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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 17 January, are sidelined.

M M Deyes

M M DEYES

R I G ALLEN

RIG ALLEN

24 January 1983

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. Recovery over/Activity flat?

Delayed but not over. GDP some 1 per cent higher than trough in Spring 1981; industrial output some 2 per cent higher. Flatness of output during 1982 partly reflected external developments: volume of world trade fell substantially, contrary to expectation at time of 1982 Budget. But rapid progress on inflation and improvements in productivity and competitiveness are encouraging; further modest recovery expected in 1983.

3. Policy far too tight, given world recession? ~~Storage~~ Shortage of demand?

Government cannot fine-tune either money or real GDP. Domestic demand in real terms has risen by nearly 4 per cent since spring 1981. Problem is lack of external demand and UK's depressed share of home and foreign markets (reflecting weak competitiveness), though exports held up extremely well last year in face of downturn in world economy. Improvements in supply performance needed as much as increased demand. Otherwise a boost to demand may be largely wasted, even in the short term.

4. Where will growth come from?

Already seeing benefits of lower inflation and interest rates reflected in higher consumer spending and recovery of investment in housing and many parts of private industry. Recovery in world economy will assist UK growth, as will continued effort to control inflation and contain costs.

5. Higher interest rates will kill hopes for recovery - as in autumn 1981?

[Barclays, Lloyds and Natwest put up base rates 1 percentage point to 11 per cent on 11 January and Midland on 12 January. Mr Shore in 19 January broadcast claimed that high real interest rates would strangle recovery].

Does not follow: rise in interest rates only one element in picture, and interest rates still 5 points below October 1981 level. Fall in exchange rate will ease pressure on companies. And if not eroded by higher pay settlements could contribute to improved competitiveness.

6. Outlook for inflation?

Remain confident of achieving 5 per cent RPI inflation early this year. As for rest of year, path may be a little bumpier than thought at time of Autumn Statement, but must not exaggerate possible effect of exchange rate depreciation. (See also D 3-4).

7. Government attitude to interest rate rises?

As has been stated on many occasions, level of sterling only one factor taken into account in judging monetary conditions and in determining Government attitude to interest rates. If recent fall in exchange rate partly reflects market uncertainty about monetary conditions (despite reassuring position on PSBR and monetary aggregate), than rise in interest rates will reassure markets that monetary conditions required for continued control of inflation will be maintained. [See also Section E].

8. Recent developments demonstrate policy being steered by exchange rate?

Should be clearer than ever that Government has no target for exchange rate. Little in recent events to suggest it would be viable policy to adopt such a target. As one of world's major currencies, sterling bound to be influenced by events that have origins abroad - such as reappraisal of relative value of other countries' currencies and expectations about international price of oil. [See also Section F].

9. Why is sterling so weak?

Never possible to be certain of all factors affecting exchange rates. But the dollar seems to have recovered on changed perceptions about the course of US interest rates, partially reversing the long-expected rise in value of yen and D mark. There is still some continuing concern about oil price prospects. Reported Opposition views about exchange rate may have been another factor.

10. Exchange rate slide will improve external competitiveness?

Will only have lasting benefit if wage settlements continue to be contained at more moderate, and realistic levels. Keeping firm control of labour costs is the key to improving our competitive position. Past experience (eg 1967-72 and 1973-76) illustrates all too clearly how easy it is for immediate benefits of devaluation to be eroded through higher price and wage inflation.

11. Government should do more for industry?

[CBI expected publish Budget recommendations 26 January].

Measures announced in Autumn Statement (notably NIS reduction) themselves have benefits for industry particularly in helping keep down costs. Other announcements made at around same time - on energy prices ending of regional development grant deferment, local authority capital spending initiative, more sites chosen for enterprise zones also helpful. And keep in mind wider benefits of lower inflation and interest rates and benefits of 1982 Budget measures still coming through.

12. Government believes levels of industrial support are far too high? Intend to trim?

[*Observer* 9 January alleged that secret Whitehall paper questioning value of export credits had sparked off major interdepartmental row.]

Public spending is too high generally, and industry support no exception. This is not to say that industrial support is not useful in a period of transition; but must aim at deploying a declining total more flexibly, focussing help where really needed and on industries and technologies of tomorrow.

13. What kind of industrial base and pattern of employment is Government aiming for?

Size and shape of industry and employment will not be determined directly by Government and cannot be forecast with any accuracy. Clearly, much of traditional industrial base and traditional sources of employment will remain important, but new businesses are coming along too. Important thing is to provide right incentives for business and for costs to be kept under firm control. Contrary to some reports, Government does not belittle importance of traditional manufacturing industry.

14. Outlook for Budget

Cannot comment on speculation that "fiscal adjustment" is bigger than illustrative £1 billion figure included in the Autumn Statement. Fact that PSBR may be undershooting this year - and outcome still very uncertain - does not carry any necessary implications for next year's figure. Many factors enter the equation - including the path of output, inflation and interest rates, and - of course - new public expenditure figures shortly to be published. So nothing can be said at this stage. (See also H~~9~~8).

15. Labour Party programme

[Unclear from recent statements eg Foot 22 January, Shore in weekend broadcasts, exactly how far Labour leadership sticking to 'Programme for recovery' nevertheless clear that espouse substantial depreciation, substantial reflation, plus (Foot speech) 'planned trade'].

Defects of Labour programme remain. Blow to confidence; wage restraint assumed without specific mechanism to achieve, planned trade proposals equally vague. Claimed validation by running programme through Treasury model does not make definitive. And Mr Shore seems to have revised his views on what should go in.

16. Treasury model - technical advice

See B15.

17. Alliance programme a more credible alternative?

['Working together for Britain' published 20 January reiterates measures urged in earlier policy statements - designed to create over ½ million jobs at net PSBR cost of £3-4 billion].

Contains some proposals which are sensible and not too far removed from Government thinking. But largely stands or falls on success of measures to ~~effect~~ control pay and prices. Suggestions for income policy wrap old ideas in new clothes. Pays lipservice to financial prudence but vague on how this would work in practice. Claimed impact of measures in SDP statements has looked extremely optimistic.

B ECONOMIC ACTIVITY AND PROSPECTS

1. Prospects for UK economy

[Industry Act Forecast Tables summarised in Commentary at end of Brief. NB New forecast will accompany Budget 15 March; undue emphasis should not be given to precise numbers in IAF.

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

- Although recovery in 1982 has been hesitant, 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 is for year-on-year growth around 1½ per cent.
- RPI inflation has come down much faster than expected (now 5.4 per cent annual rate to December) and expected to be 5 per cent early this year.
- Wage settlements are expected to decline further over current pay round. [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 around 13 per cent above end-1980).
- Consumers' expenditure continues to recover and is provisionally estimated to be 1½ per cent up in 1982 Q4 on previous quarter and, in 1982 as whole, 1 per cent higher than 1981. Forecast is for 2½ per cent increase between 1982 and 1983.
- Current account of balance of payments likely to be around £4½ billion in 1982 - well in excess of figure in AIF. Some deterioration expected in 1983]

Prospect is for modest recovery during 1983 and lower inflation - 5 per cent RPI inflation in next few months. Further forecast taking full account of world and UK economic developments since November will be published at Budget time.

2. Recent GDP figures

[GDP on the average measure was unchanged between Q2 and Q3 of 1982, but GDP (output - which is a better indicator of short term movements - rose slightly for second successive quarter (with construction output 3 per cent up on previous quarter) to level about 1 per cent higher than in 1981 Q2. Industrial production in November 1¼ per cent down on October; 1 per cent decline in manufacturing. Now clear evidence of declining trend in manufacturing during 1982. Underlying level of industrial output in three months to November 2 per cent above 1981 Q2 trough - virtually all reflecting higher North Sea oil output; manufacturing output 1 per cent lower than in 1981 Q2.]

Level of output particularly in manufacturing remains disappointing - partly due to depressed world economic activity - but consumer goods holding up well, reflecting higher consumer expenditure. Expected higher world output and lower effective exchange rate 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.

[IF PRESSED on index of manufacturing production in November (86.8, 1975 = 100) returning to 1967 levels (87.8 in 1967 Q1):

Inappropriate to make such long term comparisons without recognising that sectoral composition of output is changing. As consumers' preferences change and balance of comparative advantage alters, so will configuration of economy. GDP is almost 26 per cent above its level in 1967.

3. Other evidence of improvement in economy?

See Bull Points (following Section A).

4. Latest CBI assessments/Business confidence collapsed?

[CBI October 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). CBI December Enquiry shows previous trends broadly continuing but orders in consumer goods industries are 'least weak' while export orders books have recovered somewhat after November deterioration.]

Results of recent 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, during last year. But CBI not entirely gloomy -favourable developments continue in unit costs and price expectations; firms' liquidity also expected to improve. December Enquiry reveals some recovery in export 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. New orders figures and short-term indicators depressing?

[New construction orders rose 8 per cent in three months to November compared previous three - 6 per cent up on year earlier. In three months to November total housing starts up 8 per cent on preceding three, and 24 per cent on same period in 1981. Volume of new orders in engineering industries fell 5 per cent in three months to September compared previous three. Car production rose to 73000 in December, but 6½ per cent down in 1982 Q4 compared 1981 Q4. New vehicle registrations (not seasonally adjusted) rose 13 per cent in 1982 Q4. Weekly rate of steel production fell in December and - 1982 Q4 was 32 per cent lower than 1981 Q4.]

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

6. Construction industry forecasts show prospects of modest recovery?

[Joint Forecasting Committee of Building and Civil Engineering Economic Development Committees (ECDs) published 6-monthly forecast on 15 December. Overall prospect is for modest recovery in three years to 1984 - although overall growth rate fails to restore output to 1970's levels].

Construction industry's problems remain difficult, but forecast moderately encouraging and recovery in housing investment in 1983 (some 16-17 per cent) very encouraging. Improved outlook for construction reflects success of policies reducing inflation and interest rates.

7. <u>Fall in investment and reduction in stocks?</u>

[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 unchanged from previous quarter but $4\frac{1}{2}$ 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. [<u>IF PRESSED</u>: latest DOI investment intentions survey suggests 3 per cent fall in manufacturing investment between 1982 and 1983. This is undoubtedly disappointing, but manufacturing is only one component in total private fixed investment, outlook for which is more encouraging. (See B6 above).]

8. <u>Stock levels a threat to recovery</u>?

[In 1982 Q3 manufacturers' and distributors' stocks fell unexpectedly sharply by around £420 million (1975 prices). Apart from 1980 Q4 and 1981 Q2, fall was larger than 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. (This view possibly supported by December Trends Inquiry). Not too much weight should be placed on single quarter's data. GDP (output) figures (see B2 above) are a better guide to recent movements in activity.

9. <u>Competitiveness not improved this year</u>?

Cost competitiveness has improved about 20 per cent since 1981 Q1 and taking into account recent exchange rate movements, is about 10 per cent worse than when Government took office; though exchange rate lower than in May 1979. 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 F).

10. <u>Government contribution to improving competitiveness</u>?

Government role is to create right environment: firm fiscal and monetary framework allowing for lower inflation and interest rates, supply side policies, NIS cut helps reduce business costs. Up to industry to secure ever higher levels of productivity and not fritter away benefits of Government policy in excessive wage increases.

11. Productivity growth falling off?

[On revised statistics, incorporating discovery of previously unidentified employees in employment (See C13), growth in output per head in manufacturing slowed down sharply during 1982; Q1 9 per cent, Q2 7 per cent, Q3 4 per cent, in three months to November 2½ per cent (compared same period a year earlier). However, productivity still almost 14 per cent higher than at end 1980.]

Manufacturing productivity gains in last two years much bigger than might have been expected on past experience. Slowing down during 1982 probably inevitable as best opportunities for plant closures and improved efficiency are taken up first. Recent experience still better than average post-war experience.

12. CSO's index of leading cyclical indicators?

Longer leading index fell in December after nine months of increase, reflecting rise in interest rates and decline in share prices. Fall in longer leader only based on one months figures. Series not particularly smooth anyway, and decline based entirely on recent financial developments. No firm conclusions can be reached.

13. Outside forecasts

[GDP profile in recent major assessments and in IAF:

Per cent change

	Simon & Coates (Jan)	Phillips & Drew (Jan)	LBS (Dec)	OECD (Dec)	CBI (Nov)	St James (Nov)	NIESR (Nov)	IAF (Nov)
1982 on 1981	+½	+½	+¼	+½	+½	+½	+¼	+½
1983 on 1982	+2	+1¾	+2	+1	+1¼	+2	+1	1½
1984 on 1983	-	-	+2	-	-	+3½	+1	-]

Nearly all major outside forecasts see prospect of continued recovery and lower inflation. (Most now need updating to take fuller account of most recently available statistics and economic developments since 1982 Q3.)

14. Treasury Economic Model

[Series of questions from Mr Austin Mitchell MP (Hansard 23 December cols W647-8) concerning detailed technical aspects of the model are typical of recent interest.]

Treasury Ministers do not comment on the detailed operation of the model, which is a matter for the professional judgement of Treasury economists. Treasury economists do not provide a professional consultancy service for MPs, though do offer technical guidance to the outside bureaux through which it is available to researchers.

C LABOUR MARKET

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

[Recent unemployment/vacancy figures shown in Table below on both old and new basis. Because of seasonal factors, sharp rise in 'headline total' expected in January, thereafter flat till May. Other labour market indicators: hours lost through shorttime working have increased steadily since July 1982 returning to 1981 Q4 and 1982 Q1 levels; overtime remains flat.

	1981 Q1	Q2	Q3	Q4	1982 Q1	Q2	Q3	Q4	Dec
'Total' unemployment (millions)	-	-	-	2.77	2.86	2.80*	2.94*	3.07	3.10 (13.3%)
(on old basis)	2.46	2.59	2.93	2.96	3.04	3.01	3.28	n.a	n.a
UK adult sa unemployment (millions)	-	-	-	2.61	2.68	2.74	2.84	2.91	2.95 (12.7%)
(on old basis)	2.28	2.48	2.64	2.75	2.82	2.88	2.98	n.a	n.a
increase in period (000's)**				+32*	+23*	+28	+31	+27	+27
(on old basis)	+77	+62	+51	+26	+18	+30	+42	n.a	n.a
Vacancies (000's)	98	89	96	104	112	107	111.0	115	118

*After allowing for over-60's transferring off register
**differences between consecutive three monthly moving averages]

Rise in underlying rate of increase in December figures probably reflects in part the modified signing-on procedures operated at Benefit Offices over Christmas. Underlying increase in unemployment broadly flat in 1982 but doubtless unemployment will continue to rise for some time until benefits of lower inflation, greater wage moderation and improved competitiveness eventually begin to filter through.

2. Unemployment still rising despite Government's policies?

Excessive wage increases - unjustified by either output levels or productivity improvements - have eroded cost competitiveness and priced people out of jobs. Deepseated problems, which have taken long time to build up, will also take long time to check and reverse.

3. Latest information on earnings/pay settlements?

See Section D.

4. Devaluation way to improve competitiveness and hence employment prospects?

See F5.

5. 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.

6. 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.

7. Will adjustment between 'old' and 'new' way of counting always be as great as ¼ million?

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.

8. 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.

9. Unemployment in UK higher than in other countries?

[On standardised definitions in 1982 Q3 UK unemployment was 12.5 per cent (new series) compared with 8.3 per cent OECD rate - over double for UK compared with OECD rise of over one half since 1979.]

Unemployment now rising sharply in many industrialised countries - increase in latest three months on previous three in number unemployed (on national definitions - not strictly comparable) was much more in US and Germany (up 8.7 per cent) Canada (8.0 per cent) or Holland (7.5 per cent), than in UK (2.8 per cent).

10. True level of UK unemployment really much higher?

[TUC say 'true' figure just under 4½ million The Times 11 November, Labour Research Department say 5 million The Times 6 December; SDP say 5¼ million Guardian 7 January.]

Gross exaggerations, relying heavily on claimed one million fall in labour force between 1979 and 1982. This is not supported by 1981 Labour Force Survey (see C12 below). Estimates also often include those benefiting from special employment measures who are not unemployed. Furthermore, as much as 10 to 20 per cent of official count may not be seriously seeking employment. Claimant figures are best available measure of trend.

11. True level of vacancies?

Official notified vacancies (118,000 in December) reflect only about one third of total openings for job seekers.

12. New employment figures significantly affect figures of GDP, manufacturing productivity etc?

[Employed labour force mid-1981 on new data about 800,000 higher than previous estimates, comprised of extra 550,000 employees in employment (found by 1981 Census of Employment), plus extra 250,000 self-employed (from 1981 Labour Force Survey). Extra employees mainly concentrated outside manufacturing sector. On new data, manufacturing sector accounts for whole of fall in employment to mid-1981.]

Effect on GDP probably quite small - manufacturing productivity revised down by about one per cent in both 1981 and 1982; whole economy productivity figures revised down more substantially in 1981 and 1982 but still suggest recovery in productivity since end-1980.

13. Cost of unemployment/Effect on PSBR?

Effects of changes in unemployment on the public finances likely to vary widely according to underlying circumstances, for example changes in world trade, UK competitiveness, level of UK earnings and so on. Not therefore sensible to talk about '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 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.

14. 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 1983-84 300,000 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.]

15. 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 D).

16. 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 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) to encourage extension of part time work and provide additional opportunities for productive jobs for unemployed people.

17. Employment continuing to fall?

[Total employment declined 2.0 million (8¾ per cent) between mid 1979 and Q2 1982. Decline of 103,000 in 1982 Q1 increased to 188,000 in 1982 Q2. Manufacturing employment fell by 21,000 between September and October last year to 5,550,000 (compared 5,896,000 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 C1~~7~~6 above).

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

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 PRICES AND EARNINGS

PRICES

1. Inflation rate

[Year on year RPI increase 5.4 per cent in December, compared 6.3 per cent in November].

Year on year rate of inflation again fell sharply in December to 5.4 per cent - lowest level for 13 years (compared 5.1 per cent in March 1970). Price level actually slightly (0.2 per cent) lower in December than November.

2. Fall in inflation due only to reduction in mortgage rate?

True that falling mortgage interest rates have helped to reduce inflation, but only account for small part of fall. Only 1.3 percentage points of fall in rate of inflation from 12.0 per cent in January 1982, when mortgage rates at peak, to 5.4 per cent in December, resulted from fall in mortgage rates over that period.

3. Comparison with 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 12.1 per cent.]

When previous Government left office (May 1979), year-on-year rate of inflation was 10.3 per cent and rising (May 1978 figure was 7.7 per cent). Now (December 1982) 5.4 per cent and falling. We will be first Government for quarter-century to achieve lower average rate of inflation during its term of office than previous Administration.

4. Effect of recent fall in sterling on rate of inflation over next 18 months?

[Chancellor discussed in 19 January Debate speech.]

Remain confident of achieving 5 per cent RPI inflation soon. For rest of year, path may be a bit bumpy. But must not exaggerate possible effect of exchange rate depreciation. Exchange rate only one factor amongst many that affect inflation, although admittedly an adverse one. Government continuing to pursue sound money policies. New forecasts, taking account of all relevant factors, will be published with the Budget.

5. Ready reckoner for effect of depreciation or inflation?

[LBS assess sterling fall will add 2 per cent to inflation in 1983, 3½ per cent 1984 Times 17 Jan].

Not possible to give precise 'ready reckoner' for effect of exchange rate changes on price level. Suggestion of 2-3 per cent effect of recent depreciation on prices after 12-18 months much too pessimistic. Offsetting factors include weak commodity prices (including oil), likely cuts in profit margins by exporters to UK, and Government's commitment to sound financial policies.

6. No further decline in inflation?

[IAF: 5 per cent in 1983 Q4.]

Progress in recent months has been faster than was forecast; and may in consequence be rather slower in the months ahead. But we shall continue to experience the benefits of sound financial policies.

7. Inflation still not as low as competitors?

[November figures UK inflation 6.3 per cent compared 4.6 per cent in US, 4.7 per cent in West Germany, 9.4 per cent in France, 16.9 in Italy and 2.3 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. TPI shows pay rises need to be ½ per cent higher than RPI to maintain living standards?

[TPI increase 12 months to December 5.8 per cent, compared RPI increase of 5.4 per cent].

Gap between RPI and TPI (now 0.4 percentage points) widened in July 1982 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 change - except for minority who have spell of unemployment during year.

9. Nationalised industry prices

[Increase in nationalised industry prices, water charges and London Transport Fares over 12 months to December 14.3 per cent compared RPI increase of 5.4 per cent.].

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 also played important part. Increases regrettable, but holding prices down artificially would distort market forces and add to burden on taxpayer. Differential between NI prices and RPI now about 9 per cent, compared 14 per cent in January 1981; over half of present differential explained by LT fares and 1981 winter electricity rebate. Signs are that the gap will continue to narrow. Sustained improvement only possible if industries succeed in holding down current costs, particularly pay.

PAY

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. Level of pay settlements?

[CBI figures published 19 January suggest manufacturing settlements averaging 6.2 per cent so far in pay round.]

Average has been in single figures, and moving downwards, in each of past two years. Only a minority of bargaining groups have settled so far in this pay round, but I believe we are seeing still lower settlements. In everyone's interest that pay settlements should come down, and come down sharply.

12. A 3½ per cent pay policy?

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

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

[Real earnings have shown little variation over past two years; in 1982 Q3 were only 0.2 per cent lower than in 1981 Q3.]

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

14. Average earnings index

[Year on year growth 8.3 per cent in November compared with 7.3 per cent in October. However, underlying increase slightly lower than in October at about 8½ per cent.]

Fact that average earnings index is ahead of RPI casts doubt on wilder claims about falling living standards. Further moderation in settlements is needed if we are to maintain jobs and get inflation down.

15. Incomes Policy

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

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

No general level of increases for board members this year. Proposals for each board being considered individually on merits, in light of circumstances. 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 need to recruit people of ability, inadequate differentials with senior staff and performance of industry. Because board pay held back in previous years, many salaries are now seriously out of line with market rates.

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

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

18. Index-linked pensions and Scott report?

Government announced in Debate 22 October that 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.

E MONETARY AND FINANCIAL POLICY

1. Monetary growth on target?

[Money and banking figures published 13 January summarised below:

	per cent s.a.		
	M1	£M3	PSL2
December increase	0.9	0.6	0.5]

Growth rates of all three aggregates within target range - M1 and £M3 at almost 11 per cent and PSL2 about 9 per cent.

2. Why have interest rates gone up?

[Barclays, Lloyds and Natwest increased their base rates by 1 per cent (to 11 per cent) on 11 January and Midland theirs by ¾ per cent (to 11 per cent) on 12 January. Still down by 5 points since peak in October 1981. Long term interest rates also reduced significantly over past year.]

Structure of interest rates in domestic money markets was dislodged by fall in sterling. Interest rates in domestic money markets rose sharply in early January but have steadied. 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.

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

Does not necessarily follow. The fall in the exchange rate, though adverse for inflation,(but see also D4-5), will ease pressure on companies. (See also A6).

4. Did Government engineer rise in interest rates?

As is evident from sequence of events, the rise in interest rates stems from market developments, including developments in currency markets.

5. Will interest rates rise further?

[Interest rate 'ruled out as means of defending sterling' claimed in Guardian 20 January.]

What Chancellor said in Debate 19 January was that there is no reason for further rise in interest rates now; if the exchange rate were to fall further, such a fall could well be only temporary. Government remain determined to maintain sound monetary conditions.

6. Prospects for resuming falls in interest rates?

Government does not make predictions about interest rates. Interest rates have to adjust to play their part in maintaining sound monetary conditions. Route to lower interest rates is ultimately through lower inflation.

7. Will slide in sterling affect monetary conditions?

Level of sterling is one of the factors taken into account in judging monetary conditions. Recent fall in exchange rate may reflect market uncertainty about monetary conditions, though this is scarcely justified, given the reassuring position on the PSBR and monetary aggregates. Rise in interest rates will reassure markets that monetary conditions required for continued control of inflation will be maintained.

8. Will mortgage rate now rise?

[Mortgage rates have fallen 5 percentage points from peak in March 1982. Latest cut, to 10 per cent, came into effect for all home buyers on 1 December.]

That is a question for the building societies. Their liquidity position is very strong at present; they do not need to be rushed into adjusting their rates.

9. Bank lending growing too fast?

[Bank lending starting to decrease slowly. Increased by (seasonally adjusted) £2 billion in September, average for October and November [because of STC distortion] £1.5 billion, and £0.8 billion in December.]

December figure lowest for last year. (NB Might have been distorted by short banking month.) Bank lending to companies has steadied; lending to persons has fallen off from its high level last summer.

F EXCHANGE RATE AND THE RESERVES

1. Policy towards the exchange rate/falling £?

[Since October, sterling has fallen 11 per cent in effective terms, 9 per cent against the dollar, 11 per cent against the D-Mark, 19 per cent against the yen.

	October average	11 Jan low points	24 Jan 10.15 am	% change Oct -24 Jan
$/£	1.6977	1.5635	1.5470	-8.9
DM/£	4.2932	3.6757	3.8273	-10.9
Y/$	460.12	357.96	373.52	-18.8
£ effective	92.5	80.6	82.3	-11.0

Markets have been volatile since end-October, largely reflecting fluctuations in market perceptions of the course of US interest rates. Thus, the recent recovery of the US dollar has gone some way to reverse what had been seen as a general re-alignment of currencies, with long-expected rise in D mark and yen (reflecting underlying strength of Germany and Japanese economies and their improving trade balances); partly from weakness and uncertainty about oil prices (lower price helps other countries and their currencies - has little impact on UK). Irresponsible Opposition policy statements also had an effect].

Government has no target for exchange rate. Nor do recent events suggest conditions exist in which pursuing a target would be a viable policy. Bank of England do intervene to seek to moderate excessive fluctuations and maintain orderly markets so far as is feasible. Government not indifferent to UK exchange rate, which is important for the economy. It is one of factors taken into account in interpreting domestic moentary conditions and taking decisions on policy.

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. Impact of fall in sterling on inflation?

Will no doubt be some modest impact on inflation from recent fall. But probably less or slower to come through than many commentators suggest. Importers into UK have had healthy profit margins. They absorbed much of the effect of sterling's fall in 1981 and they may remain reluctant to raise prices in today's market conditions. Food prices reflect the 'green pound' (which is fixed separately) and has been unchanged - see Note below. Commodity prices (including oil prices - one of reasons for sterling's fall) are weak - and tend to be set in dollars, where fall in sterling has been least. And, of course, some of the fall could prove to be temporary.

Note Report in FT 18 January suggesting green £ changed - not the case. What has happened is that fall in sterling has eliminated gap between market rate and green £.

4. Government reaction to further fall in the rate?

No sound reason for the rate to fall. The underlying financial position is strong

- Government spending and borrowing are under control and on target;
- the Government deficit, as a percentage of GDP, is one of the smallest in the industrial countries;
- we continue to run a substantial current account surplus, larger in 1982 than the £3½ billion forecast only last November;
- inflation is falling, and fell faster over the last year than in any other major country;
- monetary growth is within the targets, and the signs are it will stay there. [See also Section E].

5. Improve UK competitiveness directly by encouraging exchange rate down further?

Substantial fall in exchange rate as advocated by Opposition, would give only very temporary gains of competitiveness for UK industry. Would raise costs of imports directly and, by alleviating competitive pressures, permit general increase in prices of domestically produced goods. This would have repercussions for wage bargaining and hence trigger a general rise in costs, undermining initial competitiveness gains. We in the UK have seen striking examples of this process: improvement in competitiveness following 1967 devaluation had largely been eroded by 1972; furthermore, although the exchange rate fell by 25 per cent between 1973 and 1976, competitiveness was on balance unchanged.

6. Why did Bank of England intervene so heavily in December?

[Letter from Jack Straw MP 6 January].

Foreign exchange markets have recently been unsettled generally, with sharp movements in major currencies and uncertainties about the price of oil. In these circumstances not surprising that Bank had to intervene on a larger scale than normal to slow underlying rapid movements and to ensure that sensible two way trading could take place.

7. Are the reserves too low?

[Letter from Jack Straw MP 6 January].

Against the background of the Government's policies not only towards the exchange rate, Government do not regard the present level of the net or gross reserves as worryingly low. (Level of gross reserves rather lower than it was in mid-1979, although on any measure greatly exceeds that reached in 1976). Misleading to look at gross reserves. Real change since 1979 is the reduction achieved in the overseas debts run up by the last Government - cut from $22 billion in May 1979 to a little over $12 billion today.

8. Situation has been made worse by abolition of exchange controls?

Opposition spokesmen seem to forget the lesson they surely should have learnt in 1967 and 1976. All the experience is that exchange controls have little effect in the face of strong market movements. They did not control leads and lags in trade payments, nor the movement of massive funds invested in sterling by non-residents. (To attempt to control either would cause unacceptable disruption in trade and commercial relations).

9. Join EMS exchange rate mechanism (ERM)?

Recent events scarcely suggest that conditions that have led successive Governments to delay sterling's full membership of the ERM are yet right for us to join. Sterling as a major internationally traded currency is still being affected by oil and other factors in a different way from the D mark. Membership of the ERM not a policy: it carries ~~no~~ an obligation to take policy action to try to defend a particular rate.

G BALANCE OF PAYMENTS

[NB: December trade figures to be published 27 January.]

1. Trade figures and current account

[November trade figures showed trade account in slight surplus though non-oil trade remaining in deficit; Q3 balance of payments figures shows invisibles surplus of £200 million a month in Q3 after £260 million a month in Q2. Cumulative current account surplus of £3.8 billion in eleven months to November. IAF shows zero current account balance in 1983.]

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

2. Trade in manufactures in deficit last year ?

When exports and imports put on comparable basis [ie both valued on balance of payments basis], we recorded a surplus on trade in manufactures of over £2 billion in first 11 months of 1982. [NOT FOR USE: Figures underlying IAF suggest that trade in manufactures may go into deficit this year].

3. Heading for poorer net trade balances in manufactures? Need to improve competitiveness to avoid this?

Agree desirability of lasting improvement in competitiveness of UK manufacturing industry. Depends on better productivity growth, lower wage inflation. Have made start - productivity performance as good as any of competitors over last two years. If could match this with equally competitive performance on earnings, would be well on way to lasting improvement in competitiveness.

4. Export trends - recent

Month-to-month movements in exports during 1982 have been very erratic. There was a sharp recovery in exports from September onwards from the erratically low August level but underlying level of non-oil exports, after weakening in mid-1982, seems to have recovered in recent months to level of last spring at a time when, due to world recession world trade has probably fallen (1982 first year-on-year fall since 1975).

5. Non price competitiveness

Government has stressed need to improve design and quality, to meet delivery dates, and improve after-sales service. Such factors cannot be easily measured but are at least as important as cost competitiveness. Jaguar cars are a striking example of improvements in performance that British industry is capable of. Jaguar's drive for higher quality secured them an increase in overseas sales last year of 56 per cent over 1981.

6. 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.

7. Import trends

There has been little change in underlying level of manufacturing imports since end-1981. Manufacturing output fell back a little in 1982, so there has probably been some continued growth in import penetration, although not at anything like same rate as in 1981.

8. Protectionism?

[Mr Foot's Glasgow speech 22 January.]

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 last year [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.

9. Japan

Welcome the tariff reductions announced end-December. Small step in right direction. Fully support EC measures to step up action under GATT aimed at putting further pressure on Japanese to open up their domestic market.

10. GATT meeting

Glad to see that GATT meeting reaffirmed need to resist growing protectionist pressures. GATT declaration represented realistic commitment on behalf of signatories to the open trading system in present difficult economic climate.

11. Services

Work in the GATT on services is a major new departure and one of particular interest to UK. Field is wide but UK will contribute constructively with view to making early progress.

12. Textiles

This GATT study relates to the longer term and as such is not unreasonable. In no way affects present Multilateral Fibres Agreement and latest bilateral agreements which will run until 1986.

13. Q3 Balance of Payments and capital account

[Q3 invisibles surplus of £0.6 billion. Outflow of investment and other capital transactions of [illegible]3 billion. Private sector direct investment abroad fell to £0.8 billion and private sec[illegible] portfolio investment abroad down £0.2 billion from Q2 to £1.0 billion.]

Invisibles account continues to be in healthy surplus - £1¾ million cumulative surplus ~~as~~ on invisibles in first three quarters of 1982.

14. Continuing capital outflow shows folly of abolishing exchange controls?

Wrong to talk about money flowing out of the country. Those who wish to invest abroad have to buy foreign currency and find someone else who wishes to invest in Britain to purchase sterling in return. The nation's net capital outflow or inflow - as a matter of arithmetic - matches the current account balance. Just as countries with deficits have to borrow abroad, those with surpluses acquire net overseas assets.

15. Portfolio outflow higher than last year?

[Q3 Balance of Payments figures published 8 December showed continuing outflow of UK overseas portfolio investment. Guardian on 9 December described this as rising trend.]

True that there is little sign yet of end to expected period of stock adjustment following ending of exchange controls. But misleading to say portfolio investment abroad is rising. Figures are as follows:

		£ billion	
1981	Q1	- 1.3	
	Q2	- 1.0	average - 1.0
	Q3	- 0.7	
	Q4	- 1.1	
1982	Q1	- 1.6	
	Q2	- 1.3	
	Q3	- 1.0	

Q3 figure is smaller than in Q2 or Q1, and about the average for last year.

16. 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.

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; further reduction is projected. Inflation has fallen fast - expected to fall further (see D1). Base rates have risen but still well below (5 per cent) peak in 1981. Benefits seen in recovery of debenture market. [IF PRESSED: Would like to see rates lower still, so long as not likely to endanger progress on inflation.]

2. Government planning balanced Budget?

[Chancellor questioned in Guardian interview 17 December about reports that Professor Walters at FT bankers' conference advocated balanced Budget over run of years.]

Government aims to reduce PSBR as share of money GDP over medium term. Illustrative profile in 1982 MTFS shows figure of 2 per cent in 1984-85. Nothing has been said about later years.

3. Relationship between public sector borrowing and interest rates not as direct as this government claims?

Links between interest rates and the PSBR are not simple or instantaneous, nor do we claim them to be. But that is not to say that the relationships is not important. This Government's firm control of borrowing is certainly one of the factors responsible for the recent falls in short term interest rates, compared with last autumn 1981.

4. 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.

5. PSBR in December quarter

[PSBR in December quarter £3.1 billion (£2.5 billion seasonally adjusted). PSBR April-December £7.6 billion (£5.3 billion seasonally adjusted.)]

Wrong to prorate £5.3 billion to arrive at likely PSBR for 1982-83. On balance however December quarter figures indicate PSBR likely to undershoot IAF figure of £9 billion.

6. PSBR likely to be £8 billion in 1982-83 compared £9 billion in IAF?

[F [illegible]iams article The Times 21 January].

It is possible. But must remember that margins of error in any precise forecast substantial.

7. What would undershoot be if Government had not taken recent measures?

[CONFIDENTIAL NOT FOR USE: At time measures taken they were thought likely to 'boost' PSBR by around £1¼ billion in 1982-83 - an estimate itself liable to quite a large margin of error.]

Rather strange question. Given the uncertainty over PSBR outturn this year it is impossible to answer.

8. Government intentions for 1983-84 PSBR?

[Autumn Statement PSBR for 1983-84 assumed to be £8 billion - 2¾ per cent of GDP; 1982 MTFS was £8½ 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. (See also A14).

9. Recent rises in interest rates make nonsense of Government's claim that PSBR matters?

Never said relationship between interest rates and PSBR simple or direct. Certainly does not operate month to month. Basic principle - however PSBR over run of years implies lower interest rates - still holds true.

10. Cyclically adjusted PSBR better guide to policy?

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

11. 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 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 borrowing has adverse effects on interest rates and inflation. But a higher tax burden does not necessarily mean that people are worse off, because gross earnings have risen faster than prices since 1978-79. On average, all types of household in work at all earnings levels are better off in 1982-83 than in 1978-79. [NB: individuals may have done better or worse than average.]

2. 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 have also benefited from generous increases in benefits such as FIS.

3. Previous reductions in personal taxation favour the rich?

1979 Budget cut absurdly high top rates of income tax to EC 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.

4. British tax burden high by international standards?

[Times 13 January article highlights data published in December Economic Trends].

Not so. Accurate comparisons difficult, but UK burden about average for OECD countries [provisional 1981 data from OECD's Revenue Statistics 1965-81]. Similarly, UK taxes on personal income and UK employees' social security contributions about average for EC countries and lower than USA [1980 provisional OECD data].

5. Too few tax officials on evasion work?

Not prepared to abandon our manpower targets (see L1). Within these, we do redeploy staff as appropriate. Inland Revenue has deployed 400 extra staff to counter tax avoidance and 'the black economy'.

6. Cuts in taxation in 1983 Budget?

Decisions for 1983 Budget, both on PSBR and particular tax changes, have not yet been made.

7. Future of married man's personal allowance?

[Labour Party commitment to phase out in favour of increased CB etc; SDP proposals to abolish as part of proposals in document 'Attacking Poverty'.]

Government launched debate with 1980 Green Paper on Taxation of Husband and Wife. Green Paper set out number of different options; these being considered in light of very wide range of views received. Abolition would affect many millions of taxpayers, and by itself, leave a basic rate taxpayer £5 a week worse off. For some people it would worsen poverty and unemployment traps.

8. SDP plan to abolish poverty trap?

SDP scheme costs £5 billion - even on their own estimates - and still leaves marginal tax rates for people in poverty trap of 80-85 per cent. It extends trap both up and down the income scale. Ten times as many people would have marginal rates increased as would have them reduced. Claims to have eliminated trap are based on artificially restricted definitions. Their proposals would leave some people on below average earnings worse off.

9. Government unconcerned about poverty and unemployment traps

Government is concerned about poverty and unemployment traps, in context of incentives as a whole. Traps arise from attempts of successive Governments to alleviate poverty while keeping costs in bounds. Alternatives are to give less support for poor and unemployed or to let costs rip. Necessary step in right direction is to reduce burden of income tax by restraining public expenditure; long-term solution is increased real earnings resulting from sustained improvement in productivity and economic performance: both are goals of Government policy.

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

Outcome of annual review of public expenditure plans was to hold planning total within previously announced plans. First time this has happened since 1977.

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. Contingency Reserve 1982-83 and 1983-84?

Containment of additional expenditure within Contingency Reserve helps to keep public expenditure as a whole within planning total determined by Government. Provisional setting of Reserve at £1500 million in 1983-84, compared with £2500 million in 1981-82 and £2400 in 1982-83, reflects fact that amounts provided in those years now appear to have been unnecessarily large. [Used up in 1981-82: about £1145 million; charged to date in 1982-83: about £1290 million.]

4. Shouldn't all programmes have been reduced with fall in inflation?

No. Under cash planning, presumption is that planning totals will be maintained, unless any major change invalidates the main assumptions on which they were based. (Level of services then what can be obtained with cash available after making every effort to reduce costs.) Inflation in 1983-84 put at about 5 per cent higher than in 1982-83; this compares with 6 per cent implicit factor used when old 'volume' series was converted to cash. We took view this reduction not great enough to justify wholesale adjustment.

5. Cuts in services?

Decision to contain expenditure has inevitably meant reductions in some programmes to compensate for increases in others. But lower inflation and interest rates make it possible to accommodate such changes without major cuts in services.

6. What about years following 1983-84? How do figures compare with Budget time?

Figures for these years will be published in next Public Expenditure White Paper, early in 1983. Planning total for 1984-85 will be within total announced at Budget time. [NB No figure for 1985-86 announced yet].

PUBLIC EXPENDITURE - GENERAL

7. Will Government support St John Stevas Bill? (Second reading 28 January)

We recognised in our White Paper on the Role of the Comptroller and Auditor General (Cmnd 8323 of July 1981) the desirability of legislation on this subject. House will now have opportunity to modernise the 1866 and 1921 Acts, and that is welcome. However, there are strong arguments against the proposal in the Bill to give C & AG access to books of nationalised industries. The industries should be set clear financial targets and then be subject to minimum of interference. Bill is a move in opposite direction. All of these issues should be considered by the House.

8. Why did not Government introduce legislation?

This is a subject on which it is very desirable to proceed by con~~c~~sensus. Unfortunately that has not been the position. Hope wide measure of agreement will emerge during course of Bill's passage through House.

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 gave figures of 45 per cent in 1982-83 and 44 per cent in 1983-84.

10. Capital spending in public sector?

Government policy is that provision made for capital expenditure, both in central government and local authorities, should be fully spent, subject to 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 K~~17-19~~ 14-16 and R~~17-15~~ 12-16).

11. 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.

12. <u>Cost of pay rises for public servants - equivalents in public spending programmes</u>?

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

13. <u>Public services pay in 1983-84/3½ per cent pay assumption</u>?

Government attach great importance to realistic wage settlements in next round, in both public and private sectors. 3½ per cent assumption is <u>not</u> 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 1983-84 public expenditure plans for those groups for which Government 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

14. <u>LA capital underspending in 1982-83</u>

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: PM wrote last autumn to local authority associations; local authorities can apply for extra allocations (about £200 million issued so far), and can spend without limit on improvement grants; extra £150 million made available to Housing Corporation.

15. <u>LAs cannot increase capital spend because of revenue consequences</u>?

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.

16. <u>LA capital spending plans for 1983-84</u>

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 Development Grant) up by £70 million (to £350 million). Local authorities will be allowed to spend above allocations on improvement grants.

17. LA current overspending in 1982-83

Budget returns from LAs in Great Britain indicate that overspend of over £1 billion on current expenditure relevant for rate support in prospect. In response, rate support grant to be cut by £308 million in England, £27 million in Scotland, and £5 million in Wales.

18. RSG settlements 1983-84

Realistic and generous: expenditure provision effectively 10 per cent higher than in last settlement and grant 3 per cent higher than 1982-83 settlement - provided authorities do not overspend. [For details refer to Statements by Secretaries of State for Environment, Wales and Scotland on 16 December.]

19. Grant penalties 1983-84

Hope won't be necessary to have any. But authorities were warned in July 1982 of expenditure guidance now issued and have had ample time to adjust 1983-84 budgets to avoid incurring grant penalties.

20. Rate increases in 1983-84?

On average there should be no need for rate increases in 1983-84. If authorities spend in line with expenditure targets any increases should be low; some councils could even reduce rates. Where rate increases are high because of overspending it will be LA's own fault.

21. Service cuts?

Up to local authorities to decide how to keep to the provision in the RSG settlement. If they choose to allow irresponsible pay settlements, services may have to suffer unnecessarily.

22. Higher council house rents?

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 in 1983-84.

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

Carefully considering representations. Need scheme that will remedy shortcomings of present rating system and command widespread support. Taking account of pleas from industry, business, etc. (See also P~~6~~5.)

FALKLANDS EXPENDITURE

24. Falklands defence costs?

Latest assessment of costs of operation, of replacing equipment lost during conflict, and of garrison, is about £700-£800 million in 1982-83. Provision has been made for £624 million in 1983-84. Provision made for subsequent years will be announced in 1983 Public Expenditure White Paper. Total Falklands costs of £3 billion reported recently in Press [Guardian report 13 December] are broadly consistent with latest estimate of costs.

25. How will the defence costs be met?

Extra defence costs will be met by additions to defence budget on top of provision for NATO 3 per cent a year real growth target. Block defence cash limit for 1982-83 increased by £371 million so far on account of operations in South Atlantic (Hansard 9 November 1982 Col W108). This increase has been met from the Contingency Reserve. It has not therefore affected the Public Expenditure planning total.

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

Too soon to say what these 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 £10 million now expected to be spent in 1982-83 of which about £½ million will be found from Aid Programme and balance from Contingency Reserve. A further £5 million may be spent on rehabilitation in 1983-84. Ministers have agreed on a package of measures for long term development of the Islands tentatively estimated to cost in all £31 million over next 6 years (announced by Foreign Secretary 8 December).

27. 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 in 1982-83 will be absorbed within FCO programme.

L 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 (at 1 October 1982). Results from reduction in functions, privatisation and improvements in efficiency. On course to achieve the 630,000 target 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?

[TCSC published 17 January memorandum by Council of Civil Service Unions commenting on Government's reply (Cmnd 8616) to TCSC's report 'Efficiency and Effectiveness in the Civil Service').

Main theme of Council's memorandum is that drive for efficiency, motivated largely by Government's determination to reduce size of civil service, has taken no account of effects of cuts, specifically reduced quality of service. Government do not accept that reductions in manpower have been pursued regardless of effects on efficiency and effectiveness. Great savings already made with little effect on provision of services.

3. Civil service pay negotiations in 1983?

Government have told civil service unions that there will be room for genuine negotiations and that they intend to conduct those negotiations with the view of reaching an agreed settlement. In answer to unions' question about availability and terms of arbitration, Government have said that it is too soon to answer; they were looking for a negotiated settlement.

4. Contents of unions' claim?

Unions' claim for 1983 has been received; proposal is:

(a) flat rate increase of £12 per week for all non-industrial Civil Servants on National Salaries up to and including £6264 pa;

(b) above this level, 'substantial' percentage increases, providing, in particular, 10 per cent on salaries up to £9758 pa.

Additionally, the unions propose minimum wage for all staff aged 18 or over of £85 per week, and reduction in the working week to 35 hours net. The Government have acknowledged receipt of the claim, and said they will arrange first discussion of it when unions' supporting evidence is to hand.

5. Megaw Report

Unions have been told Government prepared to enter into negotiations with them with view to agreeing an ordered pay determination system based on recommendations of Megaw report. Unions have now confirmed their willingness to enter into joint discussion.

6. Scott Report/Public sector pensions?

See D 18.

M SOCIAL SECURITY

[Benefits uprated by 11 per cent 22 November 1982 which included 9 per cent to take account of inflation. RPI increase in 12 months to November announced 17 December was 6.3 per cent, hence 9 per cent 2.7 percentage points too high. Announced in Autumn Statement that November 1983 uprating would be adjusted to have regard to over-provision for inflation. Chief Secretary made clear to Social Services Committee on 15 December that saving would be £180 million in 1983-84 - less than would be achieved by full recovery of overshoot].

1. Pensions should not be adjusted next November?

Pensioners better off this year by extent of overshoot. Only question how much of this real increase continues beyond November 1983. No decisions on precise rise in pensions can be taken until nearer Budget time - Government will have to take account of priorities inside and outside social security programme. But it will not go back on its pledge to maintain real value of pensions over lifetime of this Parliament.

2. Level of overshoot?

Allowance of 9 per cent made for inflation between November 1981 and November 1982 in November 1982 uprating based on forecast at Budget time 1982. Actual RPI increase (published 17 December) for 12 months to November 1982 was 6.3 per cent;hence overshoot is 2.7 percentage points. Reflects Government success in reducing inflation.

3. Public expenditure saving?

Full recovery of overshoot would save about £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.

4. Improvements in benefits?

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

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 in next uprating. Decisions will, as usual, be taken at Budget time.

5. 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 full RPI which is used to uprate pensions and other benefits between 1978 Q4 and 1982 Q3. Differential between PPIs and RPI including or excluding housing costs fluctuates over time, but is never very large.]

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.

6. 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. Net long-term cost of Committee's proposals is £500 million at current benefit levels; equivalent to about ¼ per cent on employers' and employees' NICs. Required contribution for occupational pension schemes would need to increase by 15-20 per cent - about 2-3 per cent extra on payrolls].

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.

7. 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.

8. 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 £.

9. SDP proposals?

See J8-9.

N EUROPEAN COMMUNITY

1. UK budget settlement

[European Parliament on 16 December rejected draft supplementary and amending budget established by Council of Ministers on 8 November to make the necessary budgetary provision for our refund payments. This action obstructed implementation of settlement reached by Foreign Ministers 26 October, providing for basic gross refund of around £630 million (about £480 million net) by end-December.]

European Council now considering new budgetary proposals presented by Commission on 19 January. It is hoped a new draft supplementary budget for 1983 will be considered by the Parliament in week beginning 7 February and adopted in time to allow our refunds to be paid over before end-March.

[CONFIDENTIAL NOT FOR USE: As a first step, Commission has opened a new account with the Paymaster General (EEC No.3 Account) into which they have deposited funds equivalent to our refunds entitlement. We get the interest benefit from these funds. The EEC No.1 account has been temporarily run down, but Commission is expected shortly to bring the balance up to the 1982 average].

2. Refunds for 1983 and later

On 17 November the 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 and hope that progress will now be made quickly. PM has said this will have to be discussed at next European Council in March if solution not found by then.

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

5. Commission Green Paper on 'own resources' system

Commission Green Paper on 'own resources' is expected by end-January. We will study this carefully. Our opposition to an 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.

8. Euroepan Monetary System exchange rate mechanism

See F9.

P INDUSTRY

1. Latest statistics of output and investment?

See Section B.

2. Effect of NIC and NIS changes announced in Autumn Statement on private sector employers?

[Chancellor announced further reduction of 1 percentage point in National Insurance surcharge for 1983-84, cutting rate to 1½ per cent; also, half of 1 percentage point reduction in rate next financial year will be brought forward into current one. 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.]

Special reduction in NIS is worth about £350 million to private sector employers in 1982-83, and announced NIC and NIS changes taken together will benefit them by over £400 million in 1983-83. Constitute a substantial reduction in costs faced by private sector commerce and industry.

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

Private employers will pay around £1 billion less in 1983-84 than they would have done under rate of NIS and employers' NIC inherited from previous Administration.

4. High interest rates damaging for industry and investment?

Banks' base rates still 5 percentage points lower than October 1981. 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.

5. 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.

6. Energy prices?

See R7-9.

7. Companies' financial position?

[NB company sector borrowing in 1982 Q3 includes large element of unidentified transactions (-£1 billion)

	1979	1980 Year	1981 H1	H2	1982 H1	Q3
						£bn
Net borrowing requirement (+)/repayments (-)	+6.1	+6.5	-1.7	+6.2	+6.0	+1.9
Financial surplus (+)/deficit (-)	-2.9	-1.4	+1.3	+0.7	+1.1	-0.8]

Financial position of industrial and commercial companies (excluding North Sea) improved in 1981, relative to 1979 and 1980. Improvement in part reflected companies' efforts to cut costs, for example by de-stocking. Some apparent deterioration in borrowing requirement 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 first three quarters 1982 suggest companies' borrowing requirements remain high, but much less so than in 1979 or 1980.

8. ICCs liquidity ratios in 1982 Q3?

[D. Industry's survey of 200 large companies (published 3 December in British Business) shows a further significant deterioration in liquidity in 1982 Q3. Also shows £1 billion reduction in total current assets since 1982 Q1 whereas national accounts show total identified liquid assets of all ICCs increasing this year].

Liquidity ratios (total current assets divided by total current liabilities) not necessarily most fruitful method of interpreting liquidity position. Companies are not short of liquidity at the moment. Liquidity behaviour of largest companies may simply reflect relative ease with which they can meet cash flow pressures with bank over-draft facilities which may not be so readily available to smaller companies.

9. Profits/rate of return still too low?

[Gross trading profits of industrial and commercial companies (ICCs) (net of stock appreciation) rose 17 per cent 1982 Q3 compared 1981 Q3 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.

10. 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.

11. Future of cashless pay/Truck Acts?

Discussion at NEDC 5 January demonstrated CBI and TUC support ~~from~~ for major shift to cashless pay. Government considering carefully arguments both for and against repeal of Trucks Acts as means of accelerating progress.

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; increases 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. Response to Loan Guarantee Scheme?

[Nearly 7,400 guarantees already issued - about half to new businesses. Total lending under scheme over £245 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. First year cost covered by premium income. Now clear that payments will exceed income in this financial year. Department of Industry has been called to honour only about 160 guarantees out of nearly 7,400 so far issued. Future of scheme under review.

14. Enterprise zones

Response to first eleven zones has been encouranging; many new firms have been set up and others expanded. (But too early to assess overall success). Proposed sites for nine new zones in England announced by Environment Secretary 15 November; sites for two new zones for Scotland, one for Northern Ireland and one for Wales have also been announced. One more for Wales under consideration. (Total (13 or 14 in all) slightly more than 'eleven' new zones referred to by Chancellor 27 July; this reflects number and quality of applications received from local authorities).

R PUBLIC OWNERSHIP AND PRIVATISATION

NATIONALISED INDUSTRIES - GENERAL

1. EFLs for 1982-83

Nationalised industries' total external financing limits for 1982-83 were 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.

2. EFLs for 1983-84?

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

3. Why is benefit of reductions in National Insurance Surcharge being restricted to private sector?

[Reductions in nationalised industry external financing limits, to offset effect of NIS reduction, were published in a Written Answer on 22 December.]

Purpose of reduction is to stimulate private sector industry and commerce by reducing cost of employing labour. By restricting reduction to private sector, it was possible to give higher level of assistance than would otherwise have been possible. If public sector had benefited, amount going to private sector would have been only two-thirds of what we propose. We believe the money will be spent more productively in private sector than it would in public sector.

4. Government attitude to Mr St John Stevas' Bill on Parliamentary control of expenditure?

See K7-8

5. 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. Rolling programme of Monopolies and Mergers Commission investigations has been set up. Introduction of market forces provides the greatest incentive to efficiency.

NATIONALISED INDUSTRY PAY AND PRICES

6. Nationalised industries' prices

[Increase in nationalised industry prices, water charges and London Transport fares over 12 months to December 1982 14.3 per cent, compared with RPI 5.4 per cent.]

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 NI prices (including water charges and London Transport fares) and RPI now currently about 9 per cent, compared with 14 per cent in January 1981; over half of present differential explained by LT fares and last winter's electricity rebate. Signs are that gap will continue to narrow. But sustained improvement will only be possible if the industries succeed in holding down their current costs, particularly pay.

7. UK industrial energy prices above those of European counterparts?

[At NEDC on 8 December CBI complained that energy-intensive industries pay 20 to 40 per cent more for energy than European competitors.]

Vast majority of gas and electricity consumers pay comparable prices to their European competitors. Some disparities exist for limited number of intensive users of electricity. But on average, electricity prices will not increase in 1983 (see 9 below). Measures worth over £300 million in energy cost savings have been introduced in last two Budgets to help industry. Cannot expect disparities to be closed entirely especially where due to different costs of supply. Sole way of reducing real electricity costs is by containing costs of generating industry. But Energy and Industry Secretaries have indicated willingness to have further discussions with industry about electricity prices.

8. Freeze on industrial gas prices?

[BGC announcement that freeze on renewal prices for contract gas would be extended to first nine months of this year].

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

9. Electricity prices?

As announced by the Secretaries 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.

10. British Telecom's deferred tariff increase

[BT again deferred its tariff increase until at least July 1st this year. Charges last raised Nov 1981. From April 1st a low user rebate scheme is to be introduced].

We welcome BT's decision to defer its tariff increase again. This will mean that BT have not raised prices for at least 20 months. We are also pleased with the rebate scheme, which should benefit those who do not use their telephone a greal deal.

11. Nationalised industry boards' pay?

See D 18-19.

INVESTMENT

12. 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 ½ per cent, compared with 3 per cent for industrial and commercial companies.

13. 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 in current year; and each 1 per cent off total costs saves £330 million in current year.

14. 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.

15. 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.

16. <u>Investment plans unlikely to be attained?</u>

[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.]

<u>No Government</u> can unconditionally guarantee a particular level of investment by the nationalised industries. At time of 1982 Budget 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.

PRIVATISATION

17. <u>Special asset sales in 1981-82</u>

<u>Gross</u> sales in 1981-82 totalled £494 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 minus £79 million. But it is gross figure which is true measure of success of Government's privatisation programme. As Chancellor has said (Cambridge 3 July 1982), 'Public utilities and the so-called "natural monopolies" cannot be allowed permanently and without challenge to remain within State ownership'.

18. <u>What further sales expected?</u>

Special sales of assets in 1982-83 forecast at around £550 million and expected to increase in subsequent years. Sale of Britoil has been completed and will amount to about £625 million, paid partly in 1982-83 and partly in 1983-84. Programme for 1983-84 involves, primarily, sale of 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.

19. <u>Marketing of public assets unsuccessful - Amersham and Britoil failures in different ways?</u>

[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.

20. <u>Contribution to giving people satisfaction of property ownership</u>?

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 shareholders' bonus in Britoil sale designed to reward 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. P&D as reported in The Times 4 January assess Government revenue will peak in 1983-84.].

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. In general, higher estimates by others are based on combination of higher expected future production and prices and lower expected future capital expenditure.

2. Impact of lower oil prices on UK?

[Article in The Times 21 January suggested fall to $25 a barrel would have severe short term effects on tax revenues, balance of payments and exchange rates. Similarly gloomy report S Times 23 January.].

Impossible to say what will happen to oil prices. Good chance that they will not fall. Even if they do, not obvious that they will fall very far or very fast. Impact on world economy and on UK will depend on number of factors. But, despite falling North Sea tax revenues, UK could benefit from lower prices. Inflation might be lower and activity higher than would otherwise have been the case. Not easy to find strong relationship between oil prices and exchange rate. So effect on exchange rate unlikely to be as dramatic as The Times article suggests.

3. Government to relax North Sea fiscal regime?

Oil companies have argued for substantial reductions in taxation. No decisions have been taken. But fact-finding discussions have been taking place with UKOOA and individual companies since the summer to try to close the gap between Government's and companies' assessment of North Sea taxable capacity. These discussions will soon be concluded.

4. 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.

H[illegible] 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'.

5. 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.

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 1982-83.

7. Are we really any better off for 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.

8. 'Precipitous drop' in North Sea output after 1985?

[Phillips & Drew forecast of oil output almost halving between 1985 and 1990 - FT 4 January.]

Hazardous to forecast so far ahead. But always known that oil output would peak in mid-1980's and then decline - though not as steeply as P&D expect. Cannot be complacent about effects of falling North Sea output. Best thing we can do is pursue our present economic policies so that economy in better shape when output begins to decline.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. OECD Economic Outlook December 1982?

[OECD Economic Outlook forecast OECD growth of 1½ per cent in 1983 (minus ½ per cent in 1982) and inflation to fall to 6¾ per cent (7½ per cent in 1982). OECD believes it is Governments' responsibility to minimise risks to world recovery from growing protectionism and financial instability.]

OECD suggests modest recovery and falling inflation this year. Broadly in line with IAF. OECD recognises that Governments have, rightly, been reluctant to change basic thrust of policies, which have achieved hard-won gains on inflation, when inflationary expectations can easily be rekindled.

2. Prospects for US economy?

[US GNP fell ½ per cent in 1982 Q4, bringing fall for 1982 as whole to 1.8 per cent. This largest annual fal in post-war period. Press reports (eg Wall Street Journal 6 January) suggest US Administration expects growth of 1½ per cent in 1983.]

Important keep figures in perspective; although disappointing they were not unexpected as OECD had earlier forecast decline of similar magnitude in 1982. Most forecasters expect gradual recovery in 1983, helped by falls in inflation and interest rates. OECD predict for example growth of 2 per cent in 1983. US Administration's next forecast due to be published end January.

3. US budget deficit?

[Press reports suggest US Administration expect budget deficit from between \$150-200 billion in FY 83 to \$ 200 billion in FY 84 and about \$ 300 billion in FY 88. Reports suggest President Reagan will propose three year package of contingency tax increases of \$135 billion to take effect if deficits from October 1985 are expected to exceed \$100 billion].

US economy has made important progress in changing inflationary expectations and reducing inflation and interest rates. Important however that US acts to reduce budget deficits if inflation and interest rates are not to rise again as recovery gains momentum. Better to tackle public expenditure than ~~rise~~ raise taxes. Budget plans are to be published end January.

4. US monetary policy

[At end of last year Federal Reserve suspended M1 target and raised M2 target to 9½ per cent, at annual rate, over last few months of 1982. (Original M2 taget, set in February, was for growth within 6-9 per cent range; M2 growth in Sep-Dec 1982 exceeded range but was broadly in line with revised target). Targets for 1983 not yet announced: expected in February.]

Welcome Federal Reserve's flexible approach but stress that Reserve Chairman, Mr Volcker, has made clear (in evidence to Congress) that reduction of inflation remains priority and that monetary targets have not been abandoned.

5. Anti-inflation policies are working

[Consumer price inflation down from a year ago in all 7 major economies on latest available figures: US (from 9.6 to 4.6 per cent), UK (12.0 to 5.4 per cent), Japan (3.6 to 2.3 per cent), Italy (17.9 to 16.3 per cent), Canada (12.2 to 9.8 per cent) France (14.0 to 9.7 per cent), Germany (6.3 to 4.6 per cent).]

Inflation has fallen in all major countries in the past year and now averages 6 per cent. 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.

6. World financial crisis 'over'?

[Mr Leigh Pemberton reported (FT 30 December) as saying international financial crisis is over, but it is still a very serious situation which will take several years to solve.]

Most major debtors now undertaking adjustment programmes - often with IMF assistance. They may of course remain convalescent for some time, but we now have the measure of the problem. There have also been moves to improve banking supervision, and banks themselves are improving their information flows.

7. Enlarged GAB

[G10 Ministers met in Paris on 18 January to discuss, inter alia, what role an enlarged GAB (General Arrangement to Borrow) might play in augmenting IMF resources.]

G10 Ministers have agreed, subject to necessary legislative approval, that GAB should be increased from $76 billion to $196 billion. Participants' shares in GAB have been adjusted to reflect better their size and role in the world economy. UK share will be 10 per cent. Switzerland is to become a full member. At times when balance of payments position could threaten stability of international monetary system, GAB will be available not only for participants but for any IMF member that agrees a conditional programme with the Fund.

8. Increase in IMF Quotas

IMF has particularly important role in present circumstances in providing finance to countries while they go through necessary adjustments. Essential that IMF has adequate resources. UK has suggested increase of at least 50 per cent in IMF quotas and has played constructive part in building present international consensus on need for progress on Quota Review.

9. IMF Interim Committee - Next Meeting?

In view of the progress made in discussions so far on increasing IMF quotas and the priority attached to strengthening the Fund's resources, the Chancellor as newly elected Chairman of the Interim Committee, has proposed next meeting of the Committee should be brought forward from late April to 10-11 February. We hope that an early and satisfactory agreement can be reached.

COMMENTARY ON RECENT ECONOMIC DEVELOPMENTS AND STATISTICS
24 JANUARY 1983

Summary comment

The effective exchange rate has fallen by about 12 per cent since mid November and interest rates have risen 2 points since end November. However, the direction and the consistency of policy are unchanged. GDP remains flat and manufacturing activity is below 1982 trough levels. RPI inflation fell to 5½ per cent in December and 5 per cent is confidently expected in the next few months. This year, a modest rise is expected in both GDP and in manufacturing output.

World Economy: expectations held by most forecasters for an upturn in activity of 1 per cent last year unfulfilled. A modest recovery in world trade is expected this 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) under 6 per cent in November ranging from 16 per cent in Italy to 4½ per cent in Germany and 3 per cent in Japan;

- average world 3-month interest rates 9½ per cent at 3 January a fall of 4½ points between December 1982 and October 1981; US 3 month rate stood at 8.5 per cent on 3 January; 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 Oct; in the US it fell by 7½ per cent in the 12 months to November;

- unemployment (OECD total) 8.7 per cent in October compared with 6.7 per cent in 1981.

UK Balance of Payments: non-oil trade balance has deteriorated quite sharply but current account remarked in stronger surplus during 1982 than forecast in IAF. Both the loss of competitiveness during 1979 and 1980 and a smaller world market are affecting our non-oil trade but the volume of exports held up well in 1982 and are unlikely to fall below their 1981 lev[illegible]

. OPEC and Third World countries are cutting back on imports because of low commodity prices, high interest rates and debt problems in some countries.

. import volume rose sharply as activity recovered in 1981 and import penetration rose too; in 1982 non-oil import volumes showed little change on 1981 H2.

. the effective exchange rate was at 82.4 on January 21. Pound now below both 87-93 range occupied for the last year and May 1979 level (86.3).

Financial Developments

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

.most banks raised base rates by 1 point on 11 January (to reach 11 per cent) following similar increase on 26/29 November; short term interest rates down 5½ points since October 1981; base-rates down about 5 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 £10½ billion in 9 months to December.

.PSBR: £5.3 billion in 9 months to December; Industry Act Forecast of £9 billion in 1982-83 now at upper end of range of likely outcomes.

.After taking account of foreign currency borrowing and repayments, thee was an underlying fall in the reserves during December of $856 million.

Inflation

.retail price inflation, 5.4 per cent in year to December. IAF forecasts further falls with prospect of 5 per cent by spring 1983.

.TPI increase in 12 months to December was 5.8 per cent;

.Wholesale price inflation input prices up 7½ per cent in year to December compared with 6¼ per cent in November following higher oil prices due to sterling depreciation against the dollar; output prices up 8 per cent in year to December.

GDP and industrial production

.GDP(O) rose slightly in Q3 1982 for second successive quarter but remains at Q4 1981 level. Construction output in 1982 Q3 was 3 per cent up on previous quarter and 2 per cent higher than in 1981 Q3. Underlying level of industrial production also remains broadly flat but is 2 per cent above spring 1981 trough almost entirely due to increased oil and gas production; the underlying level of manufacturing output is slightly below its trough level and there are clear indications of a declining trend during 1982.

Demand Components

.consumer spending held up well during the recent recession and has continued to strengthen since 1982 H1. Some fall in RPDI (see below) offset by lower savings ratio. Retail sales rose substantially in December and in 1982 Q4 were 4½ per cent up on same period in 1981, partly reflecting abolition of HP controls. Consumers' expenditure in Q4 1982 (provisional) 1½ per cent up on previous quarter (this is being reflected in the relative buoyancy of the consumer goods industries) and, in 1982 as a whole was 1 per cent above its 1981 level.

.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 but is responsible for only 30 per cent of total investment by manufacturing, distributive and service industries.

.destocking of £410 million (at 1975 prices) occured in 1982 Q3. But in the CBI's December Survey, number of respondents with "more than adequate" stocks was lowest this year. Stocks are volatile and one quarter's figures should not be over emphasised;

.government consumption is virtually flat. In 1982 Q3 it was 1½ per cent up on the preceding quarter and on its level in the same period last year;

.non-oil exports held up well in 1982 against a 3 per cent fall in world trading activity;

.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 change since 1981 H2.

Productivity and Competitiveness

.manufacturing productivity continues to rise - at 2¼ per cent in year to Q3 1982. Productivity now 13 per cent up on end 1980;

.manufacturers' unit wage/salary costs up less than 6½ per cent in 3 months to November 1982 on a year earlier;

.Cost competitiveness has improved some 20 per cent since early 1981, but remains around 10 per cent worse than in May 1979 (whole of this deterioration is attributable to excessive wage costs).

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 third quarter by 4¾ per cent; and in first 3 quarters of 1982 were 11½ per cent up on their average 1981 level;

.non-North Sea profits fell 4¼ per cent in Q3 1982 on previous quarter but in first three quarters of 1982 were 13¾ per cent up on their average 1981 level;

.gross profits of North Sea oil companies in the first 3 quarters of 1982 were 8 per cent up on their average 1981 level;

.ICCs financial surplus was £0.5 billion in six months to September 1982 following deficit of £0.3 billion in previous six. Over same period net borrowing requirement fell from £9.1 billion to £4.0 billion.

.working days lost through industrial stoppages estimated at 211,000 in November, lowest monthly figure since December 1981.

.insolvencies: provisional totals for 1982 are 5,707 bankruptcies and 12,039 company liquidations, increases of 11 per cent and 40 per cent on 1981.

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 November 1982 was about 8½ per cent, lowest rate of increase since November 1977;

.CBI reports that pay settlements in manufacturing industry averaged 6.1 per cent in 1982 Q4 compared with 6.8 per cent in the third quarter. Bulk of settlements will occur in 1983 H1;

.real earnings broadly flat in last 12 months but RPDI in the third quarter is about 2¾ per cent lower than the average for 1981.

Labour Market

.UK employment fell 2.0 million (8¾ per cent) between 1979 Q2 and 1982 Q2 (over two-thirds concentrated in manufacturing); between 1981 Q2 and 1982 Q2 employment fell by 645,000; manufacturing employment fell a further 93,000 (1¾ per cent) between Q3 and Q2 1982;

.total employment fell more in the second quarter of 1982 (188 thousand) than in the previous quarter (103,000);

.total registered unemployment rose by 34,000 to 3.10 million (13.3 per cent on the new basis) in December;

.UK adult unemployment rose by 41,000 to 2.95 million (12.7 per cent) in December; the increase is higher than in recent months but this may reflect modified signing on procedures over Christmas; nevertheless the underlying increase in Q4 1982 was only 27,000 compared with 31,000 in Q3 1982 and 28,000 in Q2 1982;

.notified vacancies increased by 3,000 to 118,000 in December but one month's figures should be treated with caution and volume of vacancies remain at very low levels;

.other labour market indicators hours lost through short time working has increased steadily since July 1982 to the levels prevailing in 1981 Q4 and 1982 Q1. Hours of overtime worked remain flat.

Forward Indicators

.car production (seasonally adjusted) rose to 73,000 in December from 66,000 in November while commercial vehicle production fell from 25,000 to 22,900 (sa); new vehicle registrations (not seasonally adjusted) increased by 13½ per cent in 3 months to December on same period in 1981;

.steel production (seasonally adjusted) fell in December and in 1982 Q4 the weekly rate of production fell 10 per cent and was 32 per cent down on same period in 1981;

.the volume of new construction orders, which remained broadly flat since the first half of 1981, rose 8 per cent in 3 months to November, and were up 6 per cent on a year earlier. Engineering orders also disappointing with a 5 per cent fall in the lastest 3 months.

.Latest DOI investment intentions survey suggests a 3 per cent fall in manufacturing investment between 1982 and 1983 but other components of investment (distribution and services) are more encouraging;

.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 38,500 a quarter in 1980 to 53,100 in 1982 Q1, fell back in the spring, but in 3 months to November, increased 8 per cent on previous 3 months and were 24 per cent up on same period in 1981. After previously drifting downwards, total completions were fairly flat during 1982 Q2 and Q3 but in 3 months to November were 7 per cent up on previous 3 months;

.a sharp seasonal rise in unemployment occurs in January thereafter headline total should remain flat till May;

.CSO's index of longer leading indicators fell in December after 9 months of increase reflecting the rise in interest rates and the decline in share prices.

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. December Trends Enquiry suggests previous trends broadly continuing but export order recovered from November's deterioration. 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 1½ per cent, assuming some recovery in world economy, with inflation/interest rates falling at least for some time into next year.

Industry Act Forecast

NB. November IAF will be superceded by Budget Forecast (on March 15); latter will take full account of economic developments since November Forecast was prepared. Undue emphasis on precise figures in November IAF no longer appropriate.

.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. Principal demand increases are from consumers expenditure and capital investment. Reflecting strong import growth balance of payments current account goes to zero in 1983. RPI inflation is about 5 per cent in early 1983. 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 28 January

Tues 25	:	New vehicle registrations (Dec)
Thurs 27	:	Employment (Nov)
	:	Industrial stoppages (Nov)
	:	Overtime and short-time (Dec)
Fri 28	:	Sales and orders in engineering industries (Oct)
	:	car production (Dec - final)