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PS/Secretary of State for Transport
PS/Chancellor of the Duchy of Lancaster
PS/Secretary of State for Employment
PS/Paymaster General
and officials in HMT, Revenue Departments and other Departments in Whitehall

TREASURY BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 23 May, are sidelined. While we are in the run-up to a General Election, the contents are, as customary, confined to recapitulation of current Government policy and notes on latest developments, in particular new statistics. The next subsequent issue will be completed on 20 June.

M M Deyes

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RA

R I G ALLEN

6 June 1983

EB Division
H M Treasury
01-233-5503

ECONOMIC BRIEF: CONTENTS

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A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

Main objectives are to achieve, over a period, a sustained improvement in the economy through reduction of inflation, lower interest rates and promotion of enterprise and initiative. Policies will continue to be applied to these ends.

2. 1983 Budget

Budget should not be seen as isolated event but as part of continuing programme being maintained over period of years. Wider context is intention to achieve enduring changes in attitudes and expectations. Framework for continuing responsible policies for money and borrowing was set out in MTFS. Within latter, Budget was designed to give relief to persons and business in order to improve incentives and help restore base for economic growth, higher output and increased employment.

3. Implications of Dissolution of Parliament on Budget proposals?

Selected provisions of Finance Bill - including those required to authorise continuation of power to collect 'annual' taxes - were expedited so as to secure Royal Assent before Dissolution. For fuller particulars see Section J and S5. For effect on social security uprating, see M1.

4. Economic situation?

Modest recovery is under way, not just in sectors like North Sea and construction but also in manufacturing. Figures for Q1 GDP (output) and end to major destocking confirm upward trend. Other indicators - including recent CBI reports (see B5), CSO cyclical indicators (see B10) - point in this direction; with inflation lower and growing evidence (eg from US and Germany) that world economy also picking up, good prospects that recovery will be sustained.

5. Latest unemployment figures?

See C1

6. Williamsburg Summit

See F4 6-7 and T1-2.

7. Outstanding Select Committee reports overtaken by Dissolution ?

Draft only of TCSC report on international monetary arrangements was published 24 May. Understand that report of TCSC subcommittee and Select Committee on Procedure will be published after new Parliament assembles.

B ECONOMIC ACTIVITY AND PROSPECTS

[NB Industrial production (Apr) figures to be published 15 June.]

1. Recent GDP figures

[GDP (0) the best short-term indicator of the three GDP measures - rose ¾ per cent in 1983 Q1, confirming a clear upward trend since 1982 Q1; level now 2½-3 per cent above 1981 Q2 trough. Evidence of declining trend in manufacturing output during 1982 but this now seems to have been reversed. Industrial production fell almost 1 per cent between February and March, but for 1983 Q1 as whole was 1½ per cent up on previous quarter; industrial output now around 3½ per cent above 1981 Q2 trough (largely due to oil and gas); manufacturing production 1½ per cent higher in 1983 Q1 than in previous quarter. Construction output recovering strongly: up 6 per cent in year to 1982 Q4 and preliminary indications suggest increase of around 1½ per cent in 1983 Q1 over previous quarter.]

GDP has recovered 2½-3 per cent since spring of 1981, and industrial output has recovered around 3½ per cent. Despite little change in manufacturing production in March, latest quarter has seen increase of 1½ per cent on previous quarter. Expectations (eg recent CBI Trends inquiries) are for further increases in manufacturing output, and indications for some other sectors (eg construction) also remain favourable.

2. UK experience compared other major industrialised countries since 1979

[Between 1979 and 1982 latest estimates suggest output in Germany rose slightly, in US was broadly constant, in Canada fell by over 1 per cent. This compares with UK GDP (output measure) fall of about 4 per cent.]

UK GDP grew relatively slowly throughout post-war period. True that UK entered recession earlier than competitors, but also emerging sooner. In 1982 our performance was better than most.

3. Prospect for UK economy

[March Industry Act Forecast published in FSBR summarised in Commentary - Z7.]

Total output forecast to grow significantly in 1983 (2 per cent) and to be growing slightly faster (2½ per cent) in 1984 H1, with inflation remaining moderate. Recent outside forecasts in broad agreement on outlook for this year, with output growth expected to be, if anything, slightly higher than in Industry Act forecast at Budget time.

4. Where will growth come from?

Economy is now growing. Total output 2½-3 per cent above 1981 trough; industrial output up 3½ per cent on same comparison; construction output recovering strongly and manufacturing production (particularly in food, chemicals and electrical engineering) has begun to increase. With inflation at lower level, and lower interest rates, conditions are favourable for further growth in demand and activity.

5. Latest (May) CBI Industrial Trends Enquiry

[See Commentary - Z7 - for details.]

Latest results seem to confirm previous CBI reports (in particular, the more detailed April Survey) in pointing to continued improvements in business climate and gradual economic recovery. However, as Sir James Cleminson has pointed out: 'The improvement is still uneven and is led by consumer and export demand'.

6. Construction industry indicators

In 12 months ended 1982 Q4, total construction output increased 6 per cent and early indications point to further rise in 1983 Q1 of around 1½ per cent on previous quarter. In 1983 Q1 total new orders increased 6 per cent on previous quarter; total housing starts in three months to April were up 7 per cent on previous three months.

7. Recent private investment performance?

[For latest available statistics see Commentary - Z3.]

Manufacturing investment has been disappointing (6 per cent fall, including leased assets, in 1983 Q1) but accounts for only small proportion of total investment. Fixed investment in other sectors has been stronger: total fixed investment rose 3-4 per cent in 1982 and in 1983 Q1 investment in distributive and service industries (including shipping) grew by 2 per cent. Housing starts and new construction orders are encouraging, and April CBI survey showed improvement in manufacturing investment intentions: for first time since July 1979, majority of firms intended authorisations for plant and machinery investment to increase over next 12 months.

8. Investment intentions?

Latest DOI investment intensions survey indicates 4 per cent fall in manufacturing investement between 1982 and 1983; survey also suggests underlying trend should start to turn upwards later this year and outlook for distribution and service industries investment more encouraging. April CBI Survey also forecast modest recovery in manufacturing investment by end of this year and continuing into 1984.

9. Continued destocking threat to recovery?

[For latest statistics see Commentary - Z3.]

Manufacturers' and distributors' destocking in 1983 Q1 was, as expected, much smaller than stock reductions in 1982 H2, and latest (May) CBI Enquiry shows further drop in net percentage balance of firms reporting excessive finished goods stocks - now at lowest level since November 1979.

10. Productivity growth falling off in manufacturing sector?

Slight drop in productivity growth last year. But output per head gains still impressive - up 5½ per cent in year to 1983 Q1; and overall improvement of around 17 per cent since end 1980. Some slowdown in 1982 against background of some fall in manufacturing output (after some recovery in 1981). But slowdown probably inevitable since best opportunities for plant closures and improved efficiency taken first. Overall performance since 1981 better than could have been expected on past experience.

11. CSO's indices of leading cyclical indicators

All four composite indices have risen over last few months. Taken together, indicators point to continuing upswing in business cycle.

12. Outside forecasts

[GDP profile in recent major assessments and in March IAF:

Per cent change

	IAF (Mar)	Phillips & Drew (June)	Simon & Coates (June)	NIESR (May)	Cambridge Econometrics (Apr)	CBI (Mar)	LBS* (Feb)**	OECD* (Feb)
1983 on 1982	+2	+2½	+2½	+2½	2	+2	+1¾	+1½
1984 on 1983	+2½	+2	1½	+1¼	2¼	+2½	+2	+1¾***

* Taking no account of Budget measures

** More recent LBS projections point to GDP growth around 2-3 per cent in 1983, 2½-4 per cent in 1984, depending on assumptions about General Election outcome.

*** 1984 H1 on 1983 H1]

Nearly all major outside forecasts see prospect of continued modest recovery (GDP up around 2-2½ per cent in 1983) and modest price inflation around 6-7 per cent range by end 1983.

C LABOUR MARKET

[NB For latest information on earnings/pay settlements see Section D.]

1. Unemployment figures (new basis)/ other labour market indicators?

[May fall in 'headline' total largely reflects favourable seasonal factors and impact of new provisions for over 60s to get automatic credits. Vacancies are on a slowly rising trend (though fell slightly in May). Overtime worked broadly flat and still around 5 per cent down on 1982 average. Hours lost through short time working remain well below peak levels reached in early 1981.

	June	Sep	Dec	Mar	Apr*	May*
'Total unemployment' (millions)	2.77	3.07	3.10	3.17	3.17	3.05 (12.8%)
Adult sa unemployment (millions)	2.77	2.87	2.95	3.03	3.02	2.97 (12.4%)
Average change over 3 months to June, Sept etc (thousands)	+28	+31	+28	+26	+13 [+23]	-10 [+24]
Vacancies (000s)**	105	107	118	126	135	131

* From Apr 1983 unemployment figures reflect effects of automatic credits for men over 60 - figures in square brackets allow for these effects.

** Only about one third of vacancies are officially notified]

The unemployment figures continue to be affected by special factors. Large fall in headline total masks underlying upward trend. Although there are indications that this upward trend has eased, the improvement is modest. Other labour market indicators are mixed.

2. UK Government forecast of unemployment?

[Paragraph 3.39 of FSBR says: 'Growth of total output in the range 2-2½ per cent, if sustained for a period and accompanied by no major shifts in financial pressures on employers, is probably consistent with no great change in unemployment.']

Government does not publish unemployment forecast. FSBR published with Budget says what might happen to unemployment over a period of years on certain assumptions, and under certain conditions. Whether it applies during the forecast period to mid-1984 depends on number of factors, including extent to which increase in wages and other costs moderate, and financial position of companies.

3. How has unemployment moved in relation to the 1983 PEWP assumption?

1983 PEWP assumed 2.74 million unemployment (GB excluding, school leavers) for 1982-83 and 3.02 million for 1983-84. February 1983 figure, seasonally adjusted, was 2.89 million. These unemployment assumptions have not been changed from those given Government Actuary last November, except insofar as they have been revised onto the new (claimants) basis.

4. Could the outturn for unemployment be better than assumed in Cmnd 8789?

Yes. This is made clear in Cmnd 8789 which says (para 9 of Part I, and page 65 of Part II): 'The unemployment level in the later years may turn out to be lower than has been conventionally assumed if developments in the world economy are favourable and if developments at home - notably by way of continued reduction in pay settlements - permit.'

5. Unemployment in UK compared with other countries

[On standardised definitions in March 1983 UK unemployment on new basis was 13.9 per cent (compared with 5.5per cent in 1979), Canada 12.6 per cent (compared 7.4 per cent), US 10.1 per cent (compared 5.7 per cent), Japan 2.6 per cent (compared 2.1 per cent), France 8 per cent (compared 5.9 per cent), Germany 7.7 per cent (compared 3.2 per cent.]

Unemployment has risen sharply in many industrialised countries - increase over year to latest available month in number unemployed (on national definitions - not strictly comparable) was more in Germany (32 per cent - rise of 2.3 points in unemployment rate - in April), Holland (29 per cent - up 3.4 points - in March), and Canada (28 per cent - 2.6 points-in March), than in UK (8 per cent - 0.9 points - in April).

6. Government's special employment measures

On full range of employment and training schemes Government planning to spend over £2 billion in 1983-84, bringing direct help to ¾ million people. Includes £950 million allocated to Youth Training Scheme and £260 million (gross) to (a) new community programme - designed to provide up to 130,000 places for long term unemployed - and (b) new Job Splitting Subsidy to encourage extension of part time work. From 1 October Job Release Scheme will include new scheme for part-time job release for up to 40,000 more people and from 1 August Enterprise Allowances will be available throughout country within overall cash limit of £25 million in 1983-84.

D PRICES AND EARNINGS

[NB RPI and TPI (May) figures to be published 15 June.]

PRICES

1. Inflation rate

[12 monthly RPI increase 4.0 per cent in April, compared 4.6 per cent in March].

12 monthly rate of inflation again fell sharply in April to 4.0 per cent - lowest level for over 15 years (compared 3.4 per cent in March 1968).

2. Inflation increasing in second half of year

RPI scarely rose at all between June and September last year. As a matter of simple arithmetic there is likely to be an increase in the 12 month change over corresponding period in 1983. It was made clear at Budget time that after months of faster than expected progress, inflation was expected to be about 4 per cent in May with some slight rise later in the year perhaps to about 6 per cent; if anything progress since then has been better than expected.

3. Effect of fall in exchange rate

Budget forecast took into account, among other factors, depreciation of £ since the autumn. Since then fall has been partly reversed. But exchange rate only one factor amongst many that affect inflation. Offsetting factors include weak commodity prices (including oil), low increases in UK labour costs (rise in earnings slowed down further, productivity gains continuing, and cuts in NIS); likely cuts in profit margins by exporters to UK, and Government's commitment to sound financial policies.

4. Inflation in future years

Budget forecast of RPI inflation only extends to 1984 Q2. Beyond that policies will continue to be directed towards price stability. Underlying trend has been downward since 1980.

5. Effect of 1983 Budget on RPI

Increase in excise duties will add 0.4 per cent to RPI (mainly in April) but, since duties revised broadly in line with inflation, on an indexed comparison there will be little effect on the RPI (a 0.1 per cent reduction).

6. Effect of 1983 Budget on TPI

Increase in excise duties and allowances will reduce TPI by 2 per cent (or 1½ per cent including also effect of NIC increases). Since allowances were increased well ahead of inflation, Budget still gives TPI reduction of 1¼ per cent even on an indexed comparison.

7. TPI increase

12 monthly increase in TPI (3.5 per cent) over year to April 1983, now ½ per cent lower than for RPI (4.0 per cent) because of Budget increase in tax allowances.

8. Comparison with competitors

[April figures UK inflation 4.0 per cent compared 3.3 per cent in West Germany, 3.9 per cent (annual change on new index) in US, 9.2 per cent in France, 16.5 per cent in Italy, 6.6 per cent in Canada, and 2.0 per cent in Japan; 4.8 per cent weighted average 'major 6'.]

UK inflation now lower than average of major OECD 6 and well below France, Italy and Canada, but still some way to go to match West Germany and Japan.

PAY

[NB Average earnings (April) figures to be published 15 June.]

9. Current level of settlements

CBI data bank of manufacturing settlements shows average lower than last year at 5.8 per cent in pay round so far and 5.6 per cent so far in 1983 . Latest average earnings index (March) shows 8.2 per cent increase (underlying increase 7½ per cent) on year earlier; but this is still heavily influenced by settlements in the last round, and also includes effect of 'drift' as well as settlements.

10. Recommendations of Review Bodies

Government published on 12 May its decisions on Reports from the Armed Forces Pay Review Body and from the Doctors' and Dentists Review Body. The recommendations have been accepted. Two reports from the Top Salaries Review Body on the salaries of the higher civil service, senior officers in the Armed Forces and the judiciary, and on salaries of MPs and Ministers and other office holders, and Parliamentary allowances, will be for consideration after the Election.

E MONETARY AND FINANCIAL POLICY

[NB Provisional money aggregates (May) to be published Tuesday 7 June.]

1. Monetary policy

[8-12 per cent target range for 1982-83 growth of monetary aggregates set out in 1982 MTFS successfully met; target range of 7-11 per cent for 1983-84.]

Control of money supply is central part of medium term financial strategy, directed towards securing progressive reduction in underlying trend of inflation.

2. Is money supply out of control?

[M1, £M3 and PSL2 grew by 1.1 per cent, 1.9 percent and 1.9 per cent respectively in banking April (seasonally adjusted). Annualising the March and April figures produces rates of growth well over the top of the 7-11 per cent target range.]

We take a longer-term view of monetary growth than provided by just one month's figures (and annualising two months' changes is bound to produce exaggerated results). Growth rates of all three aggregates in 1982-83 (including banking April) were within 8-12 per cent target range. The 7-11 per cent range applies to 1983-84 as whole - rates of growth in any one month may be above or below the range without implying breach. Public sector borrowing was unusually high at end of 1982-83 (part of banking April).

3. Do high April money figures mean interest rates will now have to rise?

Does not follow: Government takes account of more than just one month's figures for monetary aggregates in making its assessment of monetary conditions. Other indicators - in particular, recent firming of exchange rate, progress on inflation - do not point to lax monetary conditions.

4. Does surge in US money supply mean UK interest rates will now rise?

Question assumes US interest rates will rise in response to growth in US money supply and that this will cause UK rates to follow. This need not necessarily be the case: UK rates are determined in the light of UK domestic conditions generally, of which the exchange rate is of course only one indicator.

5. Growth in bank lending

[Revised series shows that sterling bank lending increased by £1.4 billion in February, £0.6 billion in March and £0.2 billion in April (banking months).]

Recent figures show clear slackening in rate of growth.

6. <u>Mortgage interest rates likely to go up again</u>?

[No change BSA meeting 13 May. BSA secretary general stated it was unlikely societies would put up rates at next meeting 10 June.]

At current rates of interest, building societies will have either to cut back on the mortgage lending or raise their interest rates in the near future.

F EXCHANGE RATE AND THE RESERVES

1. Market developments

Compared last October, sterling has fallen 5 per cent in effective terms, 7 per cent against the dollar, 5 per cent against the D-Mark, 17 per cent against the yen. On 24 March, sterling touched 6-year low of 77.9 in effective terms and on 28 March reached record low against dollar of $1.4515. Sterling subsequently recovered with return of greater confidence about stability in oil markets.

	October average	6 June 10.15 am	% change Oct - 6 June
$/£	1.6977	1.5840	-6.7
DM/£	4.2932	4.0669	-5.3
Y/£	460.12	381.0	-17.2
£ effective	92.5	87.5	-5.4

2. Exchange rate policy

Government has no target for exchange rate and considers that recent events suggest that in current conditions pursuit of a target would not be viable policy. Bank of England do intervene to seek to moderate excessive fluctuations and maintain orderly markets so far as is feasible. Government's approach to exchange rate is symmetrical whether pound is rising or falling. It is one, but only one, of factors taken into account in interpreting domestic monetary conditions, in Government's attitude to interest rate movements. Similarly, market intervention has been provided in both directions in recent months, but intervention cannot hope to prevent movement in face of strong market pressures - or, by itself, influence the rate in other than the short term.

3. Intervention/underlying reserves change in May?

[Underlying increase in reserves in May was $233 million.]

Not practice to comment on Bank's intervention tactics. Underlying change in reserves result of variety of transactions, both debits and credits; should not be taken as indicator of market intervention during the month.

4. Williamsburg Summit 28-30 May

[See also T1-2]

Summit partners resolved to improve consultation, policy convergence and international co-operation to help stabilise exchange markets, bearing in mind their conclusions on the Jurgensen report (see F6).

5. Jurgensen Report - significance?

[Jurgensen report on exchange market intervention, commissioned at Versailles Summit, published 29 April.]

Report covers only narrow topic of intervention. It aims at giving better understanding of the methods, motives and effects of past intervention. Therefore did not make any policy recommendations. Does not herald an early return to fixed exchange rates. Although it notes importance of broader economic policies in determining the exchange rate it did not consider wider issues of greater policy convergence or IMF surveillance. These questions were considered at Williamsburg and will be taken further in IMF.

6. Jurgensen Report - verdict on UK policy?

Report's findings confirm approach taken by UK Government. Government have always felt that intervention could be useful at times to help steady and calm disturbed market conditions. But always considered that consistent pursuit of sound, counter-inflationary monetary and fiscal policies is only long-term solution to problem of exchange rate instability, and that trying to solve problem through intervention alone would be misguided and ineffective.

7. Join EMS exchange rate mechanism (ERM)?

Government considers that 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 is a constraint, not a policy: it carries an obligation to take action to try to defend a particular rate.

8. Impact on inflation of fall in sterling before April?

See D3.

9. Level of overseas debt

Total official external foreign currency debt now stands at just under $12 billion, compared with $22 billion when Government took office. Remaining debt now smaller in relation to imports than at any time since Second World War.

G BALANCE OF PAYMENTS AND TRADE POLICY

BALANCE OF PAYMENTS

[1983 Q1 balance of payments figures - with information on invisibles and capital account - will be published 3.30 pm Tuesday 7 June.]

1. April trade figures

[Current account in deficit in April £180 million; current account in three months to April £400 million in surplus].

Trade figures erratic month to month. Underlying level of non-oil imports now seems to be increasing as activity picks up.

2. Trade in manufactures in deficit?

[Trade in manufactures £664 million in first quarter - on balance of payments basis. In 1982 trade in manufactures was £2½ billion in surplus.]

Exports of manufactures have held up well. Higher manufactured imports one way in which we have benefited from N Sea oil.

3. Export trends

Underlying level of non-oil exports has probably not changed significantly over recent years, despite world recession. Latest CBI quarterly Industrial Trends Survey shows sharp improvement in order books and expectations of rise in deliveries over next few months.

4. Import trends

Having shown little change during 1982, imports have risen in 1983. Largest increases in imports of basics and semi-manufactures.

5. Invisibles

Deterioration on invisibles in 1982 for private sector largely on interest, profits and dividends, which - at a surplus of £1.1 billion - were down £0.6 billion on 1981.

6. Current account 1983 forecasts

FSBR forecasts £1½ billion current account surplus in 1983 (down from £4 billion in 1982). Import volumes 1983 on 1982 expected to increase 5 per cent - reflecting resumption of growth in UK economy. Export volumes not expected increase significantly until second half of 1983, when world economy starts to pick up. Only 1 per cent growth in exports 1983 on 1982, but 5 per cent increase projected 1984 H1 on 1983 H1. As result, current account may improve slightly in 1984 - projected surplus for first half of year is £2 billion at annual rate.

TRADE POLICY

7. Protectionism

Government has been concerned at the extent of unfair trading practices and the damaging effect of very high tariffs and quotas in some other countries. Has been pressing for positive European Community action to remedy this. But will be continuing to defend the open trading system. [Buying British: see P5.] Leaders at Williamsburg summit committed themselves to 'halt protectionism and, as recovery proceeds, to reverse it by dismantling trade barriers' They emphasised importance of working through GATT.

8. What can UK do to safeguard our producers against dumping of subsidised imports?

UK has right to take selective action where British producers subjected to unfair competition. Under international agreements, EC and GATT can counter by imposing specific duties with aim of getting countries responsible to abandon such practices.

9. Japan

Japan recently agreed Community-wide export restraints in number of sensitive product areas, including tariff cuts and improvements to non-tariff barriers to trade. A helpful review of standard procedures has also been completed. These developments welcome, but we shall continue to press for measures to increase the level of our exports to Japan and for a more equal trading relationship.

H FISCAL POLICY AND THE PSBR

[NB CGBR (May) figure to be published Thursday 9 June.]

1. Government policy

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

2. Reasons for 1982-83 PSBR overshoot

[Budget estimate £7.5 billion, provisional outturn £9.0 billion. CG own account borrowing higher by £1 billion, LABR by £0.5 billion, PCBR by £0.1 billion.]

Mainly higher than expected supply expenditure (£0.9 billion) and higher local authority borrowing (£0.5 billion). End year surge of expenditure greater than expected at time of Budget. Even so, still within £9.5 billion forecast in 1982 Budget. Downward path in ratio PSBR/GDP has been maintained. [GDP ratios in 1980-81 5¾ per cent, 1981-82 3½ per cent, 1982-83 3¼ per cent. MTFS ratio for 1983-84 is 2¾ per cent.]

3. So public expenditure plans exceeded at end of 1982-83?

No, simply less underspending then was assumed at Budget time. Only one very minor breach of cash limits, and ended year with large part of the Contingency Reserve unspent.

4. Implications for PSBR in 1983-84 given overshoot and high April 1983 CGBR?

[Budget forecast £8.2 billion, 2¾ per cent of GDP; CGBR in April £1.2 billion, compared £0.8 billion in April 1982.]

Too early to say. Next published new forecasts for CGBR and PSBR at time of Autumn Statement. [1982-83 outturns for full public sector accounts will not be published by the CSO until July Financial Statistics.]

J TAXATION

1. <u>What changes have been made in the Finance Act to proposals announced in the Budget?</u>

Main changes are that mortgage interest relief ceiling will remain at £25,000 and the higher rate bands for income tax will remain at their 1982-83 levels. In addition, the threshold and rate bands for capital transfer tax will be indexed - Government had proposed an increase in real terms - and the profits limit for the 'small companies' rate of corporation tax will remain unaltered. In addition, a variety of other proposals have had to be dropped in their entirety: these included proposals on the taxation of international business, on oil expenditure reliefs and receipts, and on capital transfer tax.

2. <u>Effect on taxpayers of changes made to earlier Finance Bill</u>?

Main change is that mortgage interest relief ceiling will remain at £25,000 and higher rate bands for income tax will remain at their 1982-83 levels. But the new income tax codes issued to employers based on the changes announced in the Budget, will continue to have effect <u>until August</u>. If a Conservative Government is elected it will introduce a short Bill to restore the omitted Budget proposals.

3. <u>Effect of Finance Act on family man</u>

There will be some 850,000 fewer tax 'units' (counting husband and wife as one) in 1983-84 than if personal allowances not increased. Of these, about 120,000 family heads with dependent children. But substantial increase in allowances over indexation will cut tax bills for all families paying tax at the basic rate. And families will also benefit from substantial increase in Child Benefit.

4. <u>Effect on lower paid</u>

Budget provides help for lowest paid by removing 1¼ million people from tax in 1983-84, compared with position if allowances had remained unchanged. Low paid therefore among greatest gainers from increase in thresholds in real terms for second successive year. Low paid with children also benefit from 11 per cent increase in Child Benefit - now at highest real level since its introduction, and from generous increases in FIS.

5. <u>Comparison with 1978-79 for families since 1978-79</u>

Necessary to measure changes in the tax burden in a way which avoids distortion because of the switch from child tax allowances to child benefit. A couple where the man is on average earnings and there are 2 children will pay a smaller proportion of their earnings in income tax <u>net of child benefit</u> in 1983-84 than they did in 1978-79.

6. Tax reductions in Budget wiped out by increases in national insurance contributions?

[NICs rise in April by 0.25 per cent of earnings for the contracted in, and 0.6 per cent for contracted out.]

Tax reductions will be greater than effect of increase in NICs for all but a minority. [BACKGROUND: Those who will lose are contracted out with above 1½ times average earnings and a very small number of contracted in.]

7. Effect on people with mortgages of MIRAS and recovery of excess tax relief?

Tax payments will go up as result of MIRAS but mortgage payments will go down. Borrowers entitled to ask building society to reduce their monthly payments in such a way that their net position is unchanged. When mortgage interest rates fell last year, PAYE codes were not altered and people received more relief than they were entitled to. Recovery of this excess relief, which increases tax payments, allows people to pay tax that should have been paid last year by easy instalments. In no sense an increase in tax burden.

8. Average worker with mortgage only 19p a week better off after Budget?

[Calculation for particular type of individual in Sheldon PQ as follows: £2.02 income tax cut, minus 40p NIC increase, minus £1.43 recovery of excess mortgage tax relief.]

Wrong to treat repayment of tax underpaid last year as a tax increase. Annex to Mr Sheldon's PQ also showed this individual over £6 a week better off than past August, as result of cut in income tax in last Budget and fall in mortgage interest rates. These interest rates falls are direct result of Government's economic policies.

9. Some people not getting mortgage interest relief as a result of switch to MIRAS?

No one entitled to the relief will be deprived of it. A number of people with bank mortgages have not been brought into the new scheme. A few of these have also lost the relief through their tax coding. Anyone in that position should contact their tax office, who will put matter right as quickly as possible.

10. What did Budget do for industry?

Budget contained substantial help for industry, worth about £¾ billion in a full year, on top of £½ billion benefit to industry of changes announced in Autumn Statement. Included further NIS cut. Number of measures in Budget precisely targeted to help particular sectors. For example, Business Expansion Scheme builds on highly successful Business Start up Scheme for small firms. Reintroduction of Small Engineering Firms Investment Scheme will be of benefit to engineering, particularly in places, such as West Midlands, most hit by recession.

11. NIS reduction

Further ½ per cent cut in NIS will benefit private industry by nearly £400 million in full year. Rate of NIS has been reduced by 2½ percentage points since April 1982 - worth nearly £2 billion to private sector in full year. Outright abolition would be very costly; another £1.2 billion in a full year.

12. Poverty and unemployment traps

Government is concerned about poverty and unemployment traps, in context of incentives as a whole. Substantial increase in allowances announced in Budget will help alleviate poverty trap, and will, together with the increase in child benefit, improve work incentives generally. Long-term solution to poverty and unemployment traps will be provided by maintaining public expenditure restraint, thus allowing tax thresholds to be increased, and by sustained improvement in economic performance, leading to higher real earnings.

13. Future of married man's personal allowance?

Government's 1980 Green Paper on Taxation of Husband and Wife set out number of different options; these being considered in light of very wide range of views received. Abolition, by itself, would affect many millions of taxpayers and leave a basic rate taxpayer nearly £6 a week worse off.

14. Keith Committee Report on Enforcement Powers of Revenue Departments

First part of report published 23 March. Second part should be ready later this year. Very substantial document deserves careful study and full consultation; inevitably lengthy process. Some aspects controversial: all the more need for careful consideration and consultation. Report draws attention to scale of 'black economy' -Government is concerned about tax evasion; numbers of investigation staff in Revenue Departments have been increased.

15. Burden of taxation

[Total taxation (including NIC) as proportion of GDP was 34½ per cent in 1978-79 and is forecast to be 39½ per cent in 1983-84. Corresponding figures excluding NIC are 28½ per cent and 32½ per cent].

Burden inevitably risen because of upward pressures on public expenditure caused by recession. Budget provided significant cut in income tax burden by increasing personal allowances by 14 per cent - 8½ percentage points over inflation. Those in work whose earnings have risen in line with national average have higher real take-home pay now than in 1978-79.

16. British tax burden compared other countries

Accurate comparisons difficult, but UK burden is 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 are about average for EC countries and lower than USA [1980 provisional OECD data].

K PUBLIC EXPENDITURE AND FINANCE

PUBLIC EXPENDITURE PLANS

1. What effect has Dissolution of Parliament had on Government's public spending plans?

No effect on plans announced in PEWP 83 as revised by Budget (total for 1983-84 in FSBR given as £119.3 billion). Plans will be reviewed as part of the annual Survey after the Election.

2. Capital spending plans lower in 1983-84 than 1982-83

Immediate problem not making more funds available but getting local authorities and nationalised industries to spend capital provision available to them. Reduction in planned expenditure compared last year's plans, reflects fact that those plans were not realised.

3. Over-run on spending plans for 1982-83

No question of any failure of public expenditure control system. There has been only one very minor breach of cash limits and we ended the year with a large part of the Contingency Reserve unspent. On total plans there has simply been less underspending than was assumed in the FSBR.

4. Implications for 1983-84 and later years

[1983-84 planning total allows for net shortfall of £1.2 billion, or 1 per cent of total. Total shortfall for 1982-83 compared plans announced in 1982 Budget thought at Budget time likely to be £2.2 billion but now likely to be much smaller.]

Not clear that expenditure was accelerating in any underlying sense in last weeks of 1982-83. There are one or two items of expenditure that could have fallen either side of 31 March, but in the event fell inside 1982-83. Wrong therefore to draw conclusions either about likelihood of expenditure overshooting in 1982-83 or about appropriateness of figures for public expenditure shortfall and Contingency Reserve published with Budget.

5. Price assumptions in spending plans

With exception of social security and provision for pay in 1983-84, no explicit price assumptions underlying FSBR plans. Of course, in determining cash plans Ministers had in mind broad view, consistent with their general strategy, about future course of prices. Not in general necessary for these to be formulated in precisely quantified terms, nor has it been.

6. Policy on contracting out

Government encouraging further use of private sector contractors by public bodies where this will increase economy, efficiency and effectiveness.

LOCAL GOVERNMENT

7. Suggestions of local authority current overspending of £1 billion in 1983-84

This is the figure that emerges from local authority budgets for 1983-84. Local authorities in England and Wales were warned, at the time of the Rate Support Grant settlements, that they might lose grant as a consequence of overspending. Scottish Secretary of State has warned five of the overspending local authorities in Scotland they could lose grant.

8. LA capital underspending in 1982-83

Latest estimates suggest that local authorities underspent their capital cash limits by a little over £1 billion in 1982-83, following underspending of £$\frac{3}{4}$ billion in 1981-82. Steps were taken last autumn to reduce the underspend: PM wrote to local authority associations; local authorities invited to apply for extra allocations (well over £$\frac{1}{4}$ billion issued), and allowed to spend without limit on improvement grants. Extra £150 million made available to Housing Corporation.

9. LA capital spending plans for 1983-84

Plans for LA capital as a whole allow net spending one third higher than likely outturn in 1982-83. Steps taken to reduce further underspending: new rules on receipts (measures announced on Budget Day by Environment Secretary to ease transitional problems including supplementary allocations), LAs can spend above allocations on improvement grants and eligible expenditure limits raised in Budget by 20 percent, also new 'enveloping' provisions (where whole streets being renovated) announced in Budget.

10. Revenue implications of capital projects

Concern about revenue implications should not inhibit full use of allocations: plans for relevant LA current expenditure allow for financing costs of full planned capital programmes; many capital projects have no immediate running costs eg roads, reclamation of derelict land; others will reduce running costs by rationalisation. Government cannot guarantee there will be no underspending - LAs take the decisions. But Government will be monitoring closely, and will take further action, if needed, to encourage full use of provisions.

11. Green Paper on Domestic Rating System

Government has been 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.

FALKLANDS EXPENDITURE

12. What defending Falklands has cost so far and foreseeable future cost

Latest assessment of costs of operation, of replacing equipment lost during conflict, and of garrison, in 1982-83 is about £750 million. Provision has been made for £624 million in 1983-84, £684 million in 1984-85 and £552 million in 1985-86 (total some £2.6 billion).

13. Costs of repairing damage and reconstructing the Islands' economy

Too soon to say. Work has begun on restoration of essential services. About £10 million now expected to be spent in 1982-83; further £5 million in 1983-84. Ministers have agreed on package of measures for long term development of the Islands, tentatively estimated to cost in all £31 million over next 6 years.

14. Cost of paying compensation for war damage

Too soon to say. Expected that bulk of claims for civilian compensation will be settled in 1982-83, and remainder in 1983-84, but no accurate figure as claims still being processed. Total expected to be in region of £3½-4 million.

PAC REPORT

[PAC Report including item on non-competitive contracts for MOD published 19 May. Another referring to non-competitive contracts for drugs out on 26 May.]

15. Government reply to PAC Report?

Reply will be made in usual way in due course to the PAC Reports. [Reply will take form of issue of Treasury Minute - it is hoped before Summer Recess - covering about 10 PAC Reports in all.]

L CIVIL SERVICE STAFFING AND PAY

1. Size of civil service

Since Government came to office, Civil Service has been reduced by 11½ per cent to 648,700 (at 1 April 1983). 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. Manpower policy after 1984

Survey of manpower needs being collated centrally. Manpower planning now on same basis as expenditure planning. Departments exploring option cuts of 5 per cent and 10 per cent and stating needs for extra staff. No decisions have been taken.

3. Government measures to improve standard of financial management in civil service

In May 1982 launched financial management initiative aimed at promoting in each Department an organisational system in which managers at all levels have clear view of their objectives, and means to assess performance against them; well-defined responsibility for making best use of their resources; and the information, training and access to expert advice to exercise responsibilities effectively. Departments were required to submit programmes of work to Treasury and MPO by January 1983; these have been assessed by Treasury and MPO officials. Government is committed to publish a central report on the initiative by July 1983.

4. Civil service pay negotiations for 1983 - non-industrials

Council of Civil Service Unions representing the non-industrial civil service have signified their acceptance of the agreement reached with Treasury. The agreement will increase pay, London Weighting and pay related allowances by 4.86 per cent on average. The cost is to be met from within the provision already made for Civil Service administrative expenditure.

5. Claim for industrial civil servants

Claim for <u>industrial</u> grades has been received and acknowledged. [It seeks: (i) "substantial" increases in basic rates; (ii) restructuring of pay bands; (iii) increases in the special efficiency productivity bonus, and consolidation of other productivity bonuses into basic pay; and (iv) other improvements in hours, leave etc.] First meeting of the JCC pay sub-committee to discuss the claim held on 21 April.

6. 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. Discussions now in progress.

7. Top Salaries Review Body and the higher civil service

See D10.

M SOCIAL SECURITY

1. Effect of Dissolution on uprating proposals?

Bill enabling reversion to historic method of uprating has completed Parliamentary passage and received Royal Assent.

2. Change in uprating method - effect on beneficiaries?

[Government has decided to revert to 'historic' method for uprating: amounts to be paid from November will be announced in June, based on inflation in year to May, instead of announced at Budget time on basis of forecast RPI inflation in year to November. Inflation between May 1982 and May 1983 expected to be 'in region of 4 per cent' (Budget Speech).]

Beneficiaries will keep 2.7 per cent 'real' increase they received last November. But increase next November will be based not on forecast but on actual inflation over 12 months to May 1983. But cannot know exact uprating until May inflation figure published (in June). Chancellor said in Budget Speech this was likely to be 'in region of 4 per cent'.

3. Choice of May

In past years there has been criticism of lag between announcement of uprating and date for implementation. Government therefore sought latest operationally feasible date for determining uprating. This entails an announcement in June - using RPI figure for May.

4. Supplementary Benefit uprating?

[Last year, SB uprated by RPI broadly adjusted for housing costs rather than full RPI, giving uprating ½ per cent lower than other benefits.]

Supplementary benefit will be uprated by the historic method but factors taken into account will be unchanged. Chancellor also announced improvements in capital disregards for SB. (Main disregard up from £2,500 to £3,000); single payment disregard up from £300 to £500; new separate disregard for life assurance policies -of £1,500.)

5. Budget improvements in social security?

[Chancellor announced:

(a) 11 per cent increase in child benefit to £6.50 in November;

(b) restoration of 5 per cent abatement of unemployment benefit;

(c) 'invalidity trap' being abolished (inability of invalidity pensioners to qualify for long term rate of supplementary benefit); pensioners under 60 will get long term rate after one year; those over 60 immediately. Helps 55,000 sick and disabled people;

(d) higher scale (long term) rate of supplementary benefit to be available to unemployed men over 60 on supplementary benefit effective from June (in addition, men between 60 and 65 no longer need to 'sign on' in order to safeguard pension entitlement);

(e) therapeutic earnings limit (amount disabled and chronic sick can earn - with doctor's approval - before benefit withdrawn) up from £20 to £22.50; and

(f) new mobility supplement for war pensioners (broadly equivalent civilian mobility allowance but with £2.10 war pensioners preference premium).]

These changes will go ahead as announced.

N EUROPEAN COMMUNITY

[NB EC Finance Council meeting 13 June.]

1. UK budget settlement for 1982

UK's basic refund is £631 million gross (about £500 million net). Supplementary and special energy measures covering this refund were announced on 28 March. 90 per cent of total was paid over by 30 March, and balance will come later in year. Further refund entitlements under the risk-sharing arrangements will be determined later this year.

2. Refunds for 1983 and later

[European Council on 21-22 March reached agreement on timetable for reaching conclusions on both lasting and interim solution to the budget problem.]

Foreign Affairs Council is meeting on 13 June to agree conclusions on both interim and lasting solutions to be reported to the June European Council, and it has been agreed that provision for 1983 refund will be made in draft budget for 1984.

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?

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

5. Commission proposals for Community financing?

UK Government are studying these carefully. At first sight they appear not to take sufficient account of problem of budgetary imbalances, though proposals for 'modulated' VAT related to relative prosperity and agricultural production are of some interest. Our opposition to new 'own resources' is well known.

6. Commission cash crisis?

UK Government has repeatedly called for better control of CAP guarantee expenditure. Recent developments in CAP have served to emphasise need for action here.

7. UK Government response to Commission request for advance to meet cash crisis?

In the absence of Parliament, it is not possible to accede to this request.

8. 1984 Preliminary Draft Budget makes no provision for refund?

March European Council has agreed our refunds should be paid from 1984 Budget. This agreement will have to be respected.

9. Policy for CAP reform

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

10. Costs of CAP to UK consumers

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

11. European Monetary System exchange rate mechanism

See F7.

P INDUSTRY

1. Latest statistics of output and investment?

See Section B and Commentary at end of Brief.

2. Company Sector

(i) Company liquidity ratios

[D. Industry's survey of 200 large companies shows continued trends to improved liquidity between 1982 Q4 and 1983 Q1. Total current assets rose by over £½ billion; current liabilities fell by about £1 billion. For manufacturing companies in the survey, current liquidity ratios rose from 79 per cent to 104 per cent - highest figures since 1979 Q2.]

Latest D Industry figures show continued encouraging improvement in liquidity, particularly for manufacturing, between 1982 Q4 and 1983 Q1. Although liquidity ratio for manufacturing companies still low, it has improved very considerably since 1980. No widespread concern about liquidity.

(ii) Company profits/rate of return

[Gross trading profits of industrial and commercial companies (ICCs), net of stock appreciation and excluding oil, rose almost 15 per cent between 1981 and 1982; but increase was from a very low base. ICC's real pre-tax rate of return (excluding North Sea) estimated up from 3½ per cent in 1981 to 4 per cent in 1982. No 1982 estimate for manufacturing available, but 1981 figure of 2 per cent was half previous cyclical low figure in 1975.]

1982 seems to have been seen some welcome improvement in ICC's rates of return. But the recovery was from a very low base. Further progress depends on better performance by companies. Government can best help by getting inflation down and setting sound basis for sustained recovery. Some encouragement from recent productivity gains and trend towards moderate pay settlements.

3. Company insolvencies

[Total bankruptcies in 1982: 5,700 - up 11 per cent on 1981. Provisional figure of liquidations in 1982: 12,000 - up 40 per cent on 1981.]

Figures to some extent reflect disappointing output performance in 1982. Need to remember that new company formation is also substantial. High company liquidations and large number of new companies formed partly a symptom of structural change.

4. Government help for small firms

Measures enacted in shortened Finance Act provided further measures to help enterprise and small businesses, increasing the number of measures taken so far from which small firms can benefit to over 100. Enterprise and small firms 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); introduced new Business Expansion Scheme to replace Business Start-Up Scheme. These measures designed to encourage start-ups and existing firms. In total, measures to assist enterprise and small firms introduced since 1979 have full year revenue cost of around £500 million.

5. Buying British

Many British products have always been competitive. New competitive ones coming onto market. When buying British must take account of price and quality - otherwise would only render firms incapable of competing effectively internationally. But should give British products - and ourselves - a full and fair chance.

6. Loan Guarantee Scheme?

[Nearly 9,400 guarantees already issued - about half to new businesses. Total lending under scheme over £310 million. 1982 Budget provided for lending ceiling in first year (to May 1982) to be raised to £150 million and for further £150 million to be available in second year (to May 1983). 1983 Budget raised ceiling by £300 million (to £600 million) for third year (to May 1984). 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. By end-January 1983, payments under scheme in respect of 'called' guarantees exceeded premium income plus recoveries by £3.8 million.

7. New Enterprise Zones

Proposed sites for nine new zones in England were announced by Environment Secretary 15 November though one of these (NE Derbyshire) is not now going ahead; sites for two new zones for Scotland, one for Northern Ireland and two for Wales have also been announced. Meanwhile, the report from consultants published 26 April shows that the zones in general appear to be succeeding in their primary purpose of bringing new life and investment to some very run-down areas.

R PUBLIC OWNERSHIP AND PRIVATISATION

NATIONALISED INDUSTRIES - GENERAL

1. EFLs for 1982-83

Estimated outturn for external financing in 1982-83 published in PEWP 1983 is £2.3 billion - about £½ billion down from 1982 PEWP. Actual outturn now expected to be about £1.8 billion. British Telecom and British Gas undershot EFLs substantially. Indications are that no EFL exceeded.

2. EFLs for 1983-84?

EFLs for 1983-84 currently total £2.5 billion (including revisions to allow for Budget NIS reductions). Current outlook suggests the industries' requirements may fall below this limit; situation is being watched closely. Already substantial reduction has been made for British Telecom; if similar circumstances arise for other industries Government would consider reducing their EFLs.

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

Government seeking greater efficiency within NIs. Setting realistic financial targets and performance aims. Rolling programme of Monopolies and Mergers Commission investigations has been set up.

INVESTMENT

4. Step up nationalised industries' investment to/improve infrastructure/provide orders to private sector/ boost economy?

Government has not prevented the industries from carrying forward a large number of profitable investment programmes. Not Government policy to provide funds for public sector projects with lower returns than those in private sector. Pre-tax rate of return on nationalised industries' capital (including subsidies) in 1981 (latest available figure) was minus ½ per cent, compared with 3 per cent for industrial and commercial companies.

5. Continuing undershoot on investment plans?

No Government can unconditionally guarantee a particular level of nationalised industries investment. Events outside industries' control may cause investment plans to be revised downwards. Industries substantially undershot investment plans in both 1981-82 and 1982-83. Even so, latest estimates suggest that actual investment in 1982-83 increased by 14 per cent over 1981-82 levels (allowing for privatisation, changes in BT's treatment of certain investment, and excluding BNOC and BTDB). PM has encouraged industries to fulfil their investment plans. If they do, investment in 1983-84 should increase by about 12 per cent over this year's estimated outturn (excluding BNOC).

PAY AND PRICES

6. Nationalised industries' prices

[Increase in NI prices water charges and London Transport fares over 12 months to April 1983 7.5 per cent, compared RPI increase of 4.0 per cent.]

NI prices expected to rise at slightly lower rate than RPI in 1983-84. This substantial improvement is sustainable only so long as the industries contain their current costs (particularly pay) in the way that private sector companies have to do.

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

CBI's recent report on comparative energy prices confirms that 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. 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 electricity.

8. Prospects for gas and electricity prices in 1983?

Freeze on industrial gas prices extended to first nine months of this year. Domestic gas prices expected to rise by no more than rate of inflation. On average, industrial and domestic electricity prices will not be increased at all in 1983. These decisions taken by the industries themselves purely on commercial grounds.

PRIVATISATION

9. Special asset sales in 1982-83?

Estimated outturn for 1982-83 around £500 million. Full details of that year's receipts will be published shortly. Sale of Britoil completed; amounted to about £625 million, paid partly in 1982-83 and partly in 1983-84. ABP has been sold, producing net receipts of £46 million.

10. What further sales expected?

Wytch Farm sale to be completed early in 1983-84. Sale of British Gas Corporation's major offshore oil assets as soon as possible. Aim to sell shares in British Telecom after General Election and to transfer British Airways to the private sector as soon as possible.

11. <u>What sales included in special asset sale targets for future years</u>?

[PEWP 1983 has targets of £750 million (previously published target £600 million) in 1983-84, £1500 million (previously £600 million) in 1984-85 and £500 million in 1985-86, for proceeds from special sales of assets.]

Not practice to disclose details of composition of targets because timing of sales dependent on market conditions and price information commercially sensitive. Changes from 1982 PEWP reflect decisions on privatisation since last targets published, and make allowance for additional disposals likely to arise from continuing scrutiny of potential candidates for privatisation.

S NORTH SEA AND UK ECONOMY

1. Will OPEC agreement hold? BNOC prices?

Whether OPEC's agreement works will depend on OPEC. Price negotiations matter for BNOC's judgment. But North Sea prices will obviously be related to prices of closely-competing crudes. BNOC will continue to monitor market developments, and act accordingly.

2. Impact of lower oil prices on UK?

Large disruptive movements in any direction are in no one's interest. But modest and gradual fall we have seen should reduce inflation and boost growth - both in UK and rest of world. Trade balance effect relatively modest. Budget forecast assumed oil prices would remain on average at about current levels.

3. Latest published projections of North Sea revenues

[FSBR/MTFS projections of Government revenues from the North Sea (in money of the day): £7.8 billion in 1982-83; £8 billion in 1983-84 and 1984-85: £9½ billion in 1985-86. Higher than last year's FSBR and Autumn Statement projections, partly because of higher production in tax-paying fields, partly higher sterling oil prices. Other forecasters generally predict higher revenues.]

Oil revenue projections depend on uncertain cost, price and production assumptions. Prospects for North Sea revenues in 1983-84 better than in 1982 FSBR and Autumn Statement because of higher than previously assumed sterling oil prices and production in tax-paying fields. Latest projections generally consistent with recent BNOC announcement on North Sea prices. In general, higher forecasts by others based on combination of higher future production and prices and lower expected future capital expenditure.

4. Fall in North Sea output after 1985?

Hazardous to forecast so far ahead. But always known that oil output would peak in mid-1980's and then decline. Cannot be complacent about effects of falling North Sea output.

5. What remains of Budget proposals in truncated Finance Act?

Phasing out of Advanced Petroleum Revenue Tax, doubling of oil allowance, and immediate Petroleum Revenue Tax relief for exploration and appraisal drilling have all been included in the truncated Finance Act. Provisions for abolishing royalties on future fields and for PRT expenditure relief on shared assets have been dropped.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Williamsburg Summit 28-30 May

Summit partners sounded note of optimism reflecting confidence in prospects for recovery. They noted success in reducing inflation and interest rates, and agreed on need for prudent, balanced policies to ensure spread of recovery to all countries. Summit governments pledged themselves to pursue monetary and fiscal policies conducive to lower inflation and interest rates, more investment and greater employment. Also agreed to take forward the multilateral surveillance process initiated at (1982) Versailles Summit.

2. New 'Bretton Woods'?

Summit partners invited Ministers of Finance, in consultation with Managing Director of IMF, to define conditions for improving international monetary system and to consider part which might, in due course, be played in this process by a high level international monetary conference.

3. World recovery under way?

[According to FT 9 May OECD Secretariat has revised up forecast for growth in industrialised countries this year to 2 per cent (from 1½ per cent December 1982 forecast).]

Welcome signs of recovery particularly in those countries which have successfully reduced inflation (notably US, Germany and UK). The recovery is likely to accelerate during the course of this year and into early next year, with output rising by perhaps 1½ per cent in 1983.

4. Latest inflation figures

[Consumer price inflation down from a year ago in all major economies apart from Italy on latest available figures: US (from 6.6 to 3.9 per cent), UK (8.4 to 4.0 per cent), Japan (2.8 to 2.3 per cent), Canada (11.6 to 7.2 per cent) France (13.9 to 9.2 per cent), Germany (5.0 to 3.3 per cent), Italy risen slightly (from 15.6 to 16.5 per cent).]

UK performance in bringing down inflation in past year as good as any, and better than most of our major trading partners. Falls in inflation together with falls in interest rates offer better prospects for recovery both in UK and rest of world this year.

5. Prospects for US economy?

[Industrial production has risen for last 5 months, retail sales have picked up, and revised estimates show ~~s~~ GNP up by about ½ per cent in first quarter although this mainly due to slower destocking. As result, many forecasts for this year have been revised upwards.]

Welcome signs of modest (by historical standards) recovery in US although too early to be sure recovery firmly established.

6. US Budget

[Agreement over budget for FY 1984 still appears some way off. Senate and House of Representatives have passed (differing) budget resolutions which allow for lower defence spending, higher taxes and lower deficit than proposed by Administration.]

Share widely expressed concern over potential size of budget deficit. Important that firm measures to reduce deficit be agreed if US interest rates are not to rise again, as economy recovers.

7. US has relaxed monetary policy?

[M1 has grown rapidly recently and is well above its 4-7 per cent target range set out in February. M2 and M3 are within their target range.]

Federal Reserve following firm but flexible policies in face of distortions affecting monetary aggregates. Federal Reserve Chairman Volcker has stressed that Federal Reserve remains committed to reducing inflation.

8. IMF borrowing on international capital market?

UK support view of Interim Committee in Washington in September 1981 that possibility of borrowing by IMF in private markets should remain open in light of evolution of IMF's commitments and available resources. Question being kept under close review.

9. What about a fresh allocation of Special Drawing Rights? Why not allocate SDRs exclusively to LDC's?

IMF will be examining desirability of further SDR allocation, in light of current trends in growth, inflation, and international liquidity. We have an open mind about case for further allocation. The Fund's Articles require SDR allocations to be issued to all member pro rota with their quota.

10. International Debt

Many developing countries have faced considerable financing difficulties due to falls in commodity prices, high interest rates and strength of dollar. Although many of largest debtors now undertaking adjustment programmes, often with IMF assistance, some short term financing difficulties may remain.

COMMENTARY ON RECENT ECONOMIC DEVELOPMENTS AND STATISTICS
6 JUNE 1983

Summary comment

Clear upward trend in GDP(O) during 1982 and encouraging signs that output is gradually picking up both inside and outside manufacturing sector. Output forecast, published with Budget, expects continued recovery with 2 per cent growth in 1983. Outside forecasters in broad agreement. RPI inflation is low (4 per cent), and forecast to stabilise around 6 per cent by end-1983. The effective exchange rate now around 7 per cent below October level.

World Economy: World trade fell about 3½ per cent in 1982. A 1 per cent recovery in world trade is expected this year.

. US economy: encouraging signs of recovery; latest estimates show GNP rose by about ½ per cent in the first quarter of 1983; housing starts up substantially on a year ago and industrial production has risen in last 5 months; retail sales have also picked up. US authorities have now revised upwards their forecast of growth through 1983 from 3.1 to 4.7 per cent (Q4 on Q4);

. world commodity prices which were at their lowest level in real terms for thirty years at end of 1982 have moved upwards only slightly in the first quarter of 1983;

. oil prices are weak and likely to remain so for the near future; North Sea prices at \$30 per barrel from March; OPEC agreed price cut to \$29 per barrel;

. consumer price inflation (OECD major 7) under 5 per cent in April (on latest figures) ranging from 16½ per cent in Italy to 3¼ per cent in Germany and only 2 per cent in Japan;

. average world 3-month interest rates around 9 per cent at 23 May; about 6 points fall between 1981 Q3 and April 1983; US 3 month rate about 8¾ per cent on 23 May. Real interest rates remain clearly positive;

. EMS: following 1 day float (21 March) 8 participating currencies have been realigned;

. total industrial production: OECD Major 7 fell 2½ per cent in year to March; in the US it rose in April and is now 1¾ points higher than a year ago;

. unemployment (Major 7) 8.5 per cent in March 1983 compared with 6.5 per cent for average 1981 on standard definitions.

UK Balance of Payments: The UK current account has now been in substantial surplus for three years. In 1982 non-oil export volumes held up well and the current account should remain in surplus in 1983, though this will be reduced as imports respond to increasing activity in UK.

. Export volumes so far this year have continued the resilience shown in 1982 when world trade actually fell, with OPEC and third world countries in particular cutting back on imports because of low commodity prices, high interest rates and debt problems in some countries;

. import volumes were flat in 1982 and, as expected, some rise has been taking place this year associated with the first signs of an end to destocking and the continued recovery in domestic activity;

. effective exchange rate at 85.7 on 3 June, having previously been as low as 77.9 (24 March); this compares with 87-93 range occupied in 1981 H2 and 1982 H1 and May 1979 level of 86.3.

Financial Developments

.Monetary aggregates: growth rates of the monetary aggregates (M1, £M3 and PSL2) were within the 8-12 per cent target range for 1982-83;

.Banks cut base rates by ½ point on 14 April (to 10 per cent) following similar fall in March (2 point increase November-January); short term interest rates down nearly 7 points since Autumn 1981; base-rates down about 6 points;

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

.real interest rates remain clearly positive (as elsewhere);

.CGBR (not seasonally adjusted) £1.2 billion in April, compared with £0.8 billion in April 1982;

.PSBR: estimated at £9.2 billion in 1982-83;

.underlying increase in the reserves during May was $233 million.

Inflation

.retail price inflation, 4.0 per cent in year to April;

.TPI increase in 12 months to April 3.5 per cent;

.Wholesale price inflation: input prices up 6.2 per cent in year to April compared with 9.2 per cent in March; 12 monthly movement in prices of products other than crude oil also fell to 6.6 per cent. Output prices up 7.3 per cent in year to April, compared with 7.2 per cent in the 12 months ending March.

GDP and industrial production

.GDP(O) rose ¾ per cent in Q1 1983 confirming clear upward trend apparent since Q1 1982. Increase of 2½-3 per cent since 1981 Q2 trough. Construction output in 1982 Q4 was 6 per cent up on year earlier and preliminary estimates suggest further increase of 1½ per cent in 1983 Q1. Industrial output is picking up and is around 3½ per cent above spring 1981 trough; manufacturing production in 1983 Q1 rose by 1½ per cent on previous quarter, despite little change in March, and was roughly at its 1981 Q1 trough level.

Demand Components

.consumer spending held up well during the recent recession and rose 3½ per cent during 1982. Some fall in RPDI (see below personal sector) offset by lower savings ratio. Retail sales remain buoyant, and in three months to April provisionally estimated to have increased ½ per cent to a level 5 per cent up on a year earlier. Consumers' expenditure, on preliminary estimates, little changed in 1983 Q1; but still around 3 per cent up on a year earlier. Car registrations in four months to April 1983 were 17 per cent up on same period in 1982. Import penetration, at 56¾ per cent (for Jan-April) below 1982 overall average of 57¼ per cent.

.total gross fixed investment broadly unchanged in 1982 H2 after a disappointing second quarter and in 1982 H2 was 5 per cent up on 1981 H1, but 7 per cent below its average 1979 level. Manufacturing investment (including leasing) in Q1 1983 almost

6 per cent down on Q4 1982 and 6 per cent down in latest 6 months on previous 6. Also, on latter comparison, total capital expenditure by manufacturing, distribution and service industries (including shipping) up 1 per cent.

.Total destocking of £400 million (1975 prices) occured in 1982 Q4 (£320 million in Q3); manufacturers' reduced stocks in Q1 1983 by £80 million on provisional estimate - compared to £385 million in 1982 Q4, £355 million in 1982 Q3;

.government consumption rose 2 per cent between 1981 and 1982. In 1982 Q4 it was a little below its third quarter level and 2 per cent up on its level in the same period last year.

Productivity and Competitiveness

.manufacturing productivity (output per head) continues to rise - at 5½ per cent in year to Q1 1983. Now 17 per cent up on end 1980;

.manufacturers' unit wage/salary costs up around 2½ per cent in Q1 1983 on a year earlier; compares very favourably with our major competitors;

.Cost competitiveness has improved about 15-20 per cent since early 1981, remains almost 20 per cent worse than in May 1979.

Company Sector

.ICCs (excluding North Sea) pre-tax real rates of return up from 3½ per cent in 1981 to 4 per cent in 1982 - but recovery from a very low base;

.gross trading profits (net of stock appreciation) of ICCs rose in the fourth quarter by over 6 per cent and in 1982 were almost 15 per cent up on their average 1981 level;

.non-North Sea profits recovered 4-5 per cent in 1982 Q4 from a disappointing third quarter and in 1982 as a whole were almost 15 per cent up on 1981;

.gross profits of North Sea oil companies in 1982 were 15 per cent up on their average 1981 level;

.DOI Survey of company liquidity showed marked improvement in 1983 Q1 in liquidity of companies (large) covered. Improv ement particularly notable in manufacturing. Liquidity ratios now at their best level since mid-1979;

.ICCs financial surplus was £1.8 billion in 1982 H2 following deficit of £1.2 billion in 1982 H1. Over same period net borrowing requirement fell from £6.1 billion to £2.5 billion;

.working days lost through industrial stoppages estimated at 335,000 in April. Total for whole of 1982 (5.3 million) well below average of 12 million for preceding ten years and latest international comparison of industrial disputes showed that, in 1981, UK occupied a middle ranking position compared with other countries;

.insolvencies: bankruptcies and company liquidations in 1982 totalled 5,700 and 12,100 respectively; increases of around 10 per cent and 40 per cent on 1981. Bankruptcies in the three months to April 1983 reached a new high point of 1686.

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 down to 7½ per cent in year to March 1983;

.CBI says that pay settlements in manufacturing industry currently running at some 5.6 per cent. Bulk of settlements occur in 1983 H1;

.real earnings up over 3 per cent in 12 months to March.

Labour Market

.Total employees in employment (UK) fell 2.4 million (10 per cent) between 1979 Q2 and 1982 Q4 (heavily concentrated in manufacturing) but fell less in 1982 Q4 (160,000) than in the previous quarter (190,000); between 1981 Q4 and 1982 Q4 the fall was 635,000; manufacturing employment fell a further 89,000 (1½ per cent) between 1982 Q4 and 1983 Q1;

.total registered unemployment fell by 121,000 to 3.05 million (12.8 per cent) in May (fall reflects seasonal factors and effects of Budget provision of automatic credits for men over 60);

.UK adult unemployment (sa) fell by 51,000 to 2.97 million (12.4 per cent) in May. After allowing for effects of "automatic credits" provisions, there was a rise of 23,000, suggesting further signs of some easing in the underlying trend. Notified vacancies fell by 3,000 to 131,000 in May, but this is first monthly fall since September 1982, and underlying trend probably remains upwards;

.redundancies (reported as due to occur) provisionally estimated at 30,000 for March and April - compares with average monthly figures of 33,000 1982 and 44,000 in 1981;

.other labour market indicators hours lost through short time working at about 1.5m in March, were over 10 per cent below the 1982 average. Overtime worked is broadly flat and still around 5 per cent down on 1982 average.

Forward Indicators

.car production (sa) down in April (largely reflecting industrial disputes) but remains similar to monthly average for 1982; commercial vehicle production little changed in April but remains down on average 1982 H2 level;

.steel production (averge weekly rate) fell by 8½ per cent in April but in latest 3 months was 32 per cent up on previous three months;

.the volume of new construction orders continues buoyant and in 1983 Q1 was 6 per cent up on preceding quarter, with private housing orders 29 per cent up on same comparison. Total engineering orders (sa) rose 3 per cent in three months to February compared with previous three months (export orders up almost 25 per cent on same comparison). Working Party on short term trends in mechanical engineering forecasts 7 per cent increase in output from mid-1983 to end-1984;

.DOI's investment intentions survey (May) suggests a 4 per cent fall in manufacturing investment between 1982 and 1983 but other components of investment (distribution and services) are more encouraging: for manufacturing, distribution and services as a whole, survey indicates a rise of 3-4 per cent in investment in both 1983 and 1984;

.total housing starts in 3 months to April rose by 7 per cent on previous 3 (private starts up 8 per cent on same comparison) and 14 per cent up on a year earlier (private sector starts up 15 per cent on latter comparison). Total completions, compared with the previous three months, rose 5 per cent in 3 months to April;

.CSO's index of cyclical indicators, taken together, point to a continued upswing in the business cycle.

CBI's latest Industrial Trends Enquiry showed encouraging improvements in total and export order books (former now stronger than in any Survey since November 1979). Net balance of firms expecting increase in output was positive for fourth successive month. Proportion of firms expecting increase in average domestic selling prices still higher than towards end of 1982 but remains low by historical standards while net balance of firms reporting excessive finished stocks now at lowest level since November 1979.

Government Forecast published with Budget expects: inflation to stabilise around 6 per cent by end 1983. GDP to rise 2 per cent between 1982 and 1983 with a similar increase in manufacturing output. All demand components increase in 1983 with total domestic demand up 3½ per cent. Current account surplus to fall to £1½ billion in 1983, PSBR at £8 billion in 1983-84 (£7½ billion in 1982-83). World trade to rise 1 per cent this year but to grow much more strongly (6 per cent) in 1984 H1.

Outside forecasting groups - many recent forecasts expect GDP growth of around 2-2½ per cent in 1983, assuming some slight recovery in world economy, with inflation forecast around 6-7 per cent by the end of 1983.

Key indicators to be published in 2 weeks ending 17 June

Mon 6	:	Housing starts and completions (Apr)
Tues 7	:	Credit Business (Apr)
	:	Wholesale prices (May)
	:	Retail sales (Apr - final)
	:	Balance of payments (1st qtr)
	:	Monetary aggregates (May - provisional)
Thurs 9	:	Car production (May - provisional)
Fri 10	:	Steel production (May)
	:	Building societies figures (May)
Mon 13	:	Retail sales (May - provisional)
Wed 15	:	Industrial production (Apr)
	:	Average earnings (Apr) wage rates (May)

Thurs 16	:	Monetary aggregates (May - final)
	:	Capital expenditure by manufacturing, distributive and service industries (1st qtr - revised)
	:	Manufacturers' and distributors' stocks (1st qtr - revised)
Fri 17	:	Retail price index (May)
	:	Tax and price index (May)