, have held up quite well. [IF PRESSED: latest DOI investment intentions survey shows slight fall in manufacturing investment between 1981 and 1982; Q2 figure not inconsistent with this.]

8. Stock levels a threat to recovery?

Falling interest rates (nominal rates lowest for four years) have eased cash pressures and should assist recovery in stock cycle.

9. Competitiveness not improved this year?

Competitiveness improved 10-15 per cent during 1981 [but remains one third worse than in 1975]. Further improvements, which are essential to regain markets and create new ones, depend above all on substantially lower wage settlements in this pay round than in the last one.

10. Productivity growth falling off?

No; productivity growth in manufacturing up 4½ per cent over last year, and 13 per cent up on end-1980, is well above UK historical average.

11. CSO's index of leading cyclical indicators?

Longer leading index rose again in September reflecting further falls in interest rates and an increase in share prices. Shorter leading index also rose in July and August. Taken with other indicators - including lower inflation and interest rates - these changes are encouraging pointers to future recovery.

12. Outside forecasts

[GDP profile in recent major assessments:

Per cent change

	Phillips & Drew (Nov)	Simon & Coates (Oct)	CBI (Aug)	St James (Aug)	OECD (July)	LBS (Nov)	NIESR (May)	IAF (Nov)
1982 on 1981	+½	+½	+½	+1¼	+1¼	+¼	+1	+½
1983 on 1982	+¾	+2½	+1½	+2½	+1¾	+3	+1	+1½

Nearly all see prospect of continued recovery and lower inflation.

ANNEX TO B

ECONOMIC PROSPECT: NOVEMBER IAF

	Percentage change		
	1981 to 1982	1982 to 1983	Average errors from forecasts, relevant for 1983
A Output and expenditure at constant 1975 prices			
Gross domestic product (at factor cost)	½	1½	± 1
Consumers' expenditure	½	2½	± 1½
General government current expenditure	2	1	± 1½
Fixed investment	3	5	± 2½
Exports of goods and services	-1	0	± 3
Change in rate of stockbuilding as a percentage of GDP	2	½	± 1
Imports of goods and services	4½	5	± 3
	1982	1983	
B Balance of payments on current account (£ billion)	3½	0	± 3
C Retail prices index (4th quarter to 4th quarter)	6	5	± 3

C LABOUR MARKET

1. Government concerned over unemployment?

Of course Government concerned; so pursuing balanced fiscal and monetary policies to curb inflation and creating conditions for enterprise - only measures that will ensure sustainable increase in employment. Nevertheless has substantially increased spending on schemes to alleviate impact on especially vulnerable groups.

2. Extent of help?

Government plan to spend £1½ billion in cash in 1982-83 (40 per cent more than in 1981-82) on special employment and training measures (including new Youth Training Scheme costing £1 billion a year from 1982-83); new community programme, designed to provide up to 130,000 places for long term unemployed; and new Job Splitting Subsidy (open on 1 January next year) to encourage extension of part time work and provide additional opportunities for productive jobs for unemployed people.

3. Recent unemployment figures and other labour market indicators?

[Underlying trend in unemployment has deteriorated since Q2, but October figures a little more favourable than of late. Because of seasonal factors, no further sharp rise in 'headline total' expected till January. Recent unemployment/vacancy figures shown below:

	1980 Q4	1981 Q1	Q2	Q3	Q4	1982 Q1	Q2	Q3	Oct
'Total' unemployment	2.16	2.46	2.59	2.93	2.96	3.04	3.01	3.28	3.30 (13.8% rate)
UK adult sa unemployment (millions)	2.02	2.28	2.48	2.64	2.75	2.82	2.88	2.98	3.06 (12.8% rate)
increase in period (000's) monthly averages	+105	+77	+62	+51	+33*	+21*	+30*	+42	+23*
Vacancies (000's)	99	98	89	96	104	112	107	111.0	112

*After allowing for over 60's transferring to supplementary benefit.

Other labour market indicators (e.g overtime, short-time) roughly flat for last 6 months.]

October figures cannot provide indication of future trends but are nonetheless welcome. Level of unemployment still tragic, but problems took a long time to build up will also take a long time to check or reverse. Recent figures reflect levelling out in activity since last autumn. Looking further ahead, lower inflation and interest rates, and improved industrial competitiveness should help promote economic recovery and create climate for sustainable jobs.

4. CBI's ideas for reducing unemployment?

[Report of Cave Committee presented to CBI Conference proposes strategy based on increasing economic growth; encouraging efficient labour-intensive sectors e.g. construction, tourism; increasing work opportunities e.g. by job splitting, phased retirement, short-time; reducing size of labour foce e.g. voluntary early retirement, youth training. Claims to reduce unemployment by 1-1½ million.]

Interesting contribution - will stimulate public debate. Group has more work to demonstrate how this package relates to CBI's other policy recommendations. 1-1½ million reduction in unemployed very optimistic; almost half estimated effect due to measures already announced.

5. Unemployment in UK higher than in other countries?

[On standardised definitions in Q2 1982 UK unemployment was 12.7 per cent compared with 8.1 per cent OECD rate; little over doubling for UK compared with OECD rise of over one half since 1979.]

Unemployment now rising sharply in many industrialised countries - in last three months number unemployed (on national definitions - not strictly comparable) rose much more in Canada (up by over 20 per cent), Holland (9 per cent), Ireland (8 per cent), Germany (7 per cent) than in UK (4 per cent).

6. UK's true unemployment figures really much higher?

No one seeks to deny there are unregistered unemployed but reliable estimates of their numbers are difficult to obtain. Available estimates vary quite widely. Figures of registered unemployed are based on accurate counts, have been accepted by successive administrations and provide reasonable estimates of trend.

7. Cost of unemployment/Effect on PSBR?

There can be no single estimate of 'the cost of unemployment'. Only costs that can be at all readily identified are additional expenditure on unemployment benefit, supplementary benefit, rent and rate rebates and administration. (Even these dependent on characteristics of those becoming unemployed - family status, resources etc). These could average £1800 in 1982-83 for each additional registered unemployed person. (NB This cannot be multiplied up by the total number unemployed.)

[IF PRESSED: Estimates of effect of other influences on PSBR directly or indirectly associated with unemployment vary widely depending on large number of highly debatable assumptions. And a major change in the level of unemployment would have impact on other economic indicators effective in the calculation of PSBR.]

8. Unemployment expected to continue rising rapidly?

Unemployment forecasts uncertain; independent forecasters encompass differing views for 1983 - several projecting stabilisation, some [a slight] decline. Though there has been a worsening in the underlying trend in unemployment since June this year, rise for year as a whole has only been some 40 per cent of rate over same period last year. Employment situation should benefit from some further recovery in activity.

9. Fiddling the statistics?

[Rayner cost-saving exercise means that from November onwards method of measuring unemployed will change. November count will be some 100,000 lower than on traditional measure. Even further reduced in summer when school leavers register.]

No question of a fiddle. Detailed and considered study revealed substantial savings on collecting statistics for registered non-claimants. D.Employment will be providing estimates of effect on past statistics, and will provide similar information for up to a year from the change.

10. What is Government's own forecast of unemployment?

No forecasts given in IAF for unemployment. Paragraph 1.02 of Autumn Statement says: 'Unemployment has been rising in the UK, and in most other countries, over the past two years. But some recovery in output and profitability in the course of 1983 should help to moderate further increases'. Government Actuary was instructed to assume that number of unemployed in Great Britain, excluding school leavers etc, would average 2.9 million in 1982-83 and 3.2 million in 1983-84, (or just under 3.4 million including school leavers).

11. Employment continuing to fall?

[Total employment declined 2.4 million (10½ per cent) between mid 1979 and Q2 1982. Decline of 94,000 in 1982 Q1 increased to 189,000 in 1982 Q2. Manufacturing employment in August fell 35,000 to 5,531,000 (compared 5,871,000 in August 1981).]

Only way to achieve permanent jobs is sustainable recovery, based on improved industrial competitiveness lower inflation and lower interest rates. Substantial provision (£1½ billion) being made to help most vulnerable groups (see C2 above).

12. Recent productivity gains inimical to higher employment/lower unemployment?

[Output per head in manufacturing up 12 per cent since end-1980.]

This may be true in the short run. But in the longer term, as experience in UK, Japan and many other countries clearly demonstrates, higher productivity essential for growth and employment opportunities.

D TAXATION

1. Burden of taxation

[Total taxation (including NIC) as proportion of GDP was 34½ per cent in 1978-79 and is forecast to be 39¾ per cent in 1982-83. Corresponding figures excluding NIC are 28½ per cent and 33 per cent].

Burden has inevitably risen because of upward pressures on public expenditure caused by the recession. Increases in taxation are better - and more honest - means of financing this than borrowing, because of adverse effects borrowing has on interest rates and inflation.

2. British tax burden high by international standards?

Not so. Accurate comparisons difficult, but UK burden about average for OECD countries [1981 data from Lloyds Bank Economic Bulletin, October 1982]. Similarly, UK taxes on household income and employees' social security contributions about average for EC countries and lower than Japan and USA [1980 provisional OECD data].

3. Autumn Statement

Chancellor on 8 November announced proposals for further reductions in NIS which should be welcomed by industry: another ½ per cent for 1982-83 and 1 per cent for 1983-84 to bring the rate down to 1½ per cent. Less than half the 3½ percent level inherited from Labour. Each 1% reduction worth some £700 million pa to private sector.

4. NIC announcement

NICs not taxation but contributions giving entitlement to specific benefits. Held down the increase below what would have been required fully to balance the fund.

5. Combined effect on taxpayer/contributors?

Effect on living standards and tax burden will also depend on income tax decisions to be taken in 1983 Budget.

6. Prospects for cuts in taxation in 1983 Budget?

NIS and NIC decisions do, of course, reduce scope for tax reductions in next Budget though sticking to public expenditure totals helps. Decisions for 1983 Budget, both in PSBR and particular tax changes, will not be made for several months yet.

7. Future of married man's personal allowance?

[Labour party commitment to phase out in favour of increased child benefit etc; reported SDP proposals to abolish as part of new tax-credit scheme to assist lower paid.]

Government launched debate with December 1980 Green Paper on Taxation of Husband and Wife. Very wide range of views received, which government is considering. Abolition of married man's allowance advocated in some quarters would affect many millions of taxpayers and by itself leave a basic rate taxpayer £5 a week worse off. Abolition makes the poverty and unemployment traps worse for some people.

8. SDP plan to abolish poverty trap?

Would like to see proposals published: at the moment we only have 'leaks': seems to be a scheme costing £4 billion which still leaves marginal tax rates, for people in the poverty trap, of 80-85 per cent. A comprehensive solution to the problem along tax credit lines might cost towards £10 billion.

9. Government unconcerned about poverty and unemployment traps

[Incidence of 40-50 per cent marginal tax rates given in reply to PQ 25 October to 315. IEA document reported in Press 1 November claims 5½ million adults at risk from the traps.]

Do not accept that numbers are that high. But concerned about poverty and unemployment traps, in context of incentives as a whole. They will remain a key factor in considerations of future tax policy. Traps are essentially caused by measures to relieve poverty and unemployment. Substantive action to alleviate them through the tax system would be extremely costly. Long-term solution must be an increase in wages as a result of a sustained improvement in productivity and economic performance.

10. Burden of taxation risen most for the poor?

Proportion of income paid in income tax and NICs has fallen in 1982-83 for lowest paid taxpayers. Low paid with children are also entitled to benefits such as FIS.

11. Previous reductions in personal taxation favour the rich?

1979 Budget cut absurdly high top rates of income tax to European levels, as part of package which also involved substantial increase in thresholds. Such action was essential to restore incentives. No 'pot of gold' in higher rate tax; restoration of 83 per cent top rate would finance a cut of under ¼p in the basic rate.

12. Why should private schools enjoy tax reliefs?

Fully in favour of private schools. Tax relief per pupil minor by comparison with cost of state education. It would cost taxpayer £500 million a year to educate in the State system the ½-million or so pupils now in independent schools. [IF PRESSED: tax reliefs difficult to cost but probably worth up to £40 million a year plus around £100 million for exempting fees from VAT.]

E PUBLIC EXPENDITURE AND FINANCE

[Total spending of £120.1 billion in revised plans for 1982-83 announced 8 November. Compares total of £120.7 billion in 1982-83 in Cmnd 8494 published 9 March, adjusted for Budget (and other minor changes). Revised plans for 1984-85 and 1985-86 will be published in next Public Expenditure White Paper in late January/early February 1983. Plans now announced are firm. Precise figures may change slightly between now and White Paper in light of more detailed calculations. Contingency Reserve will also be reviewed before White Paper finalised.]

PUBLIC EXPENDITURE 1982-83 AND AUTUMN STATEMENT

1. How do revised plans for 1983-84 compare with those previously announced?

Outcome of annual review of public expenditure plans has been to hold planning total within previously announced plans. First time this has happened since 1977. Unlike 1977, Government not forced to hold to plans by outside intervention of IMF.

2. What is change in real terms?

Small fall in expenditure in 'real' (cost) terms now planned for 1983-84 compared with 1982-83 plans. [NB cost terms means cash adjusted for general level of inflation as measured by GDP deflator]. No 'volume' (constant price) figures available.

3. Cuts in services?

Decision to contain expenditure has inevitably meant reductions in some programmes to compensate for increases in others. But Government's success in reducing inflation and interest rates has made it possible to accommodate such changes without major cuts in services.

4. Hasn't Government gone too far in reducing public expenditure?

Still planning for an increase (£5½ billion) between plans for 1982-83 and 1983-84. Reduction below Budget-time plans largely accounted for by two factors: £400 million benefit from NIS clawback: revised forecasts of receipts from special sales of assets. When effect of these discounted, Government has held closely to its previous plans.

PUBLIC EXPENDITURE - GENERAL

5. Ratio of public spending to GDP

Ratios in 1980-81 (43 per cent) and 1981-82 (44½ per cent estimated) remain below level of 1974-75 and 1975-76 (46 per cent in both years). Rise in ratio in 1981-82 compared 1980-81 mainly reflected higher expenditure on social security at a time when real GDP falling. Ratio expected to fall in next few years. Autumn Statement gives figures of 45 per cent in

1982-83 and 44 per cent in 1983-84. [IF PRESSED: If shortfall in 1982-83 allowed for in table 1.6 of the Autumn Statement - but not explicitly mentioned - is included, than 1982-83 ratio becomes 44½ per cent.]

6. Figures quoted in Weekend World programme 10 October?

[Ratio of public expenditure planned for 1982-83 to GDP in that year given in Weekend World programme was 46.8 per cent. Apparently derived (incorrectly) by someone at ITV taking from the FSBR the wrong numerator for the ratio. They took it from Table 8. The correct figures were given in the FSBR at para 2.21, and a reconciliation set out in Table 6.]

Figure of 46.8 per cent shown on Weekend World for 1982-83 based by them on incorrect calculation. At Budget time, the estimated ratio of public expenditure to GDP in 1982-83 was 44.5 per cent.

7. Increase spending in recession?

No good trying to spend way out of recession. Any benefits would be short-term. If increased spending not financed responsibly, would soon lead to more inflation. If financed prudently, would lead to higher interest rates and/or higher taxes. We are responding, within limits of prudence, to needs of current circumstances.

8. Capital spending in public sector?

Government's policy is that provision made for capital expenditure both in central government and local authorities, should be fully spent, subject to the normal prudential margin. (Of course always necessary to take account of implications for future current running costs - and interest). In nationalised industries, criterion is that capital expenditure should show an adequate return. (See also E13-14 and R9).

9. Cut public sector pay bill/administrative costs of central government?

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. Provision for public service pay increases 1982-83 limited to 4 per cent. Administrative costs are not far short of 10 per cent of total public expenditure. We are determined to reduce that proportion, and to maintain drive for more efficient management throughout public sector.

10. Cost of pay rises for public servants - equivalents in public spending programmes?

Every 1 per cent extra on pay for public servants (excluding Nationalised Industries) costs £335 million - the approximate equivalent of two frigates, 50 Harriers or about 70 miles of motorway.

11. What allowance will Government make for pay increase in public services next year?

Government attaches great importance to realistic wage settlements next year, in both public and private sectors. Provision for public service pay will be made from within cash plans.

12. 3½ per cent pay assumption for 1983-84?

[Announced from Treasury 10 October.]

Assumption is not a 'norm'. Nor is it a decision on the offer to be made in any particular case. Each will be considered on its merits. It concerns the provision in public expenditure plans for next year for those groups for which Government is directly responsible, other than NHS. It does not directly cover local authorities, or nationalised industries, which are not within Government's direct control. But they will be controlled by the rate support grant and the external financing limits.

LOCAL GOVERNMENT

13. LA capital underspending and measures to prevent recurrence in 1983-84

Following underspend of more than £¾ billion in 1981-82, local authorities seem set to underspend their capital cash limits for 1982-83 by at between £1 and £1½ billion (GB figures). Some steps in hand to reduce the underspend: Prime Minister is writing to local authority associations, and extra allocations will be given to authorities who can use them.

14. LAs cannot increase capital spend because of revenue consequences?

Plans for relevant LA current expenditure allow for financing costs of full planned capital programme. Many capital projects have no immediate running costs eg roads, reclamation of derelict land. Others will reduce running costs by rationalisation. LAs would be able to afford running costs of worthwhile investments if curbed wasteful expenditure and held down pay settlements.

15. LA current overspending in 1982-83

Budget returns from LAs indicate overspend of over £1 billion on current expenditure is under way. Secretaries of State have announced intentions to abate rate support grant to overspenders in response. (For details, refer to statements in Parliament 27/28 July by Secretaries of State.)

16. Local government finance 1983-84?

[Refer to Autumn Statement.] Plans for LA current spending have been increased by over £1 billion to ensure that they are realistic. Only some £270 million of this increase will be allocated to service programmes·the rest will be included in expenditure targets as it represents an extra provision which the Government does not consider desirable, but which has been included to make plans realistic in relation to this year's overspend.

17. Rate increases implied by plans?

What happens next year depends on what LAs decide to spend. If LAs comply with their expenditure targets, rate increases need only be very modest overall, and in some areas will be no need for any increase. Of course, if LAs decide to overspend, the rate burden they have to impose will be higher, and they may lose rate support grant if they exceed targets.

18. Holdback of RSG in 1983-84 ?

Refer written Answer from Environment Secretary (Hansard 4 November) announcing options for holdbacks in England. Consultation with LAs underway (also in Scotland and Wales). Schemes adopted will depend on outcome of consultations.

19. Green Paper on Domestic Rating System: Government response?

Carefully considering representations. Need scheme to run that will remedy shortcomings of present rating system which will command widespread support. Taking account of pleas from industry, business, etc.

FALKLANDS EXPENDITURE

20. Falklands defence costs?

[Answers given by PM 26 October OR cols 885-6; Defence Secretary 28 October OR cols W 453-4.]

Latest assessment of costs of operation, and of replacing equipment lost during the conflict, is about £700 million in current year; over next three years the cost will be £200 million, £350 million and £320 million respectively. Decisions have yet to be taken on size (and thus cost) of garrison.

21. Equipment replacement costs

Defence budget will be compensated in full for Falklands costs. This will include full replacement costs of new - and usually better - ships, aircraft and other equipment. In some cases (eg the four new frigates) Ministry of Defence are considering detailed design requirements before going out to tender.

22. How will the various costs be met?

Extra costs in current year will be met from Contingency Reserve. For 1983-84, an increase to be Defence Budget of just over £620 million has been announced. Future years' provision will be announced in the 1983 Public Expenditure White Paper. Extra defence costs will be met out of monies additional to path of annual real growth of 3 per cent.

23. What will be costs of repairing damage and reconstructing the Islands' economy?

Too soon to say what these costs will be. Work has begun on restoration of essential services and on implementing Civil Commissioner's recommendations for priority action (accommodation, inter-Islands air service, education). Up to £10 million is being made available for this. Not yet able to say whether these costs will require additions to existing FCO and ODA funds and how far additional sums will be needed. Ministers studying Shackleton Report proposals for long term development of Islands; in advance of decisions, impossible to say what costs will be.

[BACKGROUND WHICH CAN BE DRAWN UPON: Estimates of cost given in the Report are £31-36 million for new development aid; £40 million for offshore fishing; up to £12 million for additional housing/infrastructure. Total estimate of £83-89 million (at 1982 prices) excludes aid for rehabilitation and compensation for war damage already being made available.]

24. Cost of paying compensation for war damage?

Too soon to say what total will be. Claims are being processed, and further claims may be received. About £1 million has so far been paid out, but this is no guide to what the final total might be. Not yet clear whether the compensation scheme will require an addition to existing FCO programme.

F CIVIL SERVICE STAFFING AND PAY

1. Civil service too big/does too much/is over staffed?

Since Government came to office, Civil Service has been reduced by 10 per cent to 659,300. Results from reduction in functions, privatisation and improvements in efficiency. On course to achieve aim of having Civil Service of 630,000 by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean smallest Civil Service since end of Second World war.

2. Civil service efficiency?

[Government reply to TCSC was published 28 September entitled 'Efficiency and Effectiveness in the Civil Service Government Observations on TCSC Report Cmnd 8616].

Measures to increase efficiency in civil service set out in Government's recent White Paper welcoming Report from TSCS, and accepting (totally or with reservations) no less than 20 of the Committee's 26 recommendations. White Paper gives details of new financial management initiative, and responds to Committee recommendations on management information systems, training in management and financial management, and the filling of senior posts.

3. Civil service pay in 1983?

Unions have asked Government, in light of 3½ per cent planning assumption announced 1 October (see E 12), whether Government intend to have genuine negotiations, and whether arbitration will be available. They believe arbitration should be unconditionally binding ie not subject to Parliamentary over-ride.

4. Megaw Report

[MST speech Harrogate 21 October].

Report of Megaw Inquiry into arrangements for deciding civil service pay in future (Cmnd 8590) contained number of important recommendations which are now being considered. Government pleased with widespread support that has emerged for the general approaches which the Inquiry endorsed. Preliminary 'ground-clearing' discussions with unions have commenced. Not likely new system can be agreed in time for 1983 pay.

4. Scott Report/Public sector pensions?

See K 20.

G SOCIAL SECURITY

1. National Insurance contributions?

Outcome of the annual review of national insurance contributions was announced by Chancellor in Autumn Statement on Monday 8 November, and more detail given by the Social Services Secretary and in Report of the Government Actuary later the same day. (Briefing on this subject, including effects on employers and on individuals, contained in separate Brief on Autumn Statement.)

2. Social Security benefits up-rating

Outcome of the annual review of public expenditure as it affected 1983-84 was announced by Chancellor in Autumn Statement and in more detail by Social Service Secretary later same day. (Briefing on this subject contained in separate Brief on Autumn Statement.)

3. Occupational pensions - increase supervision?

[Recent report by Occupational Pensions Board recommending, inter alia, disclosure of information to pension fund members; end to 'franking' (whereby schemes implement requirement to maintain value of guaranteed minimum pension only by eroding accumulated pension rights above that minimum).]

Government welcome recommendations of OPB. Accept in principle need for legislation on disclosure of information to members of pension funds. Social Services Secretary will be consulting interested parties about content. He also hopes to bring forward in first half of next year regulations to prohibit practice of 'franking'.

4. Death grant - increase to realistic level?

[Consultative document about death grant published 3 March, deadline for comments 30 July.]

Social Services Secretary grateful for comments received on consultative document on death grant published in spring and is considering them carefully.

5. Cost of social security proposals in 'Labour's Programme 1982'?

[Proposals include raising single/married pension to one-third/half of average earnings; reducing pension age to 60; increasing Child Benefit to £7.75; paying unemployment benefit for men, without limiting duration, at rate equal to RP.]

Cost of implementing Labour's proposals in full probably over £20 billion in full year - an increase of over 60 per cent in social security programme. Labour proposes revenue increases to finance changes of less than £4 billion (abolition of married man's tax allowance and of upper earnings limit of contributions). To raise remainder would require, for example, rise in employee's NIC from 8.75 per cent to around 22 per cent; or rise in basic rate income tax to 46p in £.

H FISCAL POLICY AND THE PSBR

1. Progress on fiscal policy?

[Aim is to achieve reduction in PSBR as percentage of GDP over run of years, so as to achieve lower inflation and interest rates.]

Have made progress; Government has succeeded in reducing PSBR as percentage of GDP, and further reduction is projected. Inflation has fallen fast and is expected to fall further (see K2-3). Long term interest rates now lower than at any time in last 9 years. Benefits seen in recovery of debenture market. [IF PRESSED: Government would like to see rates lower still, so long as further reductions not likely to endanger progress or inflation.]

2. How does UK fiscal stance compare with other countries?

[IMF Annual Report noted that among major industrial countries by far the largest 'restrictive shift' over past two years, equivalent to more than 3½ per cent, was that of UK.]

Many countries reducing borrowing; UK budget deficit now well below average of OECD countries. ~~France~~ demonstrates problems with reflation option and US experience shows that fiscal and monetary policy must be broadly consistent.

3. 1981-82 undershoot shows fiscal policy too tight?

[PSBR for last year turned out £1.8 billion lower than estimate of £10.6 billion given in 1982-83 FSBR.]

Last year's undershoot probably does mean fiscal policy somewhat tighter than planned, but must examine strategy as a whole. Firm control of Government borrowing one factor responsible for fall in short term interest rates (7½ percentage points down since last autumn). Recovery of corporate bond market shows how lower PSBR creates room for investment.

4. Why treat PSBR as crucial statistic when prone to very substantial forecasting error?

[Margins of error are wide: plus or minus £4 billion.]

Although forecasting PSBR is hazardous, this in no way diminishes importance of achieving better balance between Government spending and income. Recognised by all Governments, whatever the difficulties of forecasting.

5. Why 1982-83 PSBR now expected to be lower than FSBR forecast?

[1982-83 FSBR forecast £9.5 billion. Industry Act Forecast (IAF) published 8 November £9.0 billion.]

It is only slightly lower, particularly in context of plus or minus £2 billion forecasting errors at this time of year. North Sea tax receipts are now higher and local authorities' capital expenditure lower than thought at time of FSBR. Some factors went other way: e.g. local authorities' over-spend on current expenditure.

6. How can Industry Act forecast of £9 billion PSBR in 1982-83 be reconciled with seasonally adjusted outturn for first half of year?

[Seasonally adjusted, PSBR April-September £3.0 billion. Commentators may multiply this by two to get £6 billion as PSBR figure for year as whole.]

It would be wrong to multiply seasonally adjusted half-yearly outturn by two as there are many erratic and irregular influences in the underlying data which seasonal adjustment does not pick up (nor is it meant to).

[IF PRESSED: what factors will increase PSBR in rest of year?

Public corporations expected to borrow more in second half of year than their £0.4 billion to end-September; there are a number of outstanding public sector pay awards which have not been implemented (eg nurses); National Insurance up-rating of 11 per cent, higher than present rate of inflation, will affect second half of year.]

[CONFIDENTIAL NOT FOR USE: recently-decided measures on revenue and expenditure are intended to make PSBR £1½ billion higher than it would have been otherwise. IAF allows for this.]

7. PSBR seriously undershooting and Government has been forced to inflate the economy?

No. PSBR was not seriously undershooting. There are a number of factors which are likely to increase PSBR in second half of year.

8. Why has Government cut PSBR for 1983-84?

[IAF figure of £8 billion for 1983-84 comapres with £8½ billion in this year's MTFS.]

PSBR figures in IAF and MTFS for 1983-84 are not targets. The actual plan will depend on judgement taken in next Budget. Both PSBR figures are same percentage (2¾ per cent) of money GDP. Reduction in money GDP forecast since March merely means that this implies £8 billion rather than £8½ billion.

9. Cyclically adjusted PSBR better guide to policy?

Government fiscal policy has taken account of recession. Acid test of PSBR is level of interest rates at which it can be finaned, not its value at some hypothetical cyclically adjusted level of output.

10. Inflation-adjusted or 'real' PSBR in surplus - isn't fiscal policy too tight?

['Real' PSBR subtracts from actual PSBR erosion by inflation of real value of Government debt. Calculations by Bank of England and others produce a surplus 'real' PSBR in most years since the 60's].

No. Fall in inflation has raised the 'real' PSBR (because the 'inflation tax' is reduced). Real PSBR is interesting indicator but poor guide to setting policy e.g. suggests raising PSBR when inflation accelerates.

J MONETARY AND FINANCIAL POLICY

[NB Provisional money figures for October to be published on Tuesday 9 November (likely to be distorted by sale of STC).]

1. Monetary growth in 1982-83 on target

[The target aggregates M1, £M3 and PSL2 grew by 1.2, 1.1 and 0.9 per cent respectively in banking September. These changes bring rates of growth in the 1982-83 target period to 9½, 11½ and 8½ per cent per annum respectively, compared with target range of 8-12 per cent (all figures seasonally adjusted).]

Rates of growth of all three target aggregates are within Government's target range. £M3 is towards top of range. But looking also at behaviour of exchange rate and progress in reducing inflation, overall picture is of sound domestic monetary conditions.

2. Prospects for further reductions in interest rates?

[Latest reduction in bank base rates made on 4 November - to 9 per cent. Have come down by 7 points since peak in October 1981. Long term interest rates also reduced significantly -by one point in October alone - 6 points since peak last year.]

Substantial interest rate reductions this year reflect sound monetary conditions, and good inflation prospects. Impulse also from US developments. Government would like to see rates lower still, so long as further reductions do not seem likely to endanger progress on inflation.

3. Benefit of interest rate falls to home buyers

Mortgage rate falls mean for average couple buying first home saving of over £20 a month.

4. Effect of US interest rates on ours?

[US rates fell substantially during July/August, and again in October.]

The falls in US rates were helpful and facilitated reductions in our own. But of course US rates are not sole determinant of UK's, and this spring progress was made in reducing ours at a time when US rates were rising. UK rates are determined in the light of domestic monetary conditions generally, including the behaviour of the exchange rate.

5. Monetary conditions too tight - stifling recovery?

No. Behaviour of exchange rate and money supply suggest financial conditions moderately restrictive, as intended. Interest rates reductions have cut companies' costs and should promote climate for investment. Have given boost to corporate bond market - reducing companies' dependence on banks and easing pressure on monetary growth.

6. Bank lending growing too fast?

[Lower growth rate in May/June not maintained. Increased by £1.3 billion in banking August and £2 billion in September (seasonally adjusted).]

Reasons for growth of bank lending to companies not entirely clear. Companies may be trying to build up gross liquidity levels which fell back in spring. Strong growth in personal lending is partly result of structural changes, such as move by banks into home loans market, replacing lending by building societies; ending of HP controls in July does not appear to have had a large effect. To the extent that increases in bank lending are additional, ie not just in substitution for lending by eg building societies, do represent potential cause for concern, as add to monetary growth. To be taken into account in interest rate policy.

7. Prospects for reactivation of corporate bond market?

[Tax treatment of 'zero coupon' and 'deep discount' stocks and removal of embargo on company issues of this type of stock announced 25 June. BOC announced issue of £100 million conventional bond 10 September, followed by other companies.]

Zeros broaden options available to companies, though not expected to transform capital market. Best hopes for resurgence of market provided by lower interest rates and inflation, for which we are on course.

8. Why has Bank of England been providing such large-scale money market assistance?

The rapid growth of bank lending has caused problems for conduct of monetary policy. By selling long-term Government debt on a larger scale outside the banking system, it has been possible to contain the rapid growth in money which could otherwise have taken place. This in turn has created shortages of liquidity in money markets. If Bank had not intervened, short-term interest rates would have been forced up to unnecessarily high levels.

9. What is significance of National Loans Funds surplus with Banking Department last week? Result of over-funding?

[A balance is accumulated at the Banking Department of the Bank of England when flows into NLF exceed flows out and there are no further Ways and Means Advances borrowed from the Issue Department to be repaid]

Need for a balance reflects many factors. Major ones have been low Government borrowing requirements earlier in year together with continuing sales of Government debt, and underlying decline in the reserves (recently reversed in part). Flow of debt sales of all kinds have been high in recent months but by no means exceptional, having regard to level of bank lending.

K PRICES AND EARNINGS

PRICES

1. September RPI

[Year on year increase in RPI 7.3 per cent in September, compared with 8.0 per cent in August].

Annual rate of inflation fell sharply in September to 7.3 per cent, its lowest level for 10 years (compared 7.0 per cent in September 1972). The price level in September was no higher than in June and actually slightly (0.1 per cent) lower than in August - the first time the index has fallen for 12 years (since August 1970).

2. How low inflation by end 1982?

[Budget time forecast Q4 1981 to Q4 1982 9 per cent and Q2 1982 to Q2 1983 7½ per cent.]

We expect inflation to be at or below 6½ per cent by end 1982.

3. Further falls likely in 1983?

We expect inflation to be down to 5 per cent by next spring.

4. Inflation turning up again next year?

(Q4 1982)

We have forecast a figure of 5 per cent for price increase over the year to next autumn. No evidence at all for expecting resurgence of inflation.

5. No decline in inflation between spring and autumn 1983?

[Mansion House speech: 5 per cent by spring. Industry Act forecast: 5 per cent in fourth quarter.]

Obviously we cannot expect to maintain the very rapid progress on inflation which is now being made. What we will maintain are the policies which have given us this success; confident that they will keep inflation down.

6. Inflation lower than under previous Government?

[Average year-on-year rate of inflation between February 1974 and May 1979 was 15.4 per cent; average level of inflation since May 1979 has been 12.8 per cent.]

Year-on-year rate of inflation was 10.3 per cent and rising when previous Government left office in May 1979. Now (September 1982) 7.3 per cent and falling. We will be first Government for quarter of a century to achieve a lower average rate of inflation during its term of office than the previous Administration.

7. Inflation still not as low as competitors?

[UK inflation 7.3 per cent in September compared with 5.0 per cent in US, 4.9 per cent in West Germany, and (August figure) 3.2 per cent in Japan.]

UK inflation now lower than Western European (OECD Europe) average, and well below many countries - such as France and Italy. Still some way to go to match US, West Germany and Japan, but good progress being made in right direction.

8. Long term inflation objective?

Recent developments encouraging. But inflation rate still higher than some competitors e.g Germany. Múst not let up. Have always made it clear that price stability not unattainable.

9. TPI now shows pay increases need to be ½ per cent higher than RPI to maintain living standards?

[Increase in TPI over 12 months to September 7.9 per cent, compared with RPI increase of 7.3 per cent].

The gap between the RPI and the TPI (now 0.6 percentage points) widened in July when benefits paid to the unemployed became taxable. Pay increases go to people in work, who will not pay any more tax as result of the change - except for the minority who have a spell of unemployment during the year.

10. Nationalised industry prices

[Increase over 12 months to September 13.7 per cent, compared RPI increase of 7.3 per cent].

Increases regrettable, but holding prices down artificially would distort market forces and add to burden on taxpayer. Underlying position has been improving steadily for past year or so. But sustained improvement only possible if industries succeed in holding down current costs, particularly pay. (See also Section R).

PAY

[NB: Average earnings in 1983-84 6½ per cent higher than in 1982-83 assumption in GAD Report published 8 November.]

11. What pay settlements does Government now want?

Low enough to be consistent with improved job prospects in the industry concerned. The lower the better. Certainly lower than in the past year.

12. What has been average over past year/pay round?

[CBI Databank suggests 7 per cent average for manufacturing in last (1981-82) pay round.]

Average has been in single figures, and moving downwards, in each of past two years. We need a substantial further reduction, with really low settlements, and thus a better outlook for jobs, in the year ahead.

13. Pay settlements failing to come down?

[FT article (1 November) and November Incomes Data Services Report suggest pay settlements still averaging 7% inspite of falling inflation.]

Too early to say. Few settlements so far this autumn. But in everyone's interest that pay settlements should come down, and come down sharply.

14. A 3½ per cent pay policy?

The 3½ per cent pay assumption [announced 1 October for calculating the pay element in cash expenditure plans for 1983-84] does not represent a 'norm', still less an 'incomes policy'. Nor is it a decision on the offer to be made in any individual case. Settlements higher or lower than the assumption are not ruled out. Each case will be considered on merits.

15. Government exhortations on pay imply aiming to cut living standards?

[Real earnings show little variation over past two years; August 1982 broadly similar to August 1981 and about 1 per cent higher than August 1980.]

Lower pay settlements have not in fact cut real earnings in either of the past two years; prices have also come down. This fact casts doubt on the wilder claims about the effect of pay moderation on living standards.

16. 1982 New Earnings Survey shows public services falling behind?

Taking account of the effect of overtime on those working in the private sector, and public service settlements which were delayed beyond the Survey date, difference shown between public services and private sector pay movements over period covered by April 1981 and 1982 Surveys no more than 2 per cent.

17. Average earnings index

[Year on year growth 7.8 per cent in August compared with 10.9 per cent in July, but August index artificially low because of large amount of civil service back pay paid in August 1981. Underlying increase about 9 per cent in both July and August.]

Encouraging that underlying rate of growth continues to fall. Further moderation in settlements can only be helpful in maintaining jobs and getting inflation down.

18. Incomes Policy

Proposals for incomes policies, including recent refinements, do not avoid many of the familiar problems of norms, administrative costs, and interference with market forces. Experience gives no encouragement to the idea that incomes policy can be made to work on a permanent basis. They always succumb to the distortions they create.

19. Top Salaries Review Body increases too large?

[Government announced on 12 May increases of 14.3 per cent for senior civil servants and senior members of armed forces, and 18.6 per cent for judiciary.]

Government believes these increases are fully justified. Essential to ensure adequate supply of candidates of sufficient calibre for the Bench, and to provide adequate career structure and differentials in higher levels of civil service and armed forces. Before the increases, TSRB were the only group whose salaries were below those recommended for April 1980.

20. Index-linked pensions and Scott report?

Question debated in House of Commons 22 October, when Government announced they favoured Megaw Committee suggestion that civil service pension scheme be made contributory. Reduction in inflation has greatly eased disparity between private and public sector pensions; Government's main aim at present is to ensure appropriate contributions are paid for index-linked benefits.

L BALANCE OF PAYMENTS

1. Trade figures and current account

[September trade figures show trade account in broad balance though non-oil trade remains in deficit; invisibles surplus of £260 million a month in Q2 and projected £200 million a month in Q3. Cumulative current account surplus of £2.6 billion in nine months to September.]

Current account remains in substantial surplus, albeit reduced from last year's levels - current account surplus for 1981 was £6 billion.

2. Export trends - recent

Month-to-month movements in exports during 1982 have been very erratic. There was a sharp recovery in exports in September from the erratically low August level but underlying level of non-oil exports has probably fallen since the spring. To a large extent this appears due to world recession; world trade in manufactures has probably fallen in 1982-83 first year-on-year fall since 1975.

3. Export trends last few years?

Growth in UK exports of manufactures significantly below world trade growth over 1977 to early 1981, when competitiveness worsening, but with improvement in competitiveness since then, our share appears to have stabilised.

4. Import trends

Manufactured imports increased in September but there has been little, if any, growth in underlying level of manufacturing imports since end-1981. Manufacturing output has fallen back a little this year, so there has probably been some continued growth in import penetration, although not at anything like same rate as in 1981.

5. New import controls on way?

[Continuing Press speculation].

We are concerned at the extent of unfair trading practices and the damaging effect of very high tarriffs and quotas in some other countries. But wish to make clear, as Chancellor said recently [Caterham 22 October] that 'we will be continuing to defend the open trading system'. A free and fair trading system is in the interest of all trading nations.

6. Overseas investment takes jobs away from UK?

30 per cent of UK exports are bought by overseas firms connected with UK companies. By increasing links between UK and overseas companies, overseas investment helps UK exports

and production, so producing more jobs. If UK does not take profitable opportunities to invest overseas, others will.

M EXCHANGE RATE AND THE RESERVES

1. Policy towards the exchange rate/falling £?

[The average £ effective rate in Q3 1982 was nearly 10 per cent lower than in Q1 1981. In last few months £ has remained broadly stable. Lately £ has been strong in effective terms although it has lost ground against the stronger dollar. Rates at noon on 4 November were $1.6692 DM 4.293 and an effective of 92.3. Previous lows were $1.6640 on 16 December 1976, DM 4.098 on 21 May 1982. Highs were $1.97 on 30 November 1981, DM 4.407 on 9 February 1982. Reserves at end-October stood at $18.5 billion, compared with $18.3 billion at end September.]

Government has no target for exchange rate. The exchange rate is only one of the factors taken into account in interpreting domestic monetary conditions and taking decisions on policy. Sterling's effective exchange rate has continued to show the broadly stable pattern of recent months. This stability reflects the continuing international confidence in this Government's economic policies.

2. Improve UK competitiveness by devaluing exchange rate?

[Sam Brittan in FT 28 October.]

Experience shows that exchange rate cannot be manipulated by Government against underlying market trends. Any attempt to lower it by intervention or by relaxing monetary control leads to higher inflation. For example the effective exchange rate depreciated by over a quarter between 1973 and 1976 without leading on balance to any improvement in UK competitiveness. As was seen at the CBI conference in October, most industrialists recognise that a lower exchange rate would not give rise to any lasting gain in competitiveness.

3. Bank of England intervention?

Policy is unchanged. Bank do intervene to smooth excessive fluctuations and preserve orderly markets particularly when conditions unsettled. But, as Chancellor has already stated, we have no target - undisclosed, secret or otherwise - for the exchange rate. Most recent reserves figures confirm that policy is unchanged.

4. Debt repayments

We have made excellent progress with our plans to reduce the burden of external debt substantially during this Parliament. We aimed to reduce official external debt to $14 billion by end of 1981. This has been more than achieved - external debt is now around $13 billion, compared with over $22 billion when the Government took office.

N EUROPEAN MATTERS

MEMBERSHIP OF EUROPEAN COMMUNITY

1. UK budget settlement

Foreign Ministers agreed on 25 May to a settlement for the UK budget contribution for 1982. The settlement provides for a basic refund of about £470 million in respect of 1982, with provision for changes to this figure if our unadjusted net contribution varies from the Commission estimate of £880 million. It was also agreed that the problem for the longer term would be settled by the end of November.

2. Implementation of budget settlement

Final agreement was reached by Foreign Ministers on 25/26 October. Although the UK will not now be fully compensated for our contribution to German refunds, we shall receive our 1982 refunds of 1,092 millionecus, about £600 million gross, much earlier than originally envisaged. Payment will now be made before the end of December this year rather than in March next year or later - a significant improvement for the UK.

3. UK objectives for longer-term negotiations?

Government has made it clear that, in spite of our relative economic position, UK is prepared to remain a net contributor - but only on a very modest scale.

4. Will Government withhold contributions?

We hope very much that the issue of our Budget contributions can be satisfactorily settled without the need for recourse to such a step.

5. Commission's ideas for changes to 'own resources' system

Understand that Commission are considering measures to diversify Community's revenue sources. If they put forward proposals we will consider them. Our opposition to any increase in the 1 per cent VAT ceiling is well known.

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

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.

9. Join the EMS for exchange rate stability?

There is no reason to suppose that by the simple act of joining the EMS exchange rate mechanism we would guarantee exchange rate stability. This has not been the experience of the current participants. Genuine stability requires a return to low inflation rates throughout the Community.

P INDUSTRY

1. Industry and the Autumn Statement

CBI and others have been pressing for further assistance to business. Should welcome the substantial cuts in NIS which reduce employers' costs and the decision to hold down NIC. Next year it is expected that NIS and NIC payments of private employers will fall by around £160 million in cash terms. Even larger fall in real terms. Other public spending decisions helpful - e.g. defence, increased provision for urban programmes.

2. Prospects for industry-recovery?

See A2-4 and Section B.

3. Companies' financial position?

[£bn

	1979	1980	1981 Year	H1	H2	1982 H1
Net borrowing requirement (+)/repayments (-)	+6.3	+6.5	+5.1	-1.5	+6.6	+5.6
Financial surplus (+)/deficit (-)	-2.9	-1.4	+1.8	+1.0	+0.8	-1.3]

Financial position of industrial and commercial companies (excluding North Sea) improved last year, relative to 1979 and 1980. Improvement in part reflected companies' efforts to cut costs, for example by de-stocking. Some apparent deterioration in second half 1981 financial position due to slowdown in de-stocking and unwinding of delays in tax payments because of the civil service dispute. Figures for H1 1982 suggest reduction in companies' borrowing requirements relative to H2 1981; but borrowing needs still high.

3. Profits rate of return still too low?

[Gross trading profits of industrial and commercial companies (ICCs) (net of stock appreciation) rose 18 per cent to 1982 H1; but increase was from a very low base ICC's real pre-tax rate of return (except North Sea was just over 3 per cent in 1981, and only 2 per cent in manufacturing - half previous cyclical low figure in 1975.]

Government can help best by getting inflation down and setting sound basis for sustained recovery. Fundamental improvement in ICC's rates of return depend on better performance by companies. Some encouragement from recent productivity gains and trend towards moderate pay settlements.

5. Real rates of return on capital lower in UK than elsewhere?

[OECD statistics comparing UK, Japan, France and UK show net rates of return to fixed capital in non-financial corporations in 195-80 lowest in UK - though all on a downward trend. 1980 figures: US 13 per cent, Japan 15 per cent, France 9 per cent, UK 5 per cent.]

Figures show how policies of earlier administrations have allowed profitability to slide in UK. Sound basis for sustained recovery rests on reducing inflation, increased productivity gains, and moderation in pay settlements which creates conditions for better performance by companies.

6. High interest rates damaging for industry and investment?

Banks' base rates have fallen 7½ percentage points since last October, and 3½ points over last three months. Outside analysis suggests that a 1 per cent reduction in interest rates improves the net financial position of the company sector by about £250 million over a full year. Lower interest rates reflect Government's firm fiscal and monetary stance and will help industry and investment.

7. Lower rates for industry?

De-rating one of a number of possible ways of assisting industry and business, but in last Budget preference given to other forms of relief, notably reductions in NIS. De-rating would be expensive, though less so if applied to industry alone - even so, 10 per cent de-rating would cost about £140 million per annum. Legislation would be required.

8. Lower energy prices

See R3.

9. Government help for small firms

Budget provided further help for small businesses, increasing the number of measures taken so far to over 100. Enterprise package included further reduction in weight of corporation tax; further increases in VAT registration limits; increase in global amount available for loans under Loan Guarantee Scheme (see below); and doubling of investment limit under Business Start-Up Scheme to £20,000 a year. New measures will encourage start-ups and existing firms.

10. How many new firms starting up?

[Correspondence in progress between Treasury and D Industry about value of giving 'net' figures of 'birth' of minus 'deaths' of companies based on VAT registrations.]

On a very rough average some 10,000 new companies come into being every month.

11. Response to Loan Guarantee Scheme?

[Over 6,400 guarantees already issued - about half to new businesses. Total lending under scheme around £215 million. Budget provided for lending ceiling in first year (to May 1982) to be raised from £100 million to £150 million and for further £150 million to be available in second year (to May 1983). Thirty financial institutions now participating.]

Scheme operating successfully. Too early to assess overall cost . After first year, out of over 6000 guarantees issued, only 150 have so far been 'called'. Cost has been covered by the premium income received over the period. Scheme is kept under continuous review.

12. New enterprise zones

Chancellor announced Tuesday 27 July eleven new Enterprise Zones to be created: 7 in England; two in Scotland; one each in Wales and Northern Ireland. Applications from local authorities in all four countries for sites in their areas to be designated now being considered. (53 applications in England).

13. First group of enterprise zones

All first eleven zones now in operation. 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.

14. Is is true that a committee has been set up to consider changing basis of regional assistance?

[Report in FT 25 October.]

Regional policy is, like other Government policies, continually open to scrutiny in case improvements can be made. [IF PRESSED: But cannot comment on precise details of official committees.]

R NATIONALISED INDUSTRIES

NATIONALISED INDUSTRY PAY AND PRICES

1. Nationalised industries' prices

[Having risen approximately in line with retail prices for several months, the latest figures show bigger 12 months increase in nationalised industry prices, water charges and London Transport fares than all items RPI (13.7 per cent in September compared 7.3 per cent). This differential reflects March increase in LT fares. Removal of these temporary distortions confirms that nationalised industry prices are still increasing somewhat faster than RPI, largely because of increases in energy sector.]

Gap between nationalised industry price increases and RPI has been due in large measure to cumulative effect of years of artifical price restraint. World oil price rises of 1979 and 1980 have also played an important part. We greatly regret the need for these increases, but holding prices down artificially would distort market forces and add to burden on taxpayer. Underlying position has been improving steadily for past year or so. The differential between RPI (all items) and NI prices (including water charges and London Transport fares) is now 6 per cent compared with 14 per cent in January 1982. But sustained improvement will only be possible if the industries succeed in holding down their current costs, particularly pay.

2. Increase in gas prices?

[Domestic gas prices increased on 1 October. Some Press speculation that industry will have to pay 1p per therm more each quarter as contracts come up for renewal next year]

Large increase in domestic prices over last three years needed to remedy under-pricing by previous Government. There will be no more massive increases in gas prices. Industrial gas users have benefited from two years of virtual freeze on renewal prices for contract gas. BCG's responsibility to decide on pricing strategy following lifting of the freeze at end of this year.

3. Energy prices should be brought into line with those of main competitors - CBI view?

Oil is now traded internationally and its value is set accordingly. Coal and gas prices to industrial users are also broadly in line with those in Europe. As for electricity, for vast majority of industrial users, prices are in line with those in Europe, with exception of France and prices for intensive users of electricity in Germany. Assistance for extensive users of electricity in UK was introduced in this year's Budget. Structure of electricity pricing is being studied in context of the Buik Supply Tariff Review.

4. What is Government doing to improve nationalised industries' efficiency?

We continue to press for greater efficiency within NIs. We are setting realistic financial targets and performance aims. A rolling programme of Monopolies and Mergers Commission investigations has been set up. The introduction of market forces provides greatest incentive to efficiency.

INVESTMENT

5. Nationalised industries' investment should be stepped up to/improve infrastructure/provide orders to private sector/as boost to economy

Government has not prevented the industries from carrying forward a large number of profitable investment programmes. It would be wasteful to provide funds for public sector projects with lower returns than those in the private sector. Unfortunately, the pre-tax rate of return on nationalised industries' capital (including subsidies) in 1980 (latest available figures) was minus one per cent, compared with 3 per cent for industrial and commercial companies.

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

As in private sector, moderate pay settlements and control of other costs are essential. Ability to finance new investment in nationalised industries bound to diminish if excessive pay settlements agreed. Each 1 per cent off wages saves about £140 million this year; and each 1 per cent off total costs saves £330 million this year.

7. Take nationalised industry investment out of PSBR?

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

8. Private finance for NI investment?

In discussions in NEDC and elsewhere, we have indicated our willingness to consider new financing proposals, provided they can be structured so as to induce improvements in efficiency at least sufficient to offset the extra cost, and provided the finance is raised in fair competition with the private sector.

9. Investment plans unlikely to be attained?

[Letter has been sent by PM to chairman of Nationalised Industries' Chairman's Group stressing importance of maintaining NI investment programme: £900 million underspend 1981-82, £500 million expected underspend 1982-83.]

No Government can unconditionally guarantee a particular level of investment by the nationalised industries. NI planned investment for 1982-83 26 per cent higher than estimated outturn 1981-82. Some signs plans may not be fulfilled. Events outside industries' control may cause investment plans to be revised downwards. PM has made it clear that industries should make full and proper use of their allocation.

EXTERNAL FINANCING LIMITS

10. EFLs for 1982-83

Nationalised industries' total external finance increased by £1.3 billion in 1982-83 (£1.2 billion after allowing for NIS cut and other changes). Increase in 1982-83 was roughly half what the industries bid for. Government has given full recognition to problems faced by the industries in a period of recession.

11. EFLs for 1983-84?

Nationalised industries EFLs for 1983-84 announced in Autumn Statement. Overall, external finance in line with previous plans. £2.7 billion being made available to nationalised industries in 1983-84.

PRIVATISATION

12. Special asset sales in 1981-82

Gross sales in 1981-82 totalled £481 million, so target published in 1981 Public Expenditure White Paper of £500 million nearly met. Pleasing result - included two large sales - Cable and Wireless (£182 million) and Amersham International (£64 million). True that delivery of BNOC oil in 1981-82 paid for in 1980-81 and taken into account in special disposals figure for that year reduced 1981-82 receipts by £573 million to total of -£92 million. But it is gross figure which is true measure of success of Government's privatisation programme. As Chancellor said in Cambridge 3 July, 'Public utilities and the so-called "natural monopolies" cannot be allowed permanently and without challenge to remain within State ownership'.

13. What further sales expected?

Special sales of assets in 1982-83 forecast at around £600 million and expected to increase in subsequent years. This year's and next year's involve primarily very large sales of energy assets - Britoil and the British Gas Corporation's major offshore oil assets - made possible by Oil and Gas (Enterprise) Act (which received Royal Assent in June). Industry Secretary announced 19 July plans to sell 51 per cent of British Telecom - but not before next Election.

14. Why is Government selling off valuable national asset such as Britoil?

Sale will create an independent British oil company free to sieze opportunities. It will substantially reduce size of public sector in an area where State ownership has no justification whatever. It will allow public to take direct personal stake in North Sea.

15. Are proceeds of sale reflected in public expenditure/PSBR plans in Autumn Statement?

Estimate of proceeds is included in public expenditure/PSBR figures for 1982-83 and 1983-84 published in the Autumn Statement. [NB Estimate will not be disclosed so as not to prejudice sale.]

16. Will Government postpone Britoil sale to prevent it being sold too cheaply?

Government intends to sell majority of Britoil shares in November, if market conditions permit. We expect investors will take a long term view of the value of Britoil's shares.

17. Government has sold assets too cheap?

[Heavy oversubscription for British Aerospace, Cable and Wireless, Amersham International, followed by large increases in prices when shares first traded.]

Not in Government's interest to see shares underpriced, given the loss to the PSBR, but also risks in pitching price too high. Getting balance right not easy - especially when company's shares have not previously been traded. Government will continue to consider alternative forms of sale eg tender, but critics should note that sale by tender could make it harder for small investor to buy shares.

18. Contribution to giving people satisfaction of property ownership?

Exercise of returning enterprises from State ownership to ownership by the public has included measures to promote employee share ownership in the enterprise they work for; for example free offers of shares (British Aerospace, Cable and Wireless, Amersham); preference in allocation of shares (B Ae, C & W, Amersham, BP); provision for matching shares - one for each share subscribed for - (B Ae, Amersham, BP). Most radical initiative taken by consortium of managers and employees who bought National Freight Company.

S NORTH SEA AND UK ECONOMY

1. New forecast of North Sea revenues?

[Autumn Statement (Industry Act forecast) projections (in money of the day) of Government revenues from North Sea: £6½ billion in 1981-82, £7 billion in 1982-83, £7½ billion in 1983-84. Higher than 1982 FSBR projections, partly because of higher production, partly higher oil prices].

Must remember that oil revenue projections are crucially dependent on inherently uncertain cost, price and production assumptions. Prospects for North Sea tax receipts have improved since 1982 FSβR published because of higher than assumed oil prices and production. New projections assume oil prices do not change much from present levels.

2. Onerous tax system damaging future field developments?

[Shell/ESSO have shelved plans for Tern partly because of tax system; Phillips postponing T-block complex and BP their Andrew field; BP statement issued with their interim results criticised fiscal regime.].

Other adverse factors - falling oil prices earlier this year; high development costs - much more important. Detailed study has shown that under new tax structure, levels of profitability should still be sufficient to make exploration and development attractive. Hope that present structure will provide more secure and stable tax regime.

3. Government about to relax North Sea fiscal regime?

No decisions have been taken, but fact-finding discussions taking place with UKOOA and individual oil companies. Government wishes to give oil companies every opportunity to present their evidence about profitability in the North Sea. The regime is kept under review.

4. Taxation of petrochemical feedstocks

[Government has announced that new rules on valuation of ethane for petrochemical use in interaffiliate transfers (Finance Act Section 134) should be extended to mixed streams of gas with a large ethane component. ICI complain that the extension and the rules themselves give unfair advantage to their integrated oil company competitors and have taken out writ against the Government.]

Government convinced that new formula will give fair valuation. New valuation will not have effect of providing subsidy to ICI's competitors. Have done best to reassure ICI. Will resist ICI's legal action.

5. Government should do more to promote UK Continental Shelf oil production in 1990's?

[Select Committee on Energy's Report on Depletion Policy published 18 May: emphasised development of fields entering production in 1990s by increasing pace of licensing rounds

and overhauling fiscal regime. Recommended reserve powers to impose production cuts. Energy Secretary and Chancellor replied in joint memorandum on 29 July].

HMG agrees with general conclusions encouraging North Sea exploration and development, thereby maximising economic oil production over time; eg decision recently announced not to impose production cuts before 1985. Agree uncertainties in oil markets too great to justify deferring new field developments in foreseeable future. Cannot accept Committee's criticism of North Sea fiscal regime - opposed to another fundamental review; industry does not want a structural upheaval.

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

[Contribution of North Sea to GNP estimated at 4 per cent of GNP in 1981. Not projected to rise significantly before 1985.]

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 lower level of interest rates to benefit of industry and economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Less than 6 per cent of total General Government receipts in 1981-82.

7. North Sea revenues should be channelled into special fund?

North Sea revenues are already committed. Setting up special Fund would make no difference. More money would not magically become available.

8. Future North Sea oil prices?

A matter for commercial negotiation between oil companies and BNOC.

9. Are we really any better off for our North Sea oil?

We are better off with oil - at current oil prices - than we would have been without it. We have been spared fall in real national income that other industrial countries have suffered following oil price rises. But North Sea oil costly to produce, so we are not necessarily any better off than we would have been had oil prices not risen. No need therefore for possession of oil to require a contraction in our industrial base.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Prospects for world recovery?

[IMF, London Business School and Bank of England Quarterly Bulletin all gloomy about immediate prospects. No overall growth seen in major countries in 1982, and only weak recovery next year. Press reports suggest OECD will also revise its previous forecasts this autumn.]

Output in the major economies appears to have recovered slightly in the spring after the downturn last winter. US economy grew slightly in both Q2 and Q3. The major European economies, however, remain depressed, and it is too early to say that a broad upturn has started. Lower inflation and interest rates however offer prospects for better growth next year.

2. Why don't major industrial countries together expand demand?

Leaders of the major countries agreed at the OECD, Summit and IMF meetings on the need to continue the fight against inflation. As the OECD's Economic Outlook explains, Governments are convinced 'a significant part of any stimulus to demand would increase public sector deficits, and dissipate itself rather quickly as an increase in inflation'.

3. Anti-inflation policies are working

[Consumer price inflation down from a year ago in all 7 major economies on latest available figures: US (from 11.0 to 5.0 per cent), UK (11.6 to 7.3 per cent), Japan (3.8 to 3.1 per cent), Italy (18.3 to 17.2 per cent), Canada (12.5 to 10.4 per cent) France (13.9 to 10.1 per cent), Germany (6.5 to 4.9 per cent).]

Inflation has fallen in all major countries in the past year. Firm fiscal and monetary responses to 1979-80 oil price rise vindicated. UK close behind US and Germany in bringing down inflation, and ahead of some other European countries. Realism in wage settlements is growing; US, Germany and Japan all have wage settlements in single figures.

4. International financial collapse?

Concern about effects of over-borrowing noted at Toronto IMF meeting. But should not exaggerate alarm. Important of course to sustain system's stability. Lower interest rates should help, as should IMF programmes to restore countries' credit-worthiness. Further progress needed on banking supervision including risk assessment and prudential standards; also watertight allocation of supervisory responsibilities.

5. <u>What about US ideas for emergency IMF assistance to countries heavily indebted to the international banking system?</u>

The IMF must certainly be endowed with the resources it needs to carry out its present role. There is widespread agreement that a substantial increase in its quotas is necessary. Its resources <u>may</u> need to be supplemented even further. The US ideas are only among a number which need to be studied carefully.

6. <u>South African credit from IMF?</u>

[Board discussed on 3 November S Africa's request for $ SDR 1 billion drawing.]

We supported the application on its technical merits. There is no provision within IMF's Articles of Agreement for declaring a member ineligible to use the Fund's resources unless it fails to fulfil any of its obligations under the Articles: S Africa is not in this position.

7. <u>Another oil energy crisis looming?</u>

[Latest World Energy Outlook from International Energy Agency raises possibility that tight oil market could reappear in late 1980's].

Always difficult to foresee future oil prices. But they are weak at present and likely to remain so in near future. In longer term, energy conservation should permanently reduce countries' dependence on oil.

8. <u>US economy?</u>

[US GNP rose only slightly in Q3 after ½ per cent rise in Q2. Unemployment has risen above 10 per cent. Consumer price inflation has fallen to 5 per cent. Interest rates have fallen 4 per cent since July. Press reports suggest that Federal Reserve only expects growth of 2 per cent next year - lower than forecasts by US Administration and other forecasters].

US output rose slightly in Q3 after small rise in Q2. Still too early to say that a strong recovery is under way, but falls in interest rates and inflation hold out better prospects for growth over the next year.

9. <u>US Budget?</u>

[Despite package of tax increases totalling $98.3 over next three years, passed in August, US budget deficit for 1982 expected to be about $109 billion; deficit for 1983 forecast to be even larger].

Welcome Congress approval of tax package. US has won a battle but long campaign lies ahead to put deficits on convincing declining path in medium term.

10. US monetary policy

[US interest rates have fallen and Federal Reserve has reduced its discount rate from 9½ to 9 per cent. Chairman Volcker has said US authorities will be attaching much less than usual weight to M1 over period ahead].

Accept that monetary indicators in US must be interpreted flexibly in light of financial innovations. Federal Reserve Chairman, Mr Volcker has made clear that reduction of inflation remains a priority and that monetary targets have not been abandoned.

11. Gloomy prospects for Europe?

[EC Commission Annual Report predicts only 1.2 per cent growth in Europe next year and 10.3 per cent unemployment. Medium-term forecast gives gloomy picture of 1983-87 with growth in EC averaging only 2½ per cent and inflation of nearly 8 per cent.]

Short-term prospects for recovery in Europe weaker than in US or Japan. But budget deficits higher and inflation rapid in many European countries. Note that EC Commission draws attention to need to curb budget deficits and reduce labour costs. Always difficult to see into medium run but improvements in competitiveness, lower inflation and interest rates all offer better prospects.

12. French franc/balance of payments?

[French trade deficit soared to F Fr 12.2 billion (£1 billion) in September. M. Joubert admits that deficit for 1982 will reach FFr 100 billion. Despite raising $4 billion standby credit on international capital markets in September, franc remains weak. French Government recently announced package of measures aimed at improving balance of payments by encouraging exports and requiring all goods to bear label showing country of origin.]

Strength of world economy depends on ensuring stability of major currencies. Glad to see French Government has acted to curb budget deficits. Suitable monetary and fiscal policies essential if balance of payments to be improved and franc strengthened. Important that -understandable- measures to promote domestic trade performance should not encourage protectionism.

13. Competitive devaluations

[Recent devaluation of Swedish krona by 16 per cent widely criticised by other Governments. Finnish marka subsequently devalued by 6 per cent. Independent 'wise men's' report on Danish economy suggests withdrawing from EMS temporarily in order to allow 20 per cent devaluation].

IMF rules forbid countries to manipulate exchange rates to gain unfair competitive advantage. Authorities in Sweden will have noted strong objections from her major trading partners. Prosperity of world economy depends on maintaining open and fair trading system. Large devaluations may hinder this, and risk encouraging competitive devaluations by others. [IF PRESSED: IMF is examining Swedish action.]

14. Japanese reflation?

[Japanese Government have introduced reflationary package of £4½ billion (Y 2 trillion) or just under 1 per cent of GDP. Mainly consists of increased expenditure upon public work in current fiscal year.]

Different conditions from UK. Inflation in Japan only 3.1 per cent; unemployment 2.3 per cent; savings high.

COMMENTARY ON RECENT ECONOMIC DEVELOPMENTS AND STATISTICS 8 NOVEMBER 1982

Summary comment

Recent financial developments favourable - inflation and interest rates falling - but activity remains flat.

World Economy: expectations held by most forecasters for an upturn in activity of 1 per cent this year unfulfilled. Outside forecasters expect only a weak recovery next year.

- world commodity prices are at their lowest level in real terms for thirty years;

- oil prices are weak and likely to remain so for the near future;

- consumer price inflation (OECD major 7) around 6½ per cent in September ranging from 17 per cent in Italy to 5 per cent in Germany and 3 per cent in Japan;

- average world 3-month interest rates 10 per cent at 1 Novmber a fall of 4 points since October 1981; US 3 month rate stood at 9 per cent on 1 November; real interest rates remain clearly positive;

- world trade volume has been more or less flat since the middle of last year;

- total industrial production for the OECD Major 7 fell 6 per cent in the twelve months to July; in the US it fell by 9½ per cent in the 12 months to September;

- unemployment (major 7) now 8½ per cent, compared with 6½ per cent in mid-1981.

UK Balance of Payments: non-oil trade balance has deteriorated quite sharply but current account remains in strong surplus this year. But both the loss of competitiveness during 1979 and 1980 and a smaller world market are affecting our non-oil trade at home and abroad.

- OPEC and Third World countries are cutting back on imports because of low commodity prices, high interest rates and debt problems in some countries. UK exports in 1981 Q3 4 per cent down on 1981 H2.

. import volume rose sharply as activity recovered last year and import penetration rose too; imports broadly flat this year.

. the effective exchange rate has been broadly stable since summer 1981; currently 92.0.

Financial Developments

.M1, £M3, PSL2 within target range for 1982-83;

.short term interest rates down 7 points since last October; base-rates down 7 points;

.real interest rates have fallen but remain clearly positive (higher real rates are being experienced in the US and Japan);

.PSBR £3 billion in first two quarters of financial year, remains within the FSBR forecast of £9½ billion for 1982-83.

Inflation

.retail price inflation, 7.3 per cent in year to September. Forecast 6½ per cent before Xmas, with prospect of 5 per cent by spring 1983;

.TPI increase in 12 months to September was 7.9 per cent;

.Wholesale price inflation also moderating; input prices up almost 3½ per cent in year to September; output prices 7½ per cent;

GDP and industrial production

.GDP has been broadly flat since 1981 Q4, as has the underlying level of industrial production; but latter 1½ per cent above spring 1981 trough;

.within industrial production total, increased North Sea oil and gas production has offset a 1 per cent reduction in manufacturing output since 1981 Q4.

Demand Components

.consumer spending has remained broadly unchanged since 1979, over period when other components of final demand fell some 4-5 per cent. Some fall in RPDI (see below) offset by lower savings ratio. Retail sales in July -September 2 per cent higher than in spring, partly reflecting abolition of HP controls.

.gross fixed investment fell back by 4 per cent in 1982 Q2 - from a strong first quarter - to a level similar to that in 1981 H1 and 10 per cent below the level in 1979. Manufacturing investment has been weak. Plant and machinery investment, however, has held up.

.the massive destocking of 1980 H2 and 1981 is over but the 1982 Q2 figures show no return to positive stockbuilding. October CBI survey suggests some further scope for destocking in manufacturing;

.government consumption in 1982 H1 was 2 per cent above its level in the same period last year. 1982 Q2 data suggests that the upward trend in volume may be flattening out.

.there has been some fall in the volume of exports in recent months reflecting both loss of competitiveness and the flatness in world trade;

.imports rose very sharply between the two halves of 1981, reflecting both the increase in activity and increased import penetration, before stabilising.

Productivity and Competitiveness

.manufacturing productivity continues to rise strongly - at 6½ per cent annual rate so far this year, following 8-10 per cent last year;

.unit wage/salary costs up only 4 per cent in 1982 Q3 on same period 1981;

.during 1981 external price and cost competitiveness improved at least 10 per cent but little or no further improvement this year.

Company Sector

.ICCs pre-tax real rates of return on capital in 1981 were very low; only 2 per cent in the manufacturing sector. Some slight improvement likely this year.

.after falling in first quarter of 1982 gross trading profits (net of stock appreciation) of ICCs rose in the second quarter by 5 per cent; this follows the strong recovery in 1981;

.non-North Sea profits in 1982 H1 were 22 per cent above their level in 1981 H1;

.gross profits of North Sea oil companies rose 10 per cent over the same period;

.ICCs financial deficit was £1.3 billion in 1982 H1, following £0.8 billion surplus in 1981 H2, partly reflecting less destocking. Over same period net borrowing requirement fell from £6½ billion to £5½ billion.

Personal Sector

.wage settlements in 1981-82 were on average around 7 per cent, 2 per cent lower than in the previous round;

.underlying rate of increase in average earnings in year to July 1982 was about 9-9½ per cent;

.real earnings broadly flat in last 12 months but RPDI is about 1½ per cent lower than the average for 1981.

Labour Market

.UK employment fell 2.4 million (10½ per cent) between 1979 Q2 and 1982 Q2 (two-thirds concentrated in manufacturing); between 1981 Q2 and 1982 Q2 employment fell by 670,000;

.Total employment fell more in the second quarter of 1982 (189 thousand) than in the previous quarter (94,000);

.total registered unemployment fell by 48,000 to 3.3 million (13.8 per cent) in October reflecting seasonal falls in school leavers which more than offset the underlying upward trend (which itself slowed to 23,000);

.UK adult unemployment rose by (only) 23,000 to 3.1 million (12.8 per cent) in October; previously the trend (since June) was accelerating;

.vacancies have not altered much in recent months;

.other labour market indicators - short time, overtime working, etc - continue to suggest some flattening out following last year's improvements.

Forward Indicators

.car production (seasonally adjusted) fell from 77,000 August to 69,000 in September;

.steel production (seasonally adjusted) fell from 229 m tons in August to 224 m tons in September;

.the volume of new construction orders, which remained broadly flat since the first half of 1981, fell 6 per cent in the 3 months to August. Within the total, orders for new housing, particularly in the private sector, remain slightly below their level last spring. Engineering orders also disappointing with a 9 per cent fall in the lastest 3 months.

.total manufacturing order books, as monitored in the CBI's monthly industrial trends enquiry, after strengthening last year, have shown some decline; and export order books have weakened.

.total housing starts, having increased from an average 40,000 a quarter in 1980 to 53,000 in 1982 Q1, fell back in the spring, but average for the first nine months is over 25 per cent up on the same period a year ago. Total completion have remained fairly flat during 1981 Q2 and Q3 having previously drifted slowly downwards.

.seasonal falls in school leavers registrations continue into November and December but a sharp seasonal rise in unemployment occurs in January;

.CSO's index of longer leading indicators rose in August and September reflecting lower interest rates and higher share prices, following a fall from April to July.

CBI's October Trends Survey suggests a further decline in business confidence, further slight falls in total new orders and output. Stock reductions are continuing and investment intentions have weakened again. The survey suggests no recovery in new export orders and deliveries over the next four months. Cost pressures are expected to slow further and a slight improvement in firms liquidity is in prospect. Consumer goods industries are benefiting slightly from some improvement in demand.

Outside forecasts

.Outside forecasting groups are now less optimistic about recovery in 1982, suggesting that growth this year will be ½-1 per cent - about ½ per cent less than expected at Budget time; for 1983 concensus of outside forecasts around 2 per cent, assuming some recovery in world economy, with inflation/interest rates continuing to fall at least for some time into next year.

.New Treasury forecast published today November 8th. (See tables attached)

Key Statistics Week-Ending Friday 12 November

Tues 9	:	Vehicle production (Oct - provisional)
	:	CGBR (Oct)
	:	Money supply (mid-October)
Friday 12	:	Steel production (Oct)
	:	Retail Prices (Oct)
	:	Industrial Production (Sept prov)

The Prospects: Summary

1.38 Table 1.9 below presents a summary of the economic prospects.

Table 1.9 Economic Prospects

	Percentage changes 1981 to 1982	1982 to 1983	Average errors from forecasts, relevant for 1983
A *Output and expenditure at constant 1975 prices*			per cent
Gross domestic product (at factor cost)	½	1½	1
Consumers' expenditure	½	2½	1½
General government current expenditure	2	1	1½
Fixed investment	3	5	2½
Exports of goods and services	−1	0	3
Change in rate of stock-building as a percentage of the level of GDP	2	½	1
Imports of goods and services	4½	5	3
	1982	1983	
B *Balance of payments on current account* (£ billion)	3½	0	3
C *Retail prices index* (4th quarter to 4th quarter)	6	5	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 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 1980. For the current balance and the retail prices index, forecasts made between June 1970 and October 1980 are used. The errors are after adjustment for the effects of major changes in fiscal policy, where excluded from the forecast. Quarterly forecasts are grouped so as to be comparable with 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.

MH: may make up £300m
in time left.
150m H Corp cash limit
50 Derelict Land Grant
Urb Prog
100 Housing Improvement

Wim: a) rev consequences of capex
b) manpower "

MH: LA achieves targets will be below
because of accrued interest on capital receipts.

X S.O.9 : Water Industry: Denis Howell : GAT a party? PM's assurance.

X S.O.9 : Steel Industry : Corbett.

X S.O.9 : Security : Wrigglesworth: Security issues generally.
Positive Vetting. Byeman and Argus systems.
Damage. Urgent: Debate before Security commission.
Reassure public opinion.

Table 1.10 Constant price forecasts of expenditure, imports and gross domestic product*

£ million at 1975 prices, seasonally adjusted

	Consumers' expenditure	General government consumption	Total 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	Gross domestic product at factor cost	GDP index 1975=100
1980	71 550	24 300	20 450	33 100	−1 550	147 850	34 150	12 200	200	101 700	108·0
1981	71 750	24 450	18 750	32 400	−1 900	145 450	34 100	12 100	0	99 250	105·4
1982	72 150	24 900	19 350	32 150	−150	148 400	35 650	12 150	−600	100 000	106·2
1983	73 800	25 100	20 300	32 200	300	151 700	37 450	12 500	−500	101 250	107·6
1981 H1	35 900	12 150	9 350	15 850	−1 350	71 900	15 950	6 100	−250	49 600	105·4
H2	35 850	12 300	9 400	16 550	−550	73 550	18 150	6 000	250	49 650	105·5
1982 H1	35 750	12 400	9 650	16 300	0	74 100	17 750	6 000	−350	50 000	106·2
H2	36 400	12 500	9 700	15 850	−150	74 300	17 900	6 150	−250	50 000	106·2
1983 H1	36 650	12 500	10 050	15 950	100	75 250	18 500	6 200	−250	50 300	106·9
H2	37 150	12 600	10 250	16 250	200	76 450	18 950	6 300	−250	50 950	108·2
% changes:											
1980 to 1981	½	½	−8	−2		−1½	0	−½		−2½	
1981 to 1982	½	2	3	−1		2	4½	½		½	
1982 to 1983	2½	1	5	0		2½	5	3		1½	

*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 half per cent. The GDP index in the final column is calculated from unrounded numbers.

Heseltine 15/11

Kaufman: Not genuine. If so, U turn. Selective statistics. Deceive? mislead?
a) Housing Association: 3 month moratorium.
b) Housing Capital > 3B capital receipts? Housing Assoc' If not 5% [illegible]
— on this years inadequate. If so, – 60% since 1979: – 14% this year.
c) targets to allow interest on capital? If not capital receipts must be spent.
— current + loan charges to be exempt from the RSG limits.
— LA have to finance UP allows.

MH: – 140000 next year houses sold
- cannot compensate for use of capital receipts.
- will carry through 81/2 cowdback exemption for UPA.
- RSG penalties self imposed.

50 Bids for EZs

GK: LA to forfeit cap receipts interest?
Current consequences of capital penalised?

SHaw: Capex projects. wastefuspend. will be penalised on current.

MH: Publicly owned unused land. 100 000 acres.

Mr Brown: Labour authorities want ; EZ
Labour politicians don't ;

MH: Oppo halved level of capex. Record current exp.

Freeson: Cap Recs to refinance borrowing to reduce rates.
How can capex rise in last months of year.

MH: Don't know capex trends till late.
LAs already receive interest from cap recs.

Privy Council Office,
Whitehall,
London, SW1A 2AT

With the Compliments

of the

Lord President of the Council

PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

12 November 1982

Dear Arthur,

As you know, the Prime Minister has agreed that a series of guidance notes should be prepared for Ministers on policy presentation. The first such note was issued under my predecessor's letter of 4 March 1982 and the series continues. The Prime Minister has now asked that a guidance note be prepared on the subject of trade policy including the need to improve our competitive position and taking account of EC aspects. I am therefore writing to ask if you would be so kind as to set in hand the preparation of such a note, in a similar format to the other notes which have already been issued to Ministers, with a view to its being available for discussion with the Prime Minister, yourself and other colleagues, perhaps in a fortnight's time. Please do not hesitate to contact me if you feel it would be helpful to have a word about this and in any case Peter Cropper will be writing to you offering Research Department assistance.

I am copying this letter to the Prime Minister, and to Peter Cropper at Research Department.

Yours
John

JOHN BIFFEN

Lord Cockfield
Secretary of State for Trade
1 Victoria Street
LONDON
SW1H OET

JRW

c/ AW.
ECON POL
WM 10/11

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

4 November 1982

Michael Scholar, Esq.,
No.10 Downing Street

Dear Michael,

SDP AND ALLIANCE REFLATIONARY PACKAGES

You asked this morning for the figures from which we deduced our costings of the SDP and Alliance packages that were used in the Prime Minister's speech to the House yesterday. Annex A to this letter reproduces the illustrative package of measures in the SDP document "Towards Full Employment" published last June. This carried the health warning, also reproduced, on the last page which disclaimed it as official Party policy. But nonetheless it was widely noted last summer as representing SDP thinking, even if not an agreed policy endorsed by the rank and file. But then of course there was the technical problem that there were no agreed SDP policies before the last day of the Yarmouth Conference.

Annex B reproduced the illustrative package contained in the joint SDP/Liberal Alliance document published in September. This also has a warning note that an Alliance Government is not bound by it, but it constitutes the best available indication of what the Alliance leadership is broadly aiming at doing.

Yours sincerely,

Jill Rutter

JILL RUTTER

1/1

Econ Pol

PPS/CHANCELLOR

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(R)
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 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 BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 25 October, are sidelined.

M M Deyes

M M DEYES

12A

R I G ALLEN

1 November 1982

EB Division
H M Treasury
01-233-5503

ECONOMIC BRIEF: CONTENTS

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 maintaining steady but not excessive downward pressure on monetary variables, and complementary fiscal policies. Improvement of supply side depends on restoration of flexible and competitive market economy and better incentives.

2. Recovery over?

Delayed but not over. Activity still 1 per cent above trough in Spring 1981. Pause this year largely reflects external developments. Expected recovery in world trade and output expected at Budget time has not materialised.

3. Recovery next year?

Prospect remains for resumed modest recovery next year - supported by upturn in cyclical indicators and by most outside forecasts. [NB. Next Industry Act forecast will probably be published later this month.]

4. Where will growth come from?

Sources of growth are expected to be:

- some modest recovery in world activity;
- improved confidence as inflation comes down, encouraging more investment and risk-taking;
- lower interest rates improving companies' financial position and encouraging more fixed investment and stockbuilding;
- increased consumers' expenditure, partly reflecting lower inflation.

5. Government policies have caused recession by deflating demand?

No. Output had fallen more strongly than demand during the current recession; and in year to 1982 Q2 real demand rose by 3 per cent, real output by only 1 per cent. Import penetration 10 per cent higher than in first half of last year. Essential problems of economy lie on 'supply side' -lack of competitiveness etc. Government policies aimed at helping industry to redress these problems by : deregulating, restoring incentives and implementing a financial strategy under which inflation and interest rates can fall over the medium term.

11. Government should do more to help business?

[Press reports 1 November of 'hint' from Chancellor of help for industry.]

Already doing a good deal (lower interest rates, NIS reduction effective August, etc). But, as CBI have stressed: 'Tackling unemployment and alleviating its problems is not just a task for government. There can be no solution to its causes, however complex, without greater competitiveness, for which the major responsibility must rest with business.' (Quotation from pre-CBI Conference document reported in The Times 29 October.)

12. Chancellor's Mansion House Speech points to abandonment of monetary targets?

No. Chancellor specifically said that 'we need to maintain a prudent monetary strategy' and that we cannot ease up on inflation: '5 per cent is still too high'. Of course, as Government has recognised for a long time, 'flexibility has to be achieved without a drift into laxity'. [For further material on monetary developments, see Section J].

13. Pressure for action on imports?

See L1 and 5.

14. Unemployment trend worsening?

See Section C.

15. Autumn Statement

[Government's reply to report on Budgetary reform from TCSC published 5 August. Will involve some changes in Budgetary procedure. But these will not go all the way towards implementing Committee's recommendations.]

Government intend to take full account of TCSC's proposals in continuing to build on significant progress already made towards greater integration of economic decision-making (eg MTFS) and involvement in it of Parliament and public. In particular, Government will advance these developments by publishing around late November/early December an Autumn Statement which will allow fuller and better-informed discussion of monetary and fiscal prospects than in past. Structure and contents of Autumn Statement will build on what is already published and can be expected to evolve over time.

16. When this year's to be published and what will it contain?

To be published probably later this month. As stated in reply to TCSC, will contain Industry Act forecast, commentary on economic developments and prospects, information about public expenditure decisions for the year ahead, information about national insurance contributions in year ahead, and tax ready reckoners.

BULL POINTS

As at 1 .11. 82

(i) Activity. Underlying level of output broadly flat since last Autumn but industrial and manufacturing output above levels spring 1981. Most recent major independent forecasts see prospect of modest recovery later this year and next.

(ii) Interest rates. Bank base rates have fallen 6½ points since last autumn (now 9½ per cent). Lowest level for almost four years. Recent falls reflect several factors:- single figure inflation, M1, £M3 and PSL2 developing favourably in relation to 8-12 per cent target, Government borrowing under control, exchange rate firm.

(iii) Inflation. The increase in the RPI over the 12 Months to September was 7.3 per cent. This is the lowest since September 1972 and close to a quarter of the peak level of 26.9 per cent in August 1975. The September level of prices is no higher than June and actually below the August level - the first fall since August 1970. Forecast of annual rate RPI inflation 6½ per cent by end of 1982 and prospect of 5 per cent by Spring of 1983. Manufacturers' output prices up 7½ per cent in year to September.

(v) Costs.

- Increase in average earnings halved in 1980-81 pay round. Public sector pay in line. Further moderation in average level of settlements in 1981-82 round. CBI pay databank for manufacturing settlements suggests average now around 7 per cent compared with 9 per cent in 1980-81 round.
- Manufacturers' unit wage and salary costs up only 5½ per cent up in year to July, below average of major competitors.
- Manufacturers' input prices up just 3¾ per cent in year to September.
- CBI October survey still shows lowest degree of unit cost pressures for 15 years.

(v) Manufacturing productivity. Output per head has risen about 13 per cent since end 1980. Output per head and output per hour now about 6 and 9 per cent higher than previous peak in 1H 1979.

(vi) Competitiveness. Cost competitiveness improved by 10-15 per cent during 1981 reflecting pay moderation, higher productivity and exchange rate fall, but remains ${}^{1}/_{3}$ worse than in 1975.

(vii) Profits: Industrial and commercial companies' gross trading profits (net of stock appreciation, excluding North Sea) risen 16 per cent in 1H 1982 compared with 1H 1981. Recovery in profits from very low base: pre-tax real rate of return of ICC's (excluding North Sea) only 3 per cent in 1981.

(viii) Housing starts (total) - up over a quarter in first eight months of 1982 compared with same period 1981.

(ix) Exports (non oil, excluding erratics) only 2 per cent lower in 12 months to September 1982 than in 1980, despite earlier substantial loss of competitiveness.

(x) Special employment measures. Total provision for special employment schemes planned to reach £1½ billion in 1982-83. Further measures announced end-July - new community work programme (started October), job splitting subsidy schemes (from January 1983).

(xi) Overseas investment in UK: US direct investment in Britain amounted to stock of over $14 billion in 1980. Nearly 60 per cent of all US outward non-oil direct investment now takes place in EC - over half of that in UK. Half of all Japanese investment in the EC also comes to Britain. Investment intentions survey of 231 German owned companies in the UK shows great majority intend to expand here in the near future.

(xii) Overseas debt repayments. Official external debt reduced from over $22 billion in May 1979 to around $12½ billion at end-September 1982.

Economic Briefing Division, HM Treasury, 01-233 5514/5503

B ECONOMIC ACTIVITY AND PROSPECTS

1. Recent output figures

[Latest GDP figures (all three measures) suggest any growth in economic activity in H1 1982 over H2 1981 was slight, but output about 1 per cent higher than in Q2 1981. Industrial production in three months to July unchanged compared with previous three months once adjustments made for holidays in May and June. Underlying level of industrial output 1½ per cent above 1981 Q2 trough - largely attributable to North Sea oil. Trend in manufacturing activity at best flat and may be deteriorating.]

Prospects for recovery this year undoubtedly receded since Budget partly because world recovery has not materialised. But rapid progress on inflation and interest rates, and productivity is higher. Beginnings of recovery in industrial competitiveness must not be undetermined. Industry's contribution to sustaining recovery is decisive; must be ready to meet (modest) recovery in world activity expected next year (see T1).

2. Other evidence of improvement in economy?

See Bull Points (following Section A).

3. Latest CBI assessments?

[CBI October Trends Enquiry shows less optimism on general business outlook and export prospects over next 12 months (optimism net balance fell from minus 22 in July to minus 28 in October). Orders and output have fallen and most (94 per cent of participants) see orders constraining future output. Stock reductions continue and investment intentions have weakened again. Most exporters expect prices to limit new orders. Cost and price pressure remain low, and company liquidity may inprove slightly in next six months. CBI August forecast suggested GDP growth next year of 1-1½ per cent; more recently, CBI emphasising lower end of range.]

Results of October Survey certainly disappointing. But deterioration in optimism, and immediate outlook (next four months), not unexpected and probably reflect in part very depressed level of activity, at home and overseas, this year - much more depressed than expected in spring. Survey not entirely gloomy - favourable developments continue in unit costs and price expectations; firms' liquidity also expected to improve. Prospect remains for renewed modest recovery next year.

4. New orders figures depressing?

[New construction orders in August fell by 22 per cent from around £450 million to £350 million (at 1975 prices) compared previous month. In three months to August, orders fell 6 per cent compared previous three. Volume of new orders in engineering industries fell 9 per cent in three months to July compared previous three.]

Figures manifest depressed economic activity which itself partly reflects flatness in world trade.

5. 80 per cent of extra consumer spending going on imports?

[S Brittan FT 28 October]

This greatly exaggerates the position. May be true for (some) manufactured goods, but for many items of consumer spending - eg housing, services - import content very low.

6. Fall in investment and reduction in stocks?

[Capital expenditure by the manufacturing, distributive and service industries in Q2 1982 4 per cent lower than level in previous quarter. Investment in manufacturing in H1 1982 was 3 per cent lower than in Q4 1981. Stocks fell by £30 million ('75 prices) in Q2; but in the first half of 1982 stocks increased by £100 million compared with destocking of £520 million in second half of 1981. CBI October survey shows, for second successive survey, decline in investment intentions.]

Figures another manifestation of hesitation in economic activity. Despite this, some categories of investment, notably plant and machinery, have held up quite well. [IF PRESSED: latest DOI investment intentions survey shows slight fall in manufacturing investment between 1981 and 1982; Q2 figure not inconsistent with this.]

7. Stock levels a threat to recovery?

Falling interest rates (nominal rates lowest for four years) have eased cash pressures and should assist recovery in stock cycle.

8. Competitiveness not improved this year?

Competitiveness improved 10-15 per cent during 1981 [but remains one third worse than in 1975]. Further improvements, which are essential to regain markets and create new ones, depend above all on substantially lower wage settlements in this pay round than in the last one.

9. Productivity growth falling off?

No; productivity growth in manufacturing at 4½ per cent over last year, and 13 per cent upon end-1980, is well above UK historical average.

10. CSO's index of leading cyclical indicators?

Longer leading index rose again in September reflecting further falls in interest rates and an increase in share prices. Shorter leading index also rose in July and August. Taken with other indicators - including lower inflation and interest rates - these changes are encouraging pointers to future recovery.

C LABOUR MARKET

1. Government concerned over unemployment?

Of course Government concerned; so pursuing balanced fiscal and monetary policies to curb inflation and creating conditions for enterprise - only measures that will ensure sustainable increase in employment. Nevertheless has substantially increased spending on schemes to alleviate impact on especially vulnerable groups.

2. Extent of help?

Government plan to spend £1½ billion in cash in 1982-83 (40 per cent more than in 1981-82) on special employment and training measures (including new Youth Training Scheme costing £1 billion a year from 1982-83); new community programme, designed to provide up to 130,000 places for long term unemployed; and new Job Splitting Subsidy (open on 1 January next year) to encourage extension of part time work and provide additional opportunities for productive jobs for unemployed people.

3. Recent unemployment figures and other labour market indicators?

[Underlying trend in unemployment has deteriorated since Q2, but October figures a little more favourable than of late. Because of seasonal factors, no further sharp rise in 'headline total' expected till January. Recent unemployment/vacancy figures shown below:

	1980 Q4	1981 Q1	Q2	Q3	Q4	1982 Q1	Q2	Q3	Oct
'Total' unemployment	2.16	2.46	2.59	2.93	2.96	3.04	3.01	3.28	3.30 (13.8% rate)
UK adult sa unemployment (millions)	2.02	2.28	2.48	2.64	2.75	2.82	2.88	2.98	3.06 (12.8% rate)
increase in period (000's) monthly averages	+105	+77	+62	+51	+33*	+21*	+30*	+42	+23
Vacancies (000's)	99	98	89	96	104	112	107	111.0	112

*After allowing for over 60's transferring to supplementary benefit.

Other labour market indicators (e.g overtime, short-time) roughly flat for last 6 months.]

October figures cannot provide indication of future trends but are nonetheless welcome. Level of unemployment still tragic, but problems took a long time to build up: will also take a long time to check or reverse. Recent figures reflect levelling out in activity since last autumn. Looking further ahead, lower inflation and interest rates, and improved industrial competitiveness should help promote economic recovery and create climate for sustainable jobs.

4. Unemployment in UK higher than in other countries?

[On standardised definitions in Q2 1982 UK unemployment was 12.7 per cent compared with 8.1 per cent OECD rate; little over doubling for UK compared with OECD rise of over one half since 1979.]

Unemployment now rising sharply in many industrialised countries - in last three months number unemployed (on national definitions - not strictly comparable) rose much more in Canada (up by over 20 per cent), Holland (9 per cent), Ireland (8 per cent), Germany (7 per cent) than in UK (4 per cent).

5. UK's true unemployment figures really much higher?

No one seeks to deny there are unregistered unemployed but reliable estimates of their numbers are difficult to obtain. Available estimates vary quite widely. Figures of registered unemployed are based on accurate counts, have been accepted by successive administrations and provide reasonable estimates of trend.

6. Cost of unemployment/Effect on PSBR?

There can be no single estimate of 'the cost of unemployment'. Only costs that can be at all readily identified are additional expenditure on unemployment benefit, supplementary benefit, rent and rate rebates and administration. (Even these dependent on characteristics of those becoming unemployed - family status, resources etc). These could average £1800 in 1982-83 for each additional registered unemployed person. (NB This cannot be multiplied out by the total number unemployed.)

[IF PRESSED: Estimates of effect of other influences on PSBR directly or indirectly associated with unemployment vary widely depending on large number of highly debatable assumptions. And a major change in the level of unemployment would have impact on other economic indicators effective in the calculation of PSBR.]

7. Unemployment expected to continue rising rapidly?

Unemployment forecasts uncertain; independent forecasters encompass differing views for 1983 - several projecting stabilisation, some [a slight] decline. Though there has been a worsening in the underlying trend in unemployment since June this year, rise for year as a whole has only been some 40 per cent of rate over same period last year. Employment situation should benefit from some further recovery in activity.

8. Fiddling the statistics?

[Rayner cost-saving exercise means that from November onwards method of measuring unemployed will change. November count will be some 100,000 lower than on traditional measure. Even further reduced in summer when school leavers register.]

No question of a fiddle. Detailed and considered study revealed substantial savings on collecting statistics for registered non-claimants. D.Employment will be providing estimates of effect on past statistics, and will provide similar information for up to a year from the change.

9. What is Government's own forecast of unemployment?

Government does not publish such a forecast. Nor did its predecessors. Unemployment depends on many factors: labour supply changes, growth in output and real earnings - all difficult to predict

IF PRESSED: in early 1980 no major outside forecasters accurately foretold fall in manufacturing output nor dramatic labour 'shake-out' of 1980-early 1981.

10. Employment continuing to fall?

[Total employment declined 2.4 million (10½ per cent) between mid 1979 and Q2 1982. Decline of 94,000 in 1982 Q1 increased to 189,000 in 1982 Q2. Manufacturing employment in August fell 35,000 to 5,531,000 (compared 5,871,000 in August 1981).]

Only way to achieve permanent jobs is sustainable recovery, based on improved industrial competitiveness lower inflation and lower interest rates. Substantial provision (£1½ billion) being made to help most vulnerable groups (see C2 above).

11. Recent productivity gains inimical to higher employment/lower unemployment?

[Output per head in manufacturing up 12 per cent since end-1980.]

This may be true in the short run. But in the longer term, as experience in UK, Japan and many other countries clearly demonstrates, higher productivity essential for growth and employment opportunities.

D TAXATION

1. Burden of taxation

[Total taxation (including NIC) as proportion of GDP was 34½ per cent in 1978-79 and is forecast to be 39¾ per cent in 1982-83. Corresponding figures excluding NIC are 28½ per cent and 33 per cent].

Burden has inevitably risen because of upward pressures on public expenditure caused by the recession. Increases in taxation are better - and more honest - means of financing this than borrowing, because of adverse effects borrowing has on interest rates and inflation.

2. British tax burden high by international standards?

Not so. Accurate comparisons difficult, but UK burden about average for OECD countries [1981 data from Lloyds Bank Economic Bulletin, October 1982]. Similarly, UK taxes on household income and employees' social security contributions about average for EC countries and lower than Japan and USA [1980 provisional OECD data].

3. Prospects for cuts in taxation in 1983 Budget?

Cannot, of course, comment now. Progress on inflation and interest rates must be maintained. Remain committed to tax reductions, but these will be made only when they can be afforded.

4. Future of married man's personal allowance?

[Labour party commitment to phase out in favour of increased child benefit etc; reported SDP proposals to abolish as part of new tax-credit scheme to assist lower paid.]

Government launched debate with December 1980 Green Paper on Taxation of Husband and Wife. Very wide range of views received, which government is considering. Abolition of married man's allowance advocated in some quarters would affect many millions of taxpayers and by itself leave a basic rate taxpayer £5 a week worse off. Costs to the losers of large scale schemes to redistribute income cannot be ignored.

5. SDP plan to abolish poverty trap?

Cannot comment on this in detail when only seen advance Press reports. SDP scheme for unified benefit would redistribute income to poor at expense of average working man and his family. Unlikely to abolish poverty trap at quoted cost of £14 billion; a comprehensive solution to the problem along tax credit lines might cost towards £10 billion.

6. Why should private schools enjoy tax reliefs?

Fully in favour of private schools. Tax relief per pupil minor by comparison with cost of state education. It would cost taxpayer £500 million a year to educate in the State system the ½ million or so pupils now in independent schools. [IF PRESSED: tax reliefs difficult to cost but probably worth up to £40 million a year plus around £100 million for exempting fees from VAT.]

6. Previous reductions in personal taxation favour the rich?

1979 Budget cut absurdly high top rates of income tax to European levels, as part of package which also involved substantial increase in thresholds. Such action was essential to restore incentives. No 'pot of gold' in higher rate tax; restoration of 83 per cent top rate would finance a cut of under ¼p in the basic rate.

8. Burden of taxation risen most for the poor?

Proportion of income paid in income tax and NICs has fallen in 1982-83 for lowest paid taxpayers. Low paid with children are also entitled to benefits such as FIS.

9. Government unconcerned about poverty and unemployment traps

[Incidence of 40-50 per cent marginal tax rates given in reply to PQ 25 October W 315. IEA document reported in Press 1 November claims 5 million 'better off without a job'.]

Government equally concerned about poverty and unemployment traps, in context of incentives as a whole. They will remain a key factor in considerations of future tax policy. Traps are essentially caused by measures to relieve poverty and unemployment. Substantive action to alleviate them through the tax system would be extremely costly. Long-term solution must be an increase in wages as a result of a sustained improvement in economic performance.

10. Further reduction in NIS?

Government accept this is a damaging tax and that it would be a good thing to abolish it eventually. This year's reduction will benefit private sector by £640 million in 1982-83. In addition, employers have been shielded from increases in NIC rates over last two years. Cannot comment on possibility of further reductions, which would be expensive.

E PUBLIC EXPENDITURE AND FINANCE

[NB. Some information on spending decisions for the year ahead to be included in Autumn Statement to be published later this month.]

[Public Expenditure White Paper (Cmnd 8494) published 9 March. Gives planning totals of £115.2 billion in 1982-83, £121.1 in 1983-84 and £128.4 in 1984-85. About £5 billion higher than last White Paper in 1982-83 and £7 billion in 1983-84. Net effect of changes announced in Budget is to reduce totals to £114.9 billion, £120.4 billion and £127.6 billion].

1. Public expenditure too high?

Spending in 1982-83 planned to be about £5 billion (4½ per cent) lower than intended by last Government even if higher than planned when this Government first took office. Decisions to increase spending represent flexible but prudent response to changed circumstances e.g additional spending to help young unemployed. Drive to improve management in public sector and reduce administration expenses continues.

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

Ratios in 1980-81 (43 per cent) and 1981-82 (44½ per cent forecast) remain below level of 1974-75 and 1975-76 (46 per cent in both years). Rise in ratio in 1981-82 mainly reflects higher expenditure on social security at a time when real GDP falling. Ratio expected to fall in next few years: assumptions in MTFS would mean figures of 44½ per cent in 1982-83, 42½ per cent in 1983-84 and 41 per cent in 1984-85. Reflects assumed GDP growth and curbing of public expenditure.

3. Higher figures quoted in Weekend World programme 10 October?

[Ratio of public expenditure planned for 1982-83 to GDP in that year given in Weekend World programme was 46.8 per cent. Apparently derived (incorrectly) by someone at ITV taking from the FSBR the wrong numerator for the ratio. They took it from Table 8. The correct figures were given in the FSBR at para 2.21, and a reconciliation set out in Table 6.]

Figure of 46.8 per cent shown on Weekend World for 1982-83 based by them on incorrect calculation. The estimated ratio of public expenditure to GDP in 1982-83 is 44.5 per cent - which compares with 46 per cent in 1975-76 before Mr Healey went to the IMF. As Chancellor said, the intention is to reduce the ratio of public spending to GDP and it could be down to 41 per cent in 1984-85

4. Longer-term outlook for public expenditure?

[Economist 18-24 September reported that radical CPRS proposals to cut public spending in the longer term were tabled but not discussed at Cabinet 9 September.]

There is a problem in that public expenditure has an inherent tendency to creep ever upward - though this Government has been more successful than most in putting the brakes on, Government is looking seriously at various options. No necessarily questions of 'decimating' services; rather of finding best ways of financing better quality with wider choice. No specific decisions have been taken as a result.

5. Increase spending in recession?

No good trying to spend way out of recession. Any benefits would be short-term. If increased spending not financed responsibly, would soon lead to more inflation. If financed prudently, would lead to higher interest rates and/or higher taxes. We are responding, within limits of prudence, to needs of current circumstances.

6. Spending Ministers seeking extra public expenditure in 1983-84?/Treasury once again seeking cuts in public expenditure?

Bids for additional expenditure put forward in usual way as part of annual public expenditure survey. Ministers collectively will have to decide which are to be allowed and, depending on size of any increase, to what extent the increase should be met by savings elsewhere.

7. Not enough 'productive' public investment/needs being jeopardised?

Government not cutting 'productive' investment. Partly question of definition - within figures for capital expenditure totals, council house sales count as a negative item and defence procurement counts as current expenditure. Also, since mid-1970's some needs have declined; future standards and public amenities will not be jeopardised.

8. More capital projects in public sector to help private industry?

Government prepared to give priority to worthwhile capital projects within overall totals. But no question of artificial and inflationary stimulus to demand. New projects must be considered on merits. Nationalised industries investment in 1982-83 planned to be about quarter higher than previous year's outturn. Real answer: to provide private sector with prospect of higher rates of return on investment by continuing policies to lower interest rates and increase incentives.

9. Cash planning means concentration on first year, not enough on services in later years?

Government recognise case for medium-term planning. But planning must be related to availability of finance as well as prospective real resources. Cannot accept unconditional commitment to forward plans for services. Volume plans formerly had to be cut when conflicted with financial constraints - e.g after IMF intervention in 1976.

10. End-year flexibility?

Possibility of end year flexibility is being looked at again. There could be some managerial advantages in such a scheme. But we also have to consider question of cost.

11. Why so much underspending by local authorities on capital expenditure?

Number of reasons including lower tender prices working through. But overwhelming reason was success in selling council houses and unused land.

12. Cut public sector pay bill/administrative costs of central government?

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. Provision for public service pay increases 1982-83 limited to 4 per cent. Administrative costs are not far short of 10 per cent of total public expenditure. We are determined to reduce that proportion, and to maintain drive for more efficient management throughout public sector.

13. Cost of pay rises for public servants - equivalents in public spending programmes?

Every 1 per cent extra on pay for publish servants (excluding Nationalised Industries) costs £335 million - the approximate equivalent of two frigates, 50 Harriers or about 70 miles of motorway.

14. What allowance will Government make for pay increase in public services next year?

Government attaches great importance to realistic wage settlements next year, in both public and private sectors. Provision for public service pay will be made from within cash plans.

15. 3½ per cent pay assumption for 1983-84?

[Announced from Treasury 10 October.]

Assumption is not a 'norm'. Nor is it a decision on the offer to be made in any particular case. Each will be considered on its merits. It concerns the provision in public expenditure plans for next year for those groups for which Government is directly responsible, other than NHS. It does not directly cover local authorities, or nationalised industries, which are not within Government's direct control. But they will be controlled by the rate support grant and the external financing limits.

16. Will Government's operation of cash limits for civil service [and NHS] pay change as result of Megaw Inquiry Report?

Government is committed to policy of using cash limits to control public expenditure. We will consider and discuss the implications of Megaw report (see F4) in due course.

LOCAL GOVERNMENT

17. Local authority capital underspending and measures to prevent recurrence in 1983-84

[Press reports 21 and 29 October.]

Following underspend of more than £¾ billion in 1981-82, local authorities seem set to underspend their capital cash limits for 1982-83 by at least £1 billion - possibly up to £1½ billion (GB figures). Some steps are in hand to reduce the underspend: Prime Minister is writing to local authority associations, and extra allocations - particularly for improvement grants - will be given to authorities who can use them. Environment Secretary has also announced steps to reduce the risk of a further underspend in 1983-84.

[FULLER EXPLANATION was given in Weekly Brief dated 25 October.]

18. Current overspending in 1982-83

Local authorities planning to spend some £1½ billion above Government's plans in 1982-83. In response, Secretaries of State have announced intentions to penalise over-spending by reducing the amount of grant to be distributed to them. (For details, refer to statements in Parliament 27/28 July by Secretaries of State.)

19. Local government finance 1983-84?

Because local authorities are spending so much this year, Government recognise they will spend more in 1983-84. So current expenditure provisions have been increased to ensure that they remain realistic. (For details refer to statements by Secretaries of State in Parliament 27/28 July). Figures announced are subject to consultation with local authorities, but Government is determined that they should be held to levels consistent with objectives for public expenditure and macro-economy.

20. Rate increases in 1983-84?

Spending in line with Government plans would imply only very modest increases overall, and in some areas no need for any increase at all. Of course, in areas where rating authorities overspend, ratepayers will bear a greater burden.

21. Government's plans imply enormous job losses?

Not necessarily. Government's plans for local authority expenditure are realistic and achievable. Local authorities could do a lot to help themselves by moderating pay and improving efficiency.

22. Proposals for direct control of local government spending?

Local authority overspending shows that the traditional consensus with central government is breaking down. We cannot afford to let damaging levels of expenditure continue unchecked. Local authorities' own responsible behaviour may force us to consider more direct action.

23. Green Paper on Domestic Rating System: Government response?

Government is considering carefully all representations received. We wish to produce proposals for a scheme that will remedy shortcomings of present system while commanding wide support.

FALKLANDS EXPENDITURE

24. Falklands defence costs?

[Answers given by PM 26 October OR cols 885-6; Defence Secretary 28 October OR cols W 453-4.]

Latest assessment of costs of operation, and of replacing equipment lost during the conflict, is about £700 million in current year; over next three years the cost will be £200 million, £350 million and £320 million respectively. Decisions have yet to be taken on size (and thus cost) of garrison.

25. Equipment replacement costs

Defence budget will be compensated in full for all Falklands costs. This will include full replacement costs of new - and usually better - ships, aircraft and other equipment. In some cases (eg the four new frigates) Ministry of Defence are considering detailed design requirements before going out to tender.

26. How will the various costs be met?

Extra costs in current year will be met from Contingency Reserve. How future years' expenditure will be funded will depend on decisions in current Public Expenditure Survey. Extra defence costs will be met out of monies additional to path of annual real growth of 3 per cent.

27. What will be costs of repairing damage and reconstructing the Islands' economy?

Too soon to say what these costs will be. Work has begun on restoration of essential services and on implementing Civil Commissioner's recommendations for priority action (accommodation, inter-Islands air service, education). Up to £10 million is being made available for this. Not yet able to say whether these costs will require additions to existing

FCO and ODA funds and how far additional sums will be needed. Ministers studying Shackleton Report proposals for long term development of Islands; in advance of decisions, impossible to say what costs will be.

[BACKGROUND WHICH CAN BE DRAWN UPON: Estimates of cost given in the Report are £31-36 million for new development aid; £40 million for offshore fishing; up to £12 million for additional housing/infrastructure. Total estimate of £83-89 million (at 1982 prices) excludes aid for rehabilitation and compensation for war damage already being made available.]

28. Cost of paying compensation for war damage?

Too soon to say what total will be. Claims are being processed, and further claims may be received. About £1 million has so far been paid out, but this is no guide to what the final total might be. Not yet clear whether the compensation scheme will require an addition to existing FCO programme.

F CIVIL SERVICE STAFFING AND PAY

1. Civil service too big/does too much/is over staffed?

Since Government came to office, Civil Service has been reduced by 10 per cent to 659,300. Results from reduction in functions, privatisation and improvements in efficiency. On course to achieve aim of having Civil Service of 630,000 by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean smallest Civil Service since end of Second World war.

2. Civil service efficiency?

[Government reply to TCSC was published 28 September entitled 'Efficiency and Effectiveness in the Civil Service Government Observations on TCSC Report Cmnd 8616].

Measures to increase efficiency in civil service set out in Government's recent White Paper welcoming Report from TSCS, and accepting (totally or with reservations) no less than 20 of the Committee's 26 recommendations. White Paper gives details of new financial management initiative, and responds to Committee recommendations on management information systems, training in management and financial management, and the filling of senior posts.

3. Civil service pay in 1983?

Unions have asked Government, in light of 3½ per cent planning assumption announced 1 October (see E 15), whether Government intend to have genuine negotiations, and whether arbitration will be available. They believe arbitration should be unconditionally binding ie not subject to Parliamentary over-ride.

4. Megaw Report

[MST speech Harrogate 21 October].

Report of Megaw Inquiry into arrangements for deciding civil service pay in future (Cmnd 8590) contained number of important recommendations which are now being considered. Government pleased with widespread support that has emerged for the general approaches which the Inquiry endorsed. Preliminary 'ground-clearing' discussions with unions have commenced. Not likely new system can be agreed in time for 1983 pay.

4. Scott Report/Public sector pensions?

See K 18.

G SOCIAL SECURITY

[NB Announcement about NI contributions in coming year expected to be included in Autumn Statement later this month.]

1.Increase in National Insurance contributions?

We are currently engaged in the annual review of national insurance contributions. It is too early to say what that review will produce.

2. Uprating benefits - will Government claw back any overshoot?

[Most benefits will be uprated by 11 per cent on 23 November. 9 per cent of this is to compensate for price increases over previous year].

Inflation is falling faster than was forecast at Budget time and we expect the outcome to be lower than the 9 per cent forecast. We shall not know the extent for some weeks yet. This November's uprating will of course go ahead as planned. The 1983 uprating will be decided nearer the time. It will depend on the forecast movement in prices which will be made at Budget time, and whether the Government decides to take account of any overshoot this year. No decision has yet been taken.

3. Burden of State pension scheme too high?

[Government Actuary's Department Quinquennial Review of National Insurance Fund, published Wednesday 21 July, analysed possible future (up to forty years) cost of contributory benefits and levels of contributions needed to pay for them. Most important factor is increasing expenditure on earnings-related pension. Conclusions depend on assumptions about growth in earnings, prices, unemployment etc over period, but on certain assumptions contributions could change from present relationship to earnings - 16.5 per cent combined employees' and employers' contributions - to 15.4 per cent by 1985-86, but rise to 16.7 per cent by year 2005-6 and 21.9 per cent by 2025-6.]

Government Actuary's conclusions not firm predictions but illustrations of possible future burden on certain assumptions. We shall be considering report carefully before reaching any conclusion. In meantime DHSS are consulting widely with interested organisations and would welcome comments by end of this year.

4. Occupational pensions - increase supervision?

[Recent report by Occupational Pensions Board recommending, inter alia, disclosure of information to pension fund members; end to 'franking' (whereby schemes implement requirement to maintain value of guaranteed minimum pension only by eroding accumulated pension rights above that minimum).]

Government welcome recommendations of OPB. Accept in principle need for legislation on disclosure of information to members of pension funds. Social Services Secretary will be consulting interested parties about content. He also hopes to bring forward in first half of next year regulations to prohibit practice of 'franking'.

5. Death grant - increase to realistic level?

[Consultative document about death grant published 3 March, deadline for comments 30 July.]

Social Services Secretary grateful for comments received on consultative document on death grant published in spring and is considering them carefully.

6. Restore abatement of Unemployment Benefit?

Our position on this has been made clear. We reviewed the possibility of restoring the abatement when the benefit was brought into tax in July, but concluded that we could not afford to do so. The matter is being kept under review, and I have nothing more to add.

7. But abatement was a proxy for tax?

Always made clear when decision to abate was announced that it was not solely a proxy for tax but also part of a public expenditure savings package, and a measure likely to improve work incentives.

8. Cost of restoration substantially less than tax revenue?

[Cost of restoration £20 million first year, £60 million full year. Revenue from taxation now estimated at £650 million.]

Wrong in principle to hypothecate money from taxing benefits. But if MPs want to make such a comparison I would draw attention to cost of restoring shortfall in November 1981 uprating - £525 million in full year - this and other increases in social security expenditure more than accounts for the additional revenue.

9. Abatement hits at poorest section of the community?

Only one quarter of the unemployed are solely dependent on UB and hence affected by the abatement. All those affected will have been unemployed for no more than a year and are primarily single people or childless married couples.

10. Cost of social security proposals in 'Labour's Programme 1982'?

[Proposals include raising single/married pension to one-third/half of average earnings; reducing pension age to 60; increasing Child Benefit to £7.75; paying unemployment benefit for men, without limiting duration, at rate equal to RP.]

Cost of implementing Labour's proposals in full probably over £20 billion in full year - an increase of over 60 per cent in social security programme. Labour proposes revenue increases to finance changes of less than £4 billion (abolition of married man's tax allowance and of upper earnings limit of contributions). To raise remainder would require, for example, rise in employee's NIC from 8.75 per cent to around 22 per cent; or rise in basic rate income tax to 46p in £.

H FISCAL POLICY AND THE PSBR

1. Progress on fiscal policy?

[Aim is to achieve reduction in PSBR as percentage of GDP over run of years, so as to achieve lower inflation and interest rates.]

Have made progress; Government has succeeded in reducing PSBR as percentage of GDP, and further reduction is projected. Inflation has fallen fast and is expected to fall further (see K2-3). Long term interest rates now lower than at any time in last 9 years. Benefits seen in recovery of debenture market. [IF PRESSED: Government would like to see rates lower still, so long as further reductions not likely to endanger progress or inflation.]

2. How does UK fiscal stance compare with other countries?

[IMF Annual Report noted that among major industrial countries by far the largest 'restrictive shift' over past two years, equivalent to more than 3½ per cent, was that of UK.]

Many countries reducing borrowing; UK budget deficit now well below average of OECD countries. France demonstrates problems with reflation option and US experience shows that fiscal and monetary policy must be broadly consistent.

3. 1981-82 undershoot shows fiscal policy too tight?

[PSBR for last year turned out £1.8 billion lower than estimate of £10.6 billion given in 1982-83 FSBR.]

Last year's undershoot probably does mean fiscal policy somewhat tighter than planned, but must examine strategy as a whole. Firm control of Government borrowing one factor responsible for fall in short term interest rates (6½ percentage points down since last autumn). Recovery of corporate bond market shows how lower PSBR creates room for investment.

4. Why treat PSBR as crucial statistic when prone to very substantial forecasting error?

[Margins of error are wide: plus or minus £4 billion.]

Although forecasting PSBR is hazardous, this in no way diminishes importance of achieving better balance between Government spending and income. Recognised by all Governments, whatever the difficulties of forecasting.

5. 1982-83 PSBR heading for undershoot?

[1982-83 FSBR forecast £9.5 billion. PSBR April-September £4.5 billion (£3.0 billion seasonally adjusted).]

Now looks as though PSBR in 1982-83 could be lower than the 1982 Budget forecast. Next indication of likely PSBR outturn will be given at time of Industry Act forecast (to be published, probably, next month).

6. PSBR in 1982-83 likely to be about £6 billion?

[Seasonally adjusted, PSBR April-September £3.0 billion. Commentators may multiply this by two to get £6 billion as PSBR figure for year as whole.]

No; wrong to multiply seasonally adjusted half-yearly outturn by two as there are many erratic and irregular influences in the underlying data which seasonal adjustment does not pick up.

[IF PRESSED: what factors will increase PSBR in rest of year?

Public corporations expected to borrow more in second half of year than their £0.4 billion to end-September; there are a number of outstanding public sector pay awards which have not been implemented (eg nurses); National Insurance up-rating of 11 per cent, higher than present rate of inflation, will affect second half of year.]

7. Unadjusted PSBR misleading guide to fiscal action?

Cyclically-adjusted PSBR may have some merit as indicator but poor guide to fiscal policy. It is actual Government expenditure and revenue that have to be financed and influence interest rates and aggregate demand.

8. Inflation-adjusted or 'real' PSBR in surplus - isn't fiscal policy too tight?

['Real' PSBR subtracts from actual PSBR erosion by inflation of real value of Government debt. Calculations by Bank of England and others produce a surplus 'real' PSBR in most years since the 60's].

Policy of this Government is to fight inflation, not to accommodate it. If 'inflation-adjusted PSBR' is in surplus, this calls for cut in inflation, not expansion of actual PSBR.

J MONETARY AND FINANCIAL POLICY

1. Monetary growth in 1982-83 on target

[The target aggregates M1, £M3 and PSL2 grew by 1.2, 1.1 and 0.9 per cent respectively in banking September. These changes bring rates of growth in the 1982-83 target period to 9½, 11½ and 8½ per cent per annum respectively, compared with target range of 8-12 per cent (all figures seasonally adjusted).]

Rates of growth of all three target aggregates are within Government's target range. £M3 is towards top of range. But looking also at behaviour of exchange rate and progress in reducing inflation, overall picture is of sound domestic monetary conditions.

2. Prospects for further reductions in interest rates?

[Last reduction in bank base rates made on 13 October - to 9½ per cent. Have come down by 6½ points since peak in September 1981. Long term interest rates also reduced significantly - by one point in October alone - 6 points since peak last year.]

Substantial interest rate reductions this year reflect sound monetary conditions, and good inflation prospects. Impulse also from US developments. Government would like to see rates lower still, so long as further reductions do not seem likely to endanger progress on inflation.

3. Benefit of interest rate falls to home buyers

Mortgage rate falls mean for average couple buying first home, saving of over £20 a month.

4. Effect of US interest rates on ours?

[US rates fell substantially during July/August, and again in October.]

The falls in US rates were helpful and facilitated reductions in our own. But of course US rates are not sole determinant of UK's, and this spring progress was made in reducing ours at a time when US rates were rising. UK rates are determined in the light of domestic monetary conditions generally, including the behaviour of the exchange rate.

5. Monetary conditions too tight - stifling recovery?

No. Behaviour of exchange rate and money supply suggest financial conditions moderately restrictive, as intended. Interest rates reductions have cut companies' costs and should promote climate for investment. Have given boost to corporate bond market - reducing companies' dependence on banks and easing pressure on monetary growth.

6. Bank lending growing too fast?

[Lower growth rate in May/June not maintained. Increased by £1.3 billion in banking August and £2 billion in September (seasonally adjusted).]

Reasons for growth of bank lending to companies not entirely clear. Companies may be trying to build up gross liquidity levels which fell back in spring. Strong growth in personal lending is partly result of structural changes, such as move by banks into home loans market, replacing lending by building societies; ending of HP controls in July does not appear to have had a large effect. To the extent that increases in bank lending are additional, ie not just in substitution for lending by eg building societies, do represent potential cause for concern, as add to monetary growth. To be taken into account in interest rate policy.

7. Prospects for reactivation of corporate bond market?

[Tax treatment of 'zero coupon' and 'deep discount' stocks and removal of embargo on company issues of this type of stock announced 25 June. BOC announced issue of £100 million conventional bond 10 September, followed by other companies.]

Zeros broaden options available to companies, though not expected to transform capital market. Best hopes for resurgence of market provided by lower interest rates and inflation, for which we are on course.

8. Why has Bank of England been providing such large-scale money market assistance?

The rapid growth of bank lending has caused problems for conduct of monetary policy. By selling long-term Government debt on a larger scale outside the banking system, it has been possible to contain the rapid growth in money which could otherwise have taken place. This in turn has created shortages of liquidity in money markets. If Bank had not intervened, short-term interest rates would have been forced up to unnecessarily high levels.

9. Measures announced in June

[Variable rate loans facility made available to local authorities etc from National Loans Fund/Public Works Loans Board; companies allowed to issue 'zero coupon' and 'deep discount' stocks]

These measures should reduce rate of growth of bank lending by encouraging LAs etc to borrow from the NLF instead of from banks and by broadening options available to companies issuing their own debt - and so reduce levels of funding, and of assistance required.

K PRICES AND EARNINGS

PRICES

1. September RPI

[Year on year increase in RPI 7.3 per cent in September, compared with 8.0 per cent in August].

Annual rate of inflation fell sharply in September to 7.3 per cent, its lowest level for 10 years (compared 7.0 per cent in September 1972). The price level in September was no higher than in June and actually slightly (0.1 per cent) lower than in August - the first time the index has fallen for 12 years (since August 1970).

2. How low inflation by end 1982?

[Budget time forecast Q4 1981 to Q4 1982 9 per cent and Q2 1982 to Q2 1983 7½ per cent.]

We expect inflation could be as low as 6½ per cent by end 1982.

3. Further falls likely in 1983?

We expect inflation to be down to 5 per cent next spring.

4. Inflation turning up again next autumn?

No evidence at all for expecting a rise in inflation next year. Government is resolved to continue getting it down.

5. Inflation lower than under previous Government?

[Average year-on-year rate of inflation between February 1974 and May 1979 was 15.4 per cent; average level of inflation since May 1979 has been 12.8 per cent.]

Year-on-year rate of inflation was 10.3 per cent and rising when previous Government left office in May 1979. Now (September 1982) 7.3 per cent and falling. We will be first Government for quarter of a century to achieve a lower average rate of inflation during its term of office than the previous Administration.

6. Inflation still not as low as competitors?

[August figures: UK inflation 7.3 per cent in September compared with 5.0 per cent in US, 4.9 per cent in West Germany, and (August figure) 3.1 per cent in Japan.]

UK inflation now lower than Western European (OECD Europe) average, and well below many countries - such as France and Italy. Still some way to go to match US, West Germany and Japan, but good progress being made in right direction.

7. Long term inflation objective?

Recent developments encouraging. But inflation rate still higher than some competitors e.g Germany. Must not let up. Have always made it clear that price stability not unattainable.

8. TPI now shows pay increases need to be ½ per cent higher than RPI to maintain living standards?

[Increase in TPI over 12 months to September 7.9 per cent, compared with RPI increase of 7.3 per cent].

The gap between the RPI and the TPI (now 0.6 percentage points) widened in July when benefits paid to the unemployed became taxable. Pay increases go to people in work, who will not pay any more tax as result of the change - except for the minority who have a spell of unemployment during the year.

9. Nationalised industry prices

[Increase over 12 months to September 13.7 per cent, compared RPI increase of 7.3 per cent].

Increases regrettable, but holding prices down artificially would distort market forces and add to burden on taxpayer. Underlying position has been improving steadily for past year or so. But sustained improvement only possible if industries succeed in holding down current costs, particularly pay. (See also Section R).

PAY

10. Average earnings index

[Year on year growth 7.8 per cent in August compared with 10.9 per cent in July, but August index artificially low because of large amount of civil service back pay paid in August 1981. Underlying increase about 9 per cent in both July and August.]

Encouraging that underlying rate of growth continues to fall. Further moderation in settlements can only be helpful in maintaining jobs and getting inflation down.

11. 1982 New Earnings Survey shows public services falling behind?

Taking account of the effect of overtime on those working in the private sector, and public service settlements which were delayed beyond the Survey date, difference shown between public services and private sector pay movements over period covered by April 1981 and 1982 Surveys no more than 2 per cent.

12. A 3½ per cent pay policy?

The 3½ per cent pay assumption [announced 1 October for calculating the pay element in cash expenditure plans for 1983-84] does not represent a 'norm', still less an 'incomes policy'.

Nor is it a decision on the offer to be made in any individual case. Settlements higher or lower than the assumption are not ruled out. Each case will be considered on merits.

13. What pay settlements does Government now want?

Low enough to be consistent with improved job prospects in the industry concerned. The lower the better. Certainly lower than in the past year.

14. What has been average over past year/pay round?

[CBI Databank suggests 7 per cent average for manufacturing in last (1981-82) pay round.]

Average has been in single figures, and moving downwards, in each of past two years. We need a substantial further reduction, with really low settlements, and thus a better outlook for jobs, in the year ahead.

15. Government exhortations on pay imply aiming to cut living standards?

[Real earnings show little variation over past two years; August 1982 broadly similar to August 1981 and about 1 per cent higher than August 1980.]

Lower pay settlements have not in fact cut real earnings in either of the past two years; prices have also come down. This fact casts doubt on the wilder claims about the effect of pay moderation on living standards.

16. Incomes Policy

Proposals for incomes policies, including recent refinements, do not avoid many of the familiar problems of norms, administrative costs, and interference with market forces. Experience gives no encouragement to the idea that incomes policy can be made to work on a permanent basis. They always succumb to the distortions they create.

17 Current position on NHS dispute

Government has twice increased money available, to final offers ranging from 6 to 7½ per cent. Now offered two-year pay settlement. Unions have refused to move from original claim of 12 per cent. Unlike Royal College of Nurses and other professional bodies, unions have refused even to discuss latest proposals.

18. Index-linked pensions and Scott report?

Question debated in House of Commons 22 October, when Government announced they favoured Megaw Committee suggestion that civil service pension scheme be made contributory. Reduction in inflation has greatly eased disparity between private and public sector pensions; Government's main aim at present is to ensure appropriate contributions are paid for index-linked benefits.

L BALANCE OF PAYMENTS

1. Trade figures and current account

[September trade figures show trade account in broad balance though non-oil trade remain in deficit; projected invisibles surplus of £260 million a month in Q2 and £200 million a month in Q3. Cumulative current account surplus of £2.6 billion in nine months to September.]

Signs are that the current account continues in substantial surplus, albeit reduced from last year's levels - current account surplus for 1981 was £6 billion.

2. Export trends

Exports during 1982 have been very erratic. There was a sharp recovery in exports in September from the erratically low August level and, although the underlying trend seems to have fallen since the spring, exports seem to be holding up better than expected given the poor level of world trade.

3. Import trends

Manufactured imports increased in September but were still below their high May levels. The underlying level of manufacturing imports has probably not altered since end-1981 when manufacturing activity levelled off.

4. Figures for 1981

1981 figures are now complete.

5. New import controls on way?

[Continuing Press speculation].

We are concerned at the extent of unfair trading practices and the damaging effect of very high tarriffs and quotas in some other countries. But wish to make clear, as Chancellor said last Friday [Caterham 22 October] that 'we will be continuing to defend the open trading system'. A free and fair trading system is in the interest of all trading nations.

6. Overseas investment takes jobs away from UK?

30 per cent of UK exports are bought by overseas firms connected with UK companies. By increasing links between UK and overseas companies, overseas investment helps UK exports and production, so producing more jobs. If UK does not take profitable opportunities to invest overseas, others will.

M EXCHANGE RATE AND THE RESERVES

1. Policy towards the exchange rate/falling £?

[The average £ effective rate in Q3 1982 was nearly 10 per cent lower than in Q1 1981. In last few months £ has remained broadly stable. Lately £ has been strong in effective terms although it has lost ground against the stronger dollar. Rates at noon on 29 October were $1.6734 (a new six-year low), DM 4.2939 and an effective of 92.4. Previous lows were $1.6708 on 17 December 1976, DM 4.098 on 21 May. Highs were $1.97 on 30 November 1981, DM 4.407 on 9 February. Reserves at end September stood at $18.3 billion, compared with $18.1 billion at end August.]

Government has no target for exchange rate. The exchange rate is only one of the factors taken into account in interpreting domestic monetary conditions and taking decisions on policy. Sterling's effective exchange rate has continued to show the broadly stable pattern of recent months. This stability reflects the continuing international confidence in this Government's economic policies.

2. Improve UK competitiveness by devaluing exchange rate?

[Sam Brittan in FT 28 October.]

Experience shows that exchange rate cannot be manipulated by Government against underlying market trends. Any attempt to lower it by intervention or by relaxing monetary control leads to higher inflation. For example the effective exchange rate depreciated by over a quarter between 1973 and 1976 without leading on balance to any improvement in UK competitiveness.

3. Bank of England intervening to support the rate?

Policy is unchanged. Bank do intervene to smooth excessive fluctuations and preserve orderly markets particularly when conditions unsettled. But, as Chancellor has already stated, we have no target - undisclosed, secret or otherwise - for the exchange rate. Most recent reserves figures confirm that policy is unchanged.

4. Concerted intervention to reduce value of dollar?

All experience in recent years that exchange rates for major currencies cannot be manipulated by intervention alone. Intervention can help to steady markets, but not counter major exchange rate trends. That takes changes in real policies, affecting interest rates, monetary conditions and fiscal policies. Lower US inflation is in everyone's interest: matter for real concern is US fiscal/interest rate mix, a problem all countries are familiar with.

5. Debt repayments

We have made excellent progress with our plans to reduce the burden of external debt substantially during this Parliament. We aimed to reduce official external debt to $14 billion by end of 1981. This has been more than achieved - external debt is now around $13 billion, compared with over $22 billion when the Government took office.

N EUROPEAN MATTERS

MEMBERSHIP OF EUROPEAN COMMUNITY

1. UK budget settlement

Foreign Ministers agreed on 25 May to a settlement for the UK budget contribution for 1982. The settlement provides for a basic refund of about £470 million in respect of 1982, with provision for changes to this figure if our unadjusted net contribution varies from the Commission estimate of £880 million. It was also agreed that the problem for the longer term would be settled by the end of November.

2. Implementation of budget settlement

Final agreement was reached by Foreign Ministers on 25/26 October. Although the UK will not now be fully compensated for our contribution to German refunds, we shall receive our 1982 refunds of 1,092 millionecus, about £600 million gross, much earlier than originally envisaged. Payment will now be made before the end of December this year rather than in March next year or later - a significant improvement for the UK.

3. UK objectives for longer-term negotiations?

Government has made it clear that, in spite of our relative economic position, UK is prepared to remain a net contributor - but only on a very modest scale.

4. Will Government withhold contributions?

We hope very much that the issue of our Budget contributions can be satisfactorily settled without the need for recourse to such a step.

5. Commission's ideas for changes to 'own resources' system

Understand that Commission are considering measures to diversify Community's revenue sources. If they put forward proposals we will consider them. Our opposition to any increase in the 1 per cent VAT ceiling is well known.

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

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.

9. Join the EMS for exchange rate stability?

There is no reason to suppose that by the simple act of joining the EMS exchange rate mechanism we would guarantee exchange rate stability. This has not been the experience of the current participants. Genuine stability requires a return to low inflation rates throughout the Community.

P INDUSTRY

1. Prospects for industry-recovery?

See A2-4 and Section B.

2. Companies' financial position?

[£bn

	1979	1980	1981 Year	H1	H2	1982 H1
Net borrowing requirement (+)/repayments (-)	+6.3	+6.5	+5.1	-1.5	+6.6	+5.6
Financial surplus (+)/deficit (-)	-2.9	-1.4	+1.8	+1.0	+8	-1.3]

Financial position of industrial and commercial companies (excluding North Sea) improved last year, relative to 1979 and 1980. Improvement in part reflected companies' efforts to cut costs, for example by de-stocking. Some apparent deterioration in second half 1981 financial position due to slowdown in de-stocking and unwinding of delays in tax payments because of the civil service dispute. Figures for H1 1982 suggest reduction in companies' borrowing requirements relative to H2 1981; but borrowing needs still high.

3. Profits rate of return still too low?

[Gross trading profits of industrial and commercial companies (ICCs) (net of stock appreciation) rose 18 per cent to 1982 H1; but increase was from a very low base ICC's real pre-tax rate of return (except North Sea was just over 3 per cent in 1981, and only 2 per cent in manufacturing - half previous cyclical low figure in 1975.]

Government can help best by getting inflation down and setting sound basis for sustained recovery. Fundamental improvement in ICC's rates of return depend on better performance by companies. Some encouragement from recent productivity gains and trend towards moderate pay settlements.

4. Real rates of return on capital lower in UK than elsewhere?

[OECD statistics comparing UK, Japan, France and UK show net rates of return to fixed capital in non-financial corporations in 195-80 lowest in UK - though all on a downward trend. 1980 figures: US 13 per cent, Japan 15 per cent, France 9 per cent, UK 5 per cent.]

Figures show how policies of earlier administrations have allowed profitability to slide in UK. Sound basis for sustained recovery rests on reducing inflation, increased productivity gains, and moderation in pay settlements which creates conditions for better performance by companies.

5. High interest rates damaging for industry and investment?

Banks' base rates have fallen 6½ percentage points since last October, and 3 points over last three months. Outside analysis suggests that a 1 per cent reduction in interest rates improves the net financial position of the company sector by about £250 million over a full year. Lower interest rates reflect Government's firm fiscal and monetary stance and will help industry and investment.

6. Lower rates for industry?

De-rating one of a number of possible ways of assisting industry and business, but in last Budget preference given to other forms of relief, notably reductions in NIS. De-rating would be expensive, though less so if applied to industry alone - even so, 10 per cent de-rating would cost about £140 million per annum. Legislation would be required.

7. Lower energy prices

See R3.

8. Government help for small firms

Budget provided further help for small businesses, increasing the number of measures taken ~~so~~ far to over 100. Enterprise package included further reduction in weight of corporation tax; further increases in VAT registration limits; increase in global amount available for loans under Loan Guarantee Scheme (see below); and doubling of investment limit under Business Start-Up Scheme to £20,000 a year. New measures will encourage start-ups and existing firms.

9. How many new firms starting up?

[Correspondence in progress between Treasury and D Industry about value of giving 'net' figures of 'birth' of minus 'deaths' of companies based on VAT registrations.]

On a very rough average some 10,000 new companies come into being every month.

10. Response to Loan Guarantee Scheme?

[Over 6,400 guarantees already issued - about half to new businesses. Total lending under scheme around £215 million. Budget provided for lending ceiling in first year (to May 1982) to be raised from £100 million to £150 million and for further £150 million to be available in second year (to May 1983). Thirty financial institutions now participating.]

Scheme operating successfully. Too early to assess overall cost . After first year, out of over 6000 guarantees issued, only 150 have so far been 'called'. Cost has been covered by the premium income received over the period. Scheme is kept under continuous review.

11. New enterprise zones

Chancellor announced Tuesday 27 July eleven new Enterprise Zones to be created: 7 in England; two in Scotland; one each in Wales and Northern Ireland. Applications from local authorities in all four countries for sites in their areas to be designated now being considered. (53 applications in England).

12. First group of enterprise zones

All first eleven zones now in operation. 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.

13. Is is true that a committee has been set up to consider changing basis of regional assistance?

[Report in FT 25 October.]

Regional policy is, like other Government policies, continually open to scrutiny in case improvements can be made. [IF PRESSED: But cannot comment on precise details of official committees.]

R NATIONALISED INDUSTRIES

NATIONALISED INDUSTRY PAY AND PRICES

1. Nationalised industries' prices

[Having risen approximately in line with retail prices for several months, the latest figures show bigger 12 months increase in nationalised industry prices, water charges and London Transport fares than all items RPI (13.7 per cent in Sept. compared 7.3 per cent). This differential reflects March increase in LT fares. Removal of these temporary distortions confirms that nationalised industry prices are still increasing somewhat faster than RPI, largely because of increases in energy sector.]

Gap between nationalised industry price increases and RPI has been due in large measure to cumulative effect of years of artifical price restraint. World oil price rises of 1979 and 1980 have also played an important part. We greatly regret the need for these increases, but holding prices down artificially would distort market forces and add to burden on taxpayer. Underlying position has been improving steadily for past year or so. The differential between RPI (all items) and NI prices (including water charges and London Transport fares) is now 6 per cent compared with 14 per cent in January 1982. But sustained improvement will only be possible if the industries succeed in holding down their current costs, particularly pay.

2. Increase in gas prices?

[Domestic gas prices increased on 1 October. Some Press speculation that industry will have to pay 1p per therm more each quarter as contracts come up for renewal next year]

Large increase in domestic prices over last three years needed to remedy under-pricing by previous Government. There will be no more massive increases in gas prices. Industrial gas users have benefited from two years of virtual freeze on renewal prices for contract gas. BCG not yet decided on pricing strategy following lifting of the freeze at end of this year.

3. Energy prices should be brought into line with those of main competitors - CBI view?

Oil is now traded internationally and its value is set accordingly. Coal and gas prices to industrial users are also broadly in line with those in Europe. As for electricity, for vast majority of industrial users, prices are in line with those in Europe, with exception of France and prices for intensive users of electricity in Germany. Assistance for extensive users of electricity in UK was introduced in this year's Budget. Structure of electricity pricing is being studied in context of the BulkSupply Tariff Review.

4. <u>What is Government doing to improve nationalised industries' efficiency?</u>

We continue to press for greater efficiency within NIs. We are setting realistic financial targets and performance aims. A rolling programme of Monopolies and Mergers Commission investigations has been set up. The introduction of market forces provides greatest incentive to efficiency.

INVESTMENT

5. <u>Nationalised industries' investment should be stepped up to/improve infrastructure/provide orders to private sector/as boost to economy</u>

Government has not prevented the industries from carrying forward a large number of profitable investment programmes. It would be wasteful to provide funds for public sector projects with lower returns than those in the private sector. Unfortunately, the pre-tax rate of return on nationalised industries' capital (including subsidies) in 1980 (latest available figures) was minus one per cent, compared with 3 per cent for industrial and commercial companies.

6. <u>Finance more nationalised industry investment by cutting current spending?</u>

As in private sector, moderate pay settlements and control of other costs are essential. Ability to finance new investment in nationalised industries bound to diminish if excessive pay settlements agreed. Each 1 per cent off wages saves about £140 million this year; and each 1 per cent off total costs saves £330 million this year.

7. <u>Take nationalised industry investment out of PSBR?</u>

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

8. <u>Private finance for NI investment?</u>

In discussions in NEDC and elsewhere, we have indicated our willingness to consider new financing proposals, provided they can be structured so as to induce improvements in efficiency at least sufficient to offset the extra cost, and provided the finance is raised in fair competition with the private sector.

9. <u>Investment plans unlikely to be attained ?</u>

/Letter sent to chairman of Nationalised Industries' Chairmen's Group stressing importance of maintaining NI investment programme/

<u>No</u> Government can unconditionally guarantee a particular level of

investment by the nationalised industries. NI planned investment for 1982-83 26 per cent higher than estimated out-turn 1981-82. Some signs planes may not be fulfilled. Events outside industries' control may cause investment plans to be revised downwards. Hope this will not happen.

EXTERNAL FINANCING LIMITS

10. EFLs for 1982-83 and future years?

Nationalised industries' total external finance increased by £1.3 billion in 1982-83 (£1.2 billion after allowing for NIS cut and other changes). Increase in 1982-83 was roughly half what the industries bid for. Government has given full recognition to problems faced by the industries in a period of recession. EFL's for 1983-84 will be announced later this year, as usual.

PRIVATISATION

11. Special asset sales in 1981-82

Gross ~~sales in~~ 1981-82 totalled £481 million, so target published in 1981 Public Expenditure ~~White Paper~~ of £500 million nearly met. Pleasing result - included two large sales - Cable and Wireless (£182 million) and Amersham International (£64 million). True that delivery of BNOC oil in 1981-82 paid for in 1980-81 and taken into account in special disposals figure for that year reduced 1981-82 receipts by £573 million to total of -£92 million. But it is gross figure which is true measure of success of Government's privatisation programme. As Chancellor said in Cambridge 3 July, 'Public utilities and the so-called "natural monopolies" cannot be allowed permanently and without challenge to remain within State ownership'.

12. What further sales expected?

Special sales of assets in 1982-83 forecast at around £600 million and expected to increase in subsequent years. This year's and next year's involve primarily very large sales of energy assets - Britoil and the British Gas Corporation's major offshore oil assets - made possible by Oil and Gas (Enterprise) Act (which received Royal Assent in June). Industry Secretary announced 19 July plans to sell 51 per cent of British Telecom - but not before next Election.

13. Will Government postpone Britoil sale to prevent it being sold too cheaply?

Government intends to sell majority of Britoil shares in November, if market conditions permit. We expect investors will take a long term view of the value of Britoil's shares.

14. Contribution to giving people satisfaction of property ownership?

Exercise of returning enterprises from State ownership to ownership by the public has included measures to promote employee share ownership in the enterprise they work for; for example free offers of shares (British Aerospace, Cable and Wireless, Amersham); preference in allocation of shares (B Ae, C & W, Amersham, BP); provision for matching shares - one for each share subscribed for - (B Ae, Amersham, BP). Most radical initiative taken by consortium of managers and employees who bought National Freight Company.

15. Government has sold assets too cheap?

[Heavy oversubscription for British Aerospace, Cable and Wireless, Amersham International, followed by large increases in prices when shares first traded.]

Not in Government's interest to see shares underpriced, given the loss to the PSBR, but also risks in pitching price too high. Getting balance right not easy - especially when company's shares have not previously been traded. Government will continue to consider alternative forms of sale eg tender, but critics should note that sale by tender could make it harder for small investor to buy shares.

S NORTH SEA AND UK ECONOMY

1. Is Government underestimating North Sea revenues?

[FSBR projections (in money of the day) of Government revenues from North Sea: £6.4 billion in 1981-82, £6.2 billion in 1982-83, £6.1 billion in 1983-84, and £8.0 billion in 1984-84. Lower than last year's projections, principally because of downward revision to oil price expectations].

Projections of oil revenues and crucially dependent on inherently uncertain cost, price and production assumptions. Prospects for North Sea revenues have improved since FSBR published because of higher than assumed oil prices. Higher recent estimates of Scott, Goff and Hancock and the Midland Bank Review are based on higher expected future production and lower expected future capital expenditure.

2. Onerous tax system damaging future field developments?

[Shell/ESSO have shelved plans for Tern partly because of tax system; Phillips postponing T-block complex and BP their Andrew field; BP statement issued with their interim results criticised fiscal regime.].

Other adverse factors - falling oil prices earlier this year; high development costs - much more important. Detailed study has shown that under new tax structure, levels of profitability should still be sufficient to make exploration and development attractive. Hope that present structure will provide more secure and stable tax regime.

3. Government about to relax North Sea fiscal regime?

No decisions have been taken, but fact-finding discussions taking place with UKOOA and individual oil companies. Government wishes to give oil companies every opportunity to present their evidence about profitability in the North Sea. The regime is kept under review.

4. Taxation of petrochemical feedstocks

[Government has announced that new rules on valuation of ethane for petrochemical use in interaffiliate transfers (Finance Act Section 134) should be extended to mixed streams of gas with a large ethane component. ICI complain that the extension and the rules themselves give unfair advantage to their integrated oil company competitors and have taken out writ against the Government.]

Government convinced that new formula will give fair valuation. New valuation will not have effect of providing subsidy to ICI's competitors. Have done best to reassure ICI. Will resist ICI's legal action.

5. Government should do more to promote UK Continental Shelf oil production in 1990's?

[Select Committee on Energy's Report on Depletion Policy published 18 May: emphasised development of fields entering production in 1990s by increasing pace of licensing rounds

and overhauling fiscal regime. Recommended reserve powers to impose production cuts. Energy Secretary and Chancellor replied in joint memorandum on 29 July].

HMG agrees with general conclusions encouraging North Sea exploration and development, thereby maximising economic oil production over time; eg decision recently announced not to impose production cuts before 1985. Agree uncertainties in oil markets too great to justify deferring new field developments in foreseeable future. Cannot accept Committee's criticism of North Sea fiscal regime - opposed to another fundamental review; industry does not want a structural upheaval.

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

[Contribution of North Sea to GNP estimated at 4 per cent of GNP in 1981. Not projected to rise before 1985.]

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 lower level of interest rates to benefit of industry and economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Less than 6 per cent of total General Government receipts in 1981-82.

7. North Sea revenues should be channelled into special fund?

North Sea revenues are already committed. Setting up special Fund would make no difference. More money would not magically become available.

8. Future North Sea oil prices?

A matter for commercial negotiation between oil companies and BNOC.

9. Are we really any better off for our North Sea oil?

We are better off with oil - at current oil prices - than we would have been without it. We have been spared fall in real national income that other industrial countries have suffered following oil price rises. But North Sea oil costly to produce, so we are not necessarily any better off than we would have been had oil prices not risen. No need therefore for possession of oil to require a contraction in our industrial base.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Prospects for world recovery?

[IMF, London Business School and Bank of England Quarterly Bulletin all gloomy about immediate prospects. No overall growth seen in major countries in 1982, and only weak recovery next year. Press reports suggest OECD will also revise its previous forecasts this autumn.]

Output in the major economies appears to have recovered slightly in the spring after the downturn last winter. US economy grew slightly in both Q2 and Q3. The major European economies, however, remain depressed, and it is too early to say that a broad upturn has started. Lower inflation and interest rates however offer prospects for better growth next year.

2. Why don't major industrial countries together expand demand?

Leaders of the major countries agreed at the OECD, Summit and IMF meetings on the need to continue the fight against inflation. As the OECD's Economic Outlook explains, Governments are convinced 'a significant part of any stimulus to demand would increase public sector deficits, and dissipate itself rather quickly as an increase in inflation'.

3. Anti-inflation policies are working

[Consumer price inflation down from a year ago in all 7 major economies on latest available figures: US (from 11.0 to 5.0 per cent), UK (11.6 to 7.3 per cent), Japan (3.8 to 3.1 per cent), Italy (18.3 to 17.2 per cent), Canada (12.5 to 10.4 per cent) France (13.9 to 10.1 per cent), Germany (6.5 to 4.9 per cent).]

Inflation has fallen in all major countries in the past year. Firm fiscal and monetary responses to 1979-80 oil price rise vindicated. UK close behind US and Germany in bringing down inflation, and ahead of some other European countries. Realism in wage settlements is growing; US, Germany and Japan all have wage settlements in single figures.

4. International financial collapse?

Concern about effects of over-borrowing noted at Toronto IMF meeting. But should not exaggerate alarm. Important of course to sustain system's stability. Lower interest rates should help, as should IMF programmes to restore countries' credit-worthiness. Further progress needed on banking supervision including risk assessment and prudential standards; also watertight allocation of supervisory responsibilities.

5. What about US ideas for emergency IMF assistance to countries heavily indebted to the international banking system?

The IMF must certainly be endowed with the resources it needs to carry out its present role. There is widespread agreement that a substantial increase in its quotas is necessary. Its resources may need to be supplemented even further. The US ideas are only among a number which need to be studied carefully.

6. South African credit from IMF?

[Board is discussing on 3 November S Africa's request for $ SDR 1 billion drawing. UK will support in very low key.]

We shall appraise/We have appraised/the application on its technical merits. There is no provision within IMF's Articles of Agreement for declaring a member ineligible to use the Fund's resources unless it fails to fulfil any of its obligations under the Articles: S Africa is not in this position.

7. Another oil energy crisis looming?

[Latest World Energy Outlook from International Energy Agency raises possibility that tight oil market could reappear in late 1980's].

Always difficult to foresee future oil prices. But they are weak at present and likely to remain so in near future. In longer term, energy conservation should permanently reduce countries' dependence on oil.

8. US economy?

[US GNP rose only slightly in Q3 after 1 per cent rise in Q2. Unemployment has risen above 10 per cent. Consumer price inflation has fallen to 5 per cent. Interest rates have fallen 4 per cent since July. Press reports suggest that Federal Reserve only expects growth of 2 per cent next year - lower than forecasts by US Administration and other forecasters].

US output rose slightly in Q3 after small rise in Q2. Still too early to say that a strong recovery is under way, but falls in interest rates and inflation hold out better prospects for growth over the next year.

9. US Budget?

[Despite package of tax increases totalling $98.3 over next three years, passed in August, US budget deficit for 1982 expected to be about $109 billion; deficit for 1983 forecast to be even larger].

Welcome Congress approval of tax package. US has won a battle but long campaign lies ahead to put deficits on convincing declining path in medium term.

10. US monetary policy

[US interest rates have fallen and Federal Reserve has reduced its discount rate from 9½ to 9 per cent. Chairman Volcker has said US authorities will be attaching much less than usual weight to M1 over period ahead].

Accept that monetary indicators in US must be interpreted flexibly in light of financial innovations. Federal Reserve Chairman, Mr Volcker has made clear that reduction of inflation remains a priority and that monetary targets have not been abandoned.

11. Gloomy prospects for Europe?

[EC Commission Annual Report published last month predicted only 1.2 per cent growth in Europe next year and 10.3 per cent unemployment.]

True that prospects for recovery in Europe weaker than in US or Japan. But budget deficits higher and inflation rapid in many European countries. Note that EC Commission draws attention to need to curb budget deficits and reduce labour costs. This the way to improve Europe's competitiveness and prospects.

12. French franc/balance of payments?

[French trade deficit soared to F Fr 12.2 billion (£1 billion) in September. M. Joubert admits that deficit for 1982 will reach FFr 100 billion. Despite raising $4 billion standby credit on international capital markets in September, franc remains weak. French Government ~~recently~~ announced package of measures aimed at improving balance of payments by encouraging exports and requiring all goods to bear label showing country of origin.]

Strength of world economy depends on ensuring stability of major currencies. Glad to see French Government has acted to curb budget deficits. Suitable monetary and fiscal policies essential if balance of payments to be improved and franc strengthened. Important that -understandable- measures to promote domestic trade performance should not encourage protectionism.

13. French government's monetary and fiscal policies?

[After prices and incomes freeze announced in June and F.Fr 10 billion economies in social security spending announced July, budget for 1983 was announced 1 September. Borrowing ceiling set at 3 per cent of GDP. Government has also announced increases in duties on tobacco and alcohol, and delays in planned increases in some social payments, including pensions].

Strength and stability of world economy will benefit if all countries can control inflation. So we welcome French government's commitment to reduce inflation and to rein in Government borrowing.

14. Competitive devaluations

[Recent devaluation of Swedish krona by 16 per cent widely criticised by other Governments. Finnish marka subsequently devalued by 6 per cent. Independent 'wise men's' report on Danish economy suggests withdrawing from EMS temporarily in order to allow 20 per cent devaluation].

IMF rules forbid countries to manipulate exchange rates to gain unfair competitive advantage. Authorities in Sweden will have noted strong objections from her major trading partners. Prosperity of world economy depends on maintaining open and fair trading system. Large devaluations may hinder this, and risk encouraging competitive devaluations by others. [IF PRESSED: IMF is examining Swedish action.]

15. Japanese reflation?

[Japanese Government have introduced reflationary package of £4½ billion (Y 2 trillion) or just under 1 per cent of GDP. Mainly consists of increased expenditure upon public work in current fiscal year.]

Different conditions from UK. Inflation in Japan only 3.1 per cent; unemployment 2.3 per cent; savings high.

2.19

COMMENTARY ON RECENT ECONOMIC DEVELOPMENTS AND STATISTICS 1 NOVEMBER 1982

Summary comment

Recent financial developments favourable - inflation and interest rates falling - but activity remains flat.

World Economy: expectations held by most forecasters for an upturn in activity of 1 per cent this year unfulfilled. Outside forecasters expect only a weak recovery next year.

- world commodity prices are at their lowest level in real terms for thirty years;

- oil prices are weak and likely to remain so for the near future;

- consumer price inflation (OECD major 7) around 7 per cent in August (12 per cent in August 1981): ranging from 17 per cent in Italy to 3 per cent in Japan;

- average world 3-month interest rates 10.3 per cent at 11th October a fall of 7 points on the 1981 Q3 average; US 3 month rate stood at 9 per cent on 22 October; real interest rates remain clearly positive;

- world trade volume has been more or less flat since the middle of last year;

- total industrial production for the OECD Major 7 fell 6 per cent in the twelve months to July; in the US it fell by 9½ per cent in the 12 months to September;

- unemployment (major 7) now 8½ per cent, compared with 6½ per cent in mid-1981.

UK Balance of Payments: non-oil trade balance has deteriorated quite sharply but current account remains in strong surplus this year. But both the loss of competitiveness during 1979 and 1980 and a smaller world market are affecting our non-oil trade at home and abroad.

- OPEC and Third World countries are cutting back on imports because of low commodity prices, high interest rates and debt problems in some countries. UK exports are substantially down in the three months to August.

. import volume rose sharply as activity recovered last year and import penetration rose too; imports broadly flat this year.

. the effective exchange rate has been broadly stable since summer 1981; currently 92.4.

Financial Developments

.M1, £M3, PSL2 within target range for 1982-83;

.short term interest rates down 7 points since last October; base-rates down 6½ points;

.real interest rates have fallen but remain clearly positive (higher real rates are being experienced in the US and Japan);

.PSBR £3 billion in first two quarters of financial year, remains within the FSBR forecast of £9½ billion for 1982-83.

Inflation

.retail price inflation, 7.3 per cent in year to September. Forecast 6½ per cent before Xmas, with prospect of 5 per cent by spring 1983;

.TPI increase in 12 months to September was 7.9 per cent;

.Wholesale price inflation also moderating; input prices up 3¾ per cent in year to September; output prices 7½ per cent;

GDP and industrial production

.GDP has been broadly flat since 1981 Q4, as has the underlying level of industrial production; but latter 1½ per cent above spring 1981 trough;

.within industrial production total, increased North Sea oil and gas production has offset a 1 per cent reduction in manufacturing output since 1981 Q4.

Demand Components

.consumer spending has remained broadly unchanged since 1979, over period when other components of final demand fell some 4-5 per cent. Some fall in RPDI (see below) offset by lower savings ratio. Retail sales in July -September 2 per cent higher than in spring, partly reflecting abolition of HP controls.

.gross fixed investment fell back by 4 per cent in 1982 Q2 - from a strong first quarter - to a level similar to that in 1981 H1 and 10 per cent below the level in 1979. Manufacturing investment has been weak. Plant and machinery investment, however, has held up.

.the massive destocking of 1980 H2 and 1981 is over but the 1982 Q2 figures show no return to positive stockbuilding. October CBI survey suggests some further scope for destocking in manufacturing;

.government consumption in 1982 H1 was 2 per cent above its level in the same period last year. 1982 Q2 data suggests that the upward trend in volume may be flattening out.

.there has been some fall in the volume of exports in recent months reflecting both loss of competitiveness and the flatness in world trade;

.imports rose very sharply between the two halves of 1981, reflecting both the increase in activity and increased import penetration, before stabilising.

Productivity and Competitiveness

.manufacturing productivity continues to rise strongly - at 6½ per cent annual rate so far this year, following 8-10 per cent last year;

.unit wage/salary costs up only 6 per cent on 3 months to August in same period 1981;

.during 1981 external price and cost competitiveness improved at least 10 per cent but little or no further improvement this year.

Company Sector

.ICCs pre-tax real rates of return on capital in 1981 were very low; only 2 per cent in the manufacturing sector. Some slight improvement likely this year.

.after falling in first quarter of 1982 gross trading profits (net of stock appreciation) of ICCs rose in the second quarter by 5 per cent; this follows the strong recovery in 1981;

.non-North Sea profits in 1982 H1 were 22 per cent above their level in 1981 H1;

.gross profits of North Sea oil companies rose 10 per cent over the same period;

.ICCs financial deficit was £1.3 billion in 1982 H1, following £0.8 billion surplus in 1981 H2, partly reflecting less destocking. Over same period net borrowing requirement fell from £6½ billion to £5½ billion.

Personal Sector

.wage settlements in 1981-82 were on average around 7 per cent, 2 per cent lower than in the previous round;

.underlying rate of increase in average earnings in year to July 1982 was about 9-9½ per cent;

.real earnings broadly flat in last 12 months but RPDI is about 1½ per cent lower than the average for 1981.

Labour Market

.UK employment fell 2.4 million (10½ per cent) between 1979 Q2 and 1982 Q2 (two-thirds concentrated in manufacturing); between 1981 Q2 and 1982 Q2 employment fell by 670,000;

.Total employment fell more in the second quarter of 1982 (189 thousand) than in the previous quarter (94,000);

.total registered unemployment fell by 48,000 to 3.3 million (13.8 per cent) in October reflecting seasonal falls in school leavers which more than offset the underlying upward trend (which itself slowed to 23,000);

.UK adult unemployment rose by (only) 23,000 to 3.1 million (12.8 per cent) in October; previously the trend (since June) was accelerating;

.vacancies have not altered much in recent months;

.other labour market indicators - short time, overtime working, etc - continue to suggest some flattening out following last year's improvements.

Forward Indicators

.car production (seasonally adjusted) fell from 77,000 August to 69,000 in September;

.steel production (seasonally adjusted) fell from 229 m tons in August to 224 m tons in September;

.the volume of new construction orders, which remained broadly flat since the first half of 1981, fell 6 per cent in the 3 months to August. Within the total, orders for new housing, particularly in the private sector, remain slightly below their level last spring. Engineering orders also disappointing with a 9 per cent fall in the lastest 3 months.

.total manufacturing order books, as monitored in the CBI's monthly industrial trends enquiry, after strengthening last year, have shown some decline; and export order books have weakened.

.total housing starts, having increased from an average 40,000 a quarter in 1980 to 53,000 in 1982 Q1, fell back in the spring, though there is some sign that the trend is levelling out at a rate well up on last year. Total completion continues to drift slowly downwards.

.seasonal falls in school leavers registrations continue into November and December but a sharp seasonal rise in unemployment occurs in January;

.CSO's index of longer leading indicators rose in August and September reflecting lower interest rates and higher share prices, following a fall from April to July.

CBI's October Trends Survey suggests a ~~and~~ further decline in business confidence; further slight falls in total new orders and output. Stock reductions are continuing and investment intentions have weakened again. The survey suggests no recovery in new export orders and deliveries over the next four months. Cost pressures are expected to slow further and a slight improvement in firms liquidity is in prospect. Consumer goods industries are benefiting slightly from some improvement in demand.

Outside forecasts

.Outside forecasting groups are now less optimistic about recovery in 1982, suggesting that growth this year will be ½-1 per cent - about ½ per cent less than expected at Budget time; for 1983 most still expect growth in the 2-2½ per cent range, assuming some recovery in world economy, with inflation/interest rates continuing to fall at least for some time into next year.

.New Treasury forecast will be published later in the autumn.

Key Statistics Week-Ending Friday 5 November

Tues 2: Official Reserves (October).

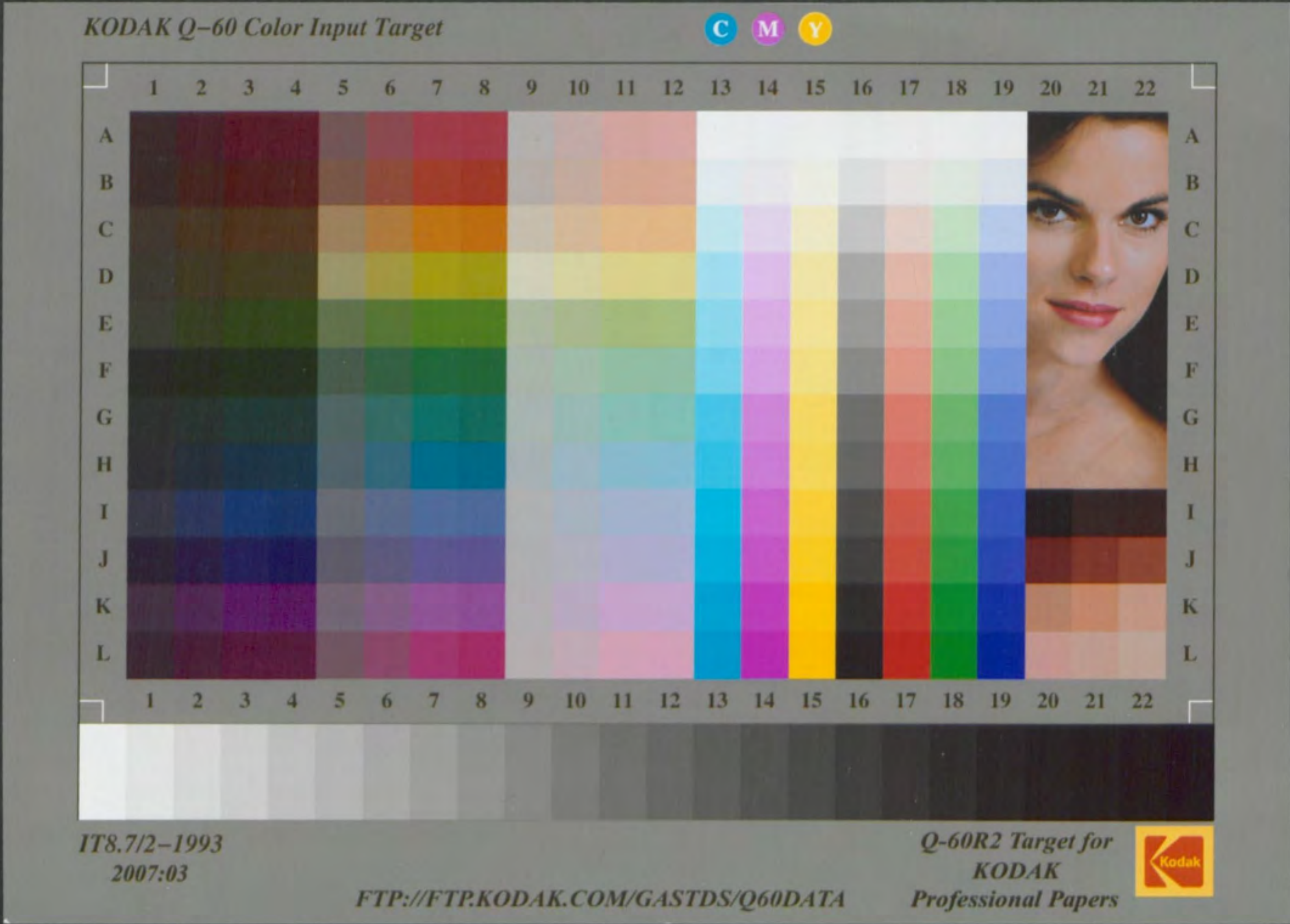
Thurs 4: Housing starts and completions (September).

PART 18 ends:-

E (82) 74 29/10/82

PART 19 begins:-

Treasury Brief : 1 Nov. 82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