1/1

PA

PPS/CHANCELLOR

file no TEB/CA/01

copied to:

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

TREASURY WEEKLY BRIEF

Attached is the latest version of this Brief. Changes from the previous Brief, of 27 June, are sidelined.

M M Deyes

M M DEYES

12/7

R I G ALLEN
4 July 1983

EB Division
H M Treasury
01-233-5503

ECONOMIC BRIEF: CONTENTS

A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

[Chancellor's speech in Debate on Address 29 June - his first major statement on economic policy as Chancellor.]

Intend to consolidate and build on progress already made in creating conditions for sustainable recovery. Will maintain sound financial policies conducive to lower inflation and take further measures to promote enterprise and encourage competition.

2. Stance of policy will shift towards reducing unemployment?

No trade off exists between inflation and unemployment. Government has important role in easing transition to low inflation-high employment economy. But to reduce unemployment on a lasting basis we need to continue fight against inflation, keep costs under control and improve productivity.

3. Future of MTFS?

Government will continue to set a framework of sound money, with an appropriate balance between fiscal and monetary policies. Heart of approach will remain the medium-term financial strategy.

4. Approach to monetary policy?

Monetary policy will continue to be operated flexibly and sensibly in light of circumstances, consistently with reducing inflation.

5. CBI critical of high interest rates/exchange rate?

[CBI saw Chancellor Wednesday 22 June and PM Monday 27 June.]

CBI not critical: like Government, would like to see lower interest rates. Also stress need not for lower exchange rate per se but less volatility. In line with Williamsburg consensus (see F5).

6. Borrowing out of control?

No evidence of this. But shall be watching course of Government borrowing closely over coming months; stand ready to take action if our objectives are endangered. [See also Section H]

7. Cuts in public spending on their way? Cut in real value of benefits to unemployed?

[Chancellor questioned in 'Face the Press' 3 July.]

Of course Government cannot rule out changes to public spending plans if need arises - as Prime Minister made clear during election campaign. Government 'have to look at public spending every year and afresh' (Weekend World 5 June). (See also K1 and M5.)

8. Government's 'secret Manifesto'

There is no secret Manifesto. The published Manifesto sets out Government's intentions fully and frankly. Their actions will be consistent with these.

9. Summer Finance Bill 'bonanza for the rich'?

Summer Bill result of choices made by Opposition about first Finance Bill. Measures need to be seen in context of whole Budget. Child Benefit is being increased to record levels and personal allowances raised by 14 per cent. Bill extends this 14 per cent increase to higher rate bands and investment income surcharge threshold. (See also Section J.)

10. Current economic situation

Modest recovery is under way. GDP up 3½ per cent since mid-1981. Restocking now taking place. Private investment recovering and retail sales remain buoyant. Other indicators - including recent CBI reports (latest Trends Inquiry 27 June - see B5), and CSO cyclical indicators - point in direction of continued gradual recovery. With inflation lower and evidence (eg from US and Germany) that world economy is picking up, good prospects that recovery will be sustained. (See also Section B.)

11. 'New Treasury forecast' shows GDP 2½ per cent growth in 1983?

[Press reports of Chancellor's 29 June speech.]

No new forecast will be published until autumn. Chancellor simply said during 29 June Debate that prospects - both for output and inflation - were a little brighter than expected at time of Budget, with GDP growing 'up to 2½ per cent' this year and inflation rising temporarily to '5 or 6 per cent' by the end of year. No more than slight amplification of earlier comments by previous Chancellor.

12. Bank of England Quarterly Bulletin take gloomier view than Government?

[Bank's June Bulletin published 30 June, widely reported as 'gloomy'.]

For Bank to comment on their view of economy. But Bulletin recognises 'signs of recovery' in world and UK economies and comments that modest expansion - and lower inflation - is likely to continue.

13. Outlook for unemployment?

[Guardian 31 May: Mr Lawson reported as saying '... in my judgment all the signs are that there is every prospect that by next year we will see the start of a fall in the level of unemployment'.]

Employment always responds to changes in output with some delay. Good progress on inflation and output has been made over past year. Much will now depend upon factors outside Government's control, including developments in world economy and our ability to hold down domestic costs. But room for some optimism about prospects. (See also Section C.)

14. New Chancellor's view of pay? Concordat with CBI?

See D9.

15. New Chancellor's view of international consensus on economic policy?

As Chancellor made clear in 29 June speech, Government continues to attach importance to working together with our partners and IMF to ensure convergence on non-inflationary growth and maintenance of a stable monetary system for world as a whole. [See also Section T.]

16. Is deficit running out of control - world interest rates heading up?

[Article by Tim Congdon in Times of 22.6.83 presented projections of exploding US fiscal deficit and predicted financial breakdown unless action taken. Key problem was that US deficit exceeded net debt interest payments so that debt accumulated rapidly.]

The US deficit is a major problem. It contributed to current high level of interest rates throughout the world. Demonstrates need to control public borrowing. Important therefore that US administration and Congress should agree on measures to put deficit on continuing declining path in medium term. (See also T7.)

17. Chancellor's meetings with Messrs Volcker/Larosiere?

See T9

18. Select Committee on Procedure (Finance) Report: Government response?

[Report published 16 June makes number of major recommendations relating to Parliamentary control of borrowing, of non-'supply' expenditure and public expenditure as a whole, and of long term expenditure projects. Also major proposals for budgetary reform, and proposals relating to contingencies fund and to provision of financial information. Report would, if fully implemented, lead to major shift of power in financial area from Executive to Legislature.]

Committee have produced substantial piece of work with large number of recommendations across whole range of financial procedure affecting expenditure, taxation and borrowing.

Government will want to consider them carefully. Detailed comment inappropriate at this stage.

BULL POINTS

Output and Demand

- Total output (GDP) up 3½ per cent on mid-1981.

- Industrial output in three months to April up 3-3½ per cent on spring 1981 trough.

- Manufacturing production recovered 1 per cent in three months to April on previous three (chemical and allied industries and electrical engineering showing strongest improvement).

- Consumers' expenditure in 1983 Q1 3 per cent up on a year earlier.

- Retail sales in three months to May almost 6 per cent up on year earlier.

- £700 million destocking in 1982H2; turn round to £100 million restocking in 1983Q1.

Prospects

- CBI (June) Enquiry balances showed (i) total order books strongest since November 1979; (ii) positive output expectations for fifth successive month; (iii) excessive finished goods stocks lowest since November 1979; (iv) expectations for increase in domestic prices still historically low.

- Fixed investment (private sector) set to rise 3-4 per cent in both 1983 and 1984.

- CSO's cyclical indicators point to continuing upswing in the business cycle.

- Outside forecasts recently suggest higher GDP growth this year than Budget estimate [NB Chancellor said 29 June that he expected an increase of "up to 2½ per cent".]

Financial Strategy

- Government borrowing amongst lowest in industrialised world.

- Public expenditure planning total in FSBR for 1983-84 (£119.3 billion) below total published in 1983 White Paper and £¾ billion below planning total in Autumn Statement. First time since 1977 that Government not increased spending plans in course of Survey.

- Short-term interest rates down about 7 points since autumn 1981.

- Official external foreign currency debt down from $22 billion in May 1979 to less than $12 billion at end-May 1983. Remaining debt now smaller in relation to imports than at any time since Second World War.

Inflation, Costs and Profits

- RPI inflation 3.7 per cent (May) - lowest since March 1968. [NB Chancellor said 29 June some temporary rise to 5-6 per cent by end-1983.]

- Output per head (manufacturing) risen 16½ per cent since end-1980 and at record levels. Output per head and output per hour now 9 and 12 per cent above previous cyclical peak in H1 1979. Manufacturers' unit wage and salary costs up 3½ per cent in 3 months to April on year earlier. (Would be lower still with NIS cut).

- Cost competitiveness (manufacturing) improved around 20 per cent since early 1981 (assuming £ effective of 84).

- Non-oil ICC's profits nearly 20 per cent above level in 1980 and 1981. (50 per cent up for oil ICC's.) Real profitability also improving slightly.

- Company liquidity at best level since mid-1979.

Labour Market

- Working days lost in May (110,000), well below average in first four months of 1983 (476,000). 5.3 million days lost last year was well below 12 million average of preceding 10 years.

Freedom, Enterprise and Initiative

- Many controls abolished in last Parliament: pay, dividends, prices, exchange controls, office development permits, industrial development certificates and HP controls.

- Further 13 enterprise zones announced in 1982 (total now 24).

- Civil Service now under 650,000 (1 April 1983) - cut of 11½ per cent since Government took office. On target to achieve smallest Civil Service since war by 1984

(630,000). LA manpower (GE) cut by 106,000 (4½ per cent) between June 1979 and December 1982.

- Owner occupation at highest ever level: 56 per cent of all dwellings in 1981. Almost ½ million public sector tenants bought their houses since May 1979; further ¼ million in process of buying.

B ECONOMIC ACTIVITY AND PROSPECTS

1. Evidence for recovery?

[GDP (0) - the best short-term indicator of the three GDP measures - rose ½ per cent in 1983 Q1, confirming a clear upward trend since 1982 Q1; GDP(O) now 3½ 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 in three months ending April was 1½ per cent up on previous three; underlying industrial output now around 3-3½ per cent above 1981 Q2 trough (largely due to oil and gas); manufacturing production 1 per cent higher in three months to April than in previous three.]

Total output has recovered 3½ per cent since spring of 1981, and industrial output has recovered around 3-3½ per cent. Manufacturing production three months to April increased 1 per cent on previous three and expectations (eg recent CBI reports, CSO leading indicators) are for further increases. Consumers' expenditure in 1983 Q1 up 3 per cent on year earlier. Retail sales at record level - almost 6 per cent higher in three months to May compared with year earlier. De-stocking in second half 1983 (£730 million at 1975 prices) has been turned round into modest restocking (£100 million) in first quarter this year.

2. UK suffered worse recession than major competitors?

[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 (average measure) fall of over 3½ per cent - though not strictly comparable measure.]

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 against difficult international trade background. Growing signs of world recovery - particularly in US - should make going easier.

3. Prospects for UK economy good?

Total output growth of up to 2½ per cent in prospect for this year, and, with world background slowly improving, should be a little easier from now on. Inflation to remain moderate at 5-6 per cent by end of year. [IF PRESSED on publication of revised forecast, see A11.]

4. Latest (June) CBI Industrial Trends Inquiry

[See Commentary 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, Sir James Cleminson has pointed out that, while Inquiry results are encouraging, not all manufacturing industry has benefited yet from this steady but modest increase in business activity.

5. Is recovery sustainable?

[Mr Shore in Debate 29 June claimed sustained 2½ per cent growth 'wildly improbable'.]

Recovery has been modest but against very difficult world background; many indicators point to continuing growth. Longer term prospects look good so long as we stick to sound financial policies and work for greater competitiveness, efficiency and enterprise. Containment of costs also of crucial importance if lower inflation to be translated into lasting growth and jobs. Much progress already made (lower inflation and interest rates, improvements in productivity and competitiveness and encouragement of competitive market forces); need to consolidate further.

6. Recovery over with stockbuilding and consumption petering out?

[June BEQB 'stimulus from stockbuilding is unlikely to be repeated, nor may there be any immediate resumption of the earlier fast growth of consumer spending. May NIESR Review 'Consumer demand .... now likely to weaken'.]

Retail sales are still at record level and CBI's June Inquiry showed consumer goods firms not pessimistic about output prospects. Inquiry also showed balance of firms with excessive finished goods stocks at lowest level since November 1979. Fixed investment also growing and world recovery should make it easier for exports. Nearly all major outside forecasters see prospects of continuing modest recovery in 1983 (GDP up around 2-½ per cent), modest price inflation (around 6 per cent by end 1983) and further growth in 1984.

7. Domestic industry missing out on the consumer spending spree?

[For details of consumer spending see Commentary. Buoyancy, particularly of retail sales contrasts sharply with movements in consumer goods production. In three months to April latter was only ½ per cent up on preceding three months and was little changed from its level a year earlier.]

Consumer goods production figures disappointing. However, CBI's June Trends I shows that output expectations are particularly strong for consumer goods sector and May trade figures showed fall in value of consumer goods imports from April level. But scope remains for further improving competitiveness by moderating wage settlements and improving product design, etc.

8. Latest construction and engineering industry indicators suggest recovery over?

[Construction output and orders have fallen in recent months. Housing starts have fallen in last three months but still well up on year ago. Total engineering orders fell 1 per cent in 1983 Q1 compared with previous quarter, reflecting continuing weakness of domestic orders.]

Construction output - particularly housebuilding - recovered relatively rapidly last year - by almost 9 per cent in year to 1982 Q4. Some pause not surprising though latest figures are disappointing. But not too much weight should be placed on one quarter's figures, particularly when set against background of general recovery. Engineering export orders have rose in 1983 Q1 and latest forecast by EEF expects mechanical engineering output to rise by around 7 per cent between mid-1983 and the end of 1984.

9. Hasn't recent investment performance been weak?

[Total fixed investment in 1983 Q1 3 per cent up on 1982 H2 level. Manufacturing investment (including leasing) in 1983 Q1 over 4 per cent down on 1982 Q4 and over 5 per cent down in latest six months compared previous six. But total capital expenditure by manufacturing, distribution and service industries up 1 per cent latest six months compared previous six.]

Manufacturing investment has been disappointing (over 4 per cent fall, including leased assets, in 1983 Q1) but accounts for only small proportion of total investment, likely to recover later this year. Fixed investment in other sectors has been stronger: total fixed investment rose almost 4 per cent in 1983 Q1 on previous quarter, and investment in distributive and service industries (excluding shipping and leased assets) almost 2 per cent on same comparison. And investment in all sectors should respond to significant improvements in company profitability and liquidity (see Section P) and growing signs of sustained recovery.

10. Investment intentions?

Latest DOI investment intentions survey indicates 4 per cent fall in manufacturing investment between 1982 and 1983 but also suggests underlying trend should start to turn upwards later this year. 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. First time since July 1979 that majority of firms intended authorisations for plant and machinery investment to increase over next 12 months.

11. Trade figures suggest that recovery will hit balance of payments 'stop' just as in the old days?

May figures affected by 'erratic' items and oil. Recent rise in imports and form it has taken are consistent with other indicators of industrial recovery (see also Section G).

12. High real interest rates choking off recovery?

Real interest rates are high whilst economy adjusts to low levels of inflation - just as real interest rates were negative when inflation was accelerating in 1970s. Real interest rates in UK not particularly high by international standards. Expect some fall in real interest rates in developed countries as inflation brought firmly under control.

13. 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 probably inevitable since best opportunities for plant closures and improved efficiency taken first. Also, manufacturing output now rising. Overall performance since 1981 better than could have been expected on past experience.

C LABOUR MARKET

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

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

[June fall in 'headline' total largely reflects favourable seasonal factors and distortions due to administrative changes announced in Budget. Vacancies are on a slowly rising trend. Overtime worked remains 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.

	1982			1983		
	June	Sep	Dec	Apr*	May*	June*
'Total unemployment' (millions)	2.77	3.07	3.10	3.17	3.05	2.98
Adult sa unemployment (millions)	2.77	2.87	2.95	3.02	2.97	2.97
Average change over 3 months to June, Sept etc (thousands)	+28	+31	+28	+13 [+23]	-10 [+24]	-18 [+22]
Vacancies (000s)**	105	107	118	135	131	139

* 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]

Fall in 'headline' total is welcome but mainly reflects special factors. Over next few months these factors will tend to go into reverse and 'headline' total will probably rise. However there are signs that upward trend has eased slightly. Vacancies have been rising and other indicators of economic recovery given grounds for cautious optimism about unemployment prospects.

2. True level of UK unemployment really much higher than published figure?

Gross exaggerations are in circulation, relying heavily on assumptions, eg out-dated estimate of one million fall in labour force between 1979 and 1981, and including those benefiting from special employment measures - who are not unemployed.

3. Official figures take no account of unregistered unemployment/non-claimants?

Long been recognised that, for variety of reasons, some people seeking work do not appear in statistics of claimants. On other hand, recognised that some claimants not actively seeking work. Estimates in June Department of Employment Gazette show that, in 1981, these groups broadly offset each other.

4. Why has Government decided to write-off nearly ½ million unemployed as scroungers? [Reference to June Employment Gazette article].

Estimate of 400,000 on unemployment count not actively seeking work nothing new. Many independent studies have come to broadly same conclusions. These people certainly not all scroungers. Include occupational pensioners and other registered only to obtain national insurance credits (before administrative change announced in Budget), some who would welcome a job if the Jobcentre were able to offer one but are not so concerned as to consider themselves as actively jobseeking (perhaps for age or family reasons), and some who are 'unemployable' or do not believe any jobs are available for them.

5. Budget measures just Government attempts to 'fiddle' the figures?

[Changes announced in Budget: automatic credits for men aged 60-65 and higher scale supplementary benefit for man over 60, plus part-time JRS and enterprise allowance. First two of these removed around 122,000 from June unemployment count; taken together, Budget measures will probably have 'register effect' of about 160,000 by March 1984, rising to about 180,000 by March 1985.]

No. Social security measures will help poorest section of unemployment over 60's and remove needless obligation. Part-time JRS will mean jobs for the unemployed because a part-time replacement must be recruited.

6. Do revised employment estimates represent further fiddling?

[Employment Gazette article on over-estimation of fall in employment since 1981.]

No. Aim is to give best guidance we can to users on what we believe to be position. Article explains why it seems that estimates are too low, and says estimates incorporating an allowance - assuming unchanged rate of under-estimation - will be published alongside basic figures.

7. 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.' 1983 PEWP assumed 2.74 million unemployment (GB excluding, school leavers) for 1982-83 and 3.02 million for 1983-84.]

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. As 1983 PEWP made clear: '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.'

8. Chancellor's forecast a fall in unemployment next year?

See A~~5~~7 13.

9. Unemployment in UK worse compared with other countries?

[On standardised definitions in April 1983 UK unemployment on new basis was 13.7 per cent (compared with 5.5per cent in 1979), Canada 12.4 per cent (compared 7.4 per cent), US 10.0 per cent (compared 5.7 per cent), Japan 2.5 per cent (compared 2.1 per cent), France 8.0 per cent (compared 5.9 per cent), Germany 7.6 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 greater in Netherlands (over 26 per cent - rise of 3½ points in unemployment rate in May), Germany (nearly 40 per cent - 2 points in May), and Canada (21½ per cent - 2 points in May) than in UK (11½ per cent - 1.3 points in June (allowing for Budget changes)).

10. Cost of unemployment £17 billion?

Government always willing to answer questions about direct cost to Exchequer of benefits paid to unemployed. But larger figures sometimes quoted, purporting to take account of income tax and national insurance contributions foregone, unhelpful because fail to address central issue of how to reduce unemployment. Government itself cannot determine level of unemployment. Its role is to set appropriate framework in which opportunities for new jobs emerge.

11. Exchequer cost of unemployment ?

Unemployment and supplementary to people counted as unemployed currently expected to total about £5-7 billion in 1983-84 (provisional DHSS estimate in 1983 PEWP).

12. Government don't care about unemployment? Should do something about it?

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. Cuts in NIS have reduced tax on jobs. Also Government creating sound foundations for sustainable growth in employment by (i) maintaining firm financial policies designed to reduce inflation and interest rates further (ii) encouraging competition, enterprise and initiative by number of 'supply side' measures. But Governments cannot do everything. Much depends on world developments and private sector's ability to hold down costs and improve competitiveness.

13. Unemployment benefits to be cut in real terms?

See M5.

D PRICES AND EARNINGS

PRICES

1. Inflation rate

[12 monthly RPI increase 3.7 per cent in May, compared 4.0 per cent in April].

12 monthly rate of inflation again fell sharply in May to 3.7 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 scarcely 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. As Chancellor said on 29 June, there is and will be no sudden resurgence of inflation of the sort we have seen in the past.

3. Effect of higher mortgage rates/petrol price rises on RPI?

[1¾ percentage points increase in mortgage interest rate (to 11¾ per cent) announced by Building Societies' Association on 22 June will add around 0.4 per cent to RPI, mainly coming through in July. Petrol price rise announced 1 July will add up to ½ per cent to RPI depending on extent to which price increase holds.]

Mortgage rate/petrol price rise only two factors 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. Taking all factors into account, outcome could still be better than Budget forecast, with retail price inflation of 5-6 per cent by 1983 Q4.

4. Inflation in future years

Budget forecast of RPI inflation only extends to 1984 Q2 (6 per cent). Beyond that policies will continue to be directed towards further progress in reducing inflation. Underlying trend has been downward since 1980.

5. Comparison with competitors

[May figures UK inflation 3.7 per cent compared 3.0 per cent in West Germany, 3.5 per cent in US, 9.0 per cent in France, 16.4 per cent in Italy, 5.4 per cent in Canada, and 2.0 per cent (April figure) in Japan]

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

6. TPI increase

12 monthly increase in TPI (3.2 per cent) over year to May 1983, now ½ per cent lower than for RPI (3.7 per cent) because of Budget increase in tax allowances.

PAY

7. 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 5.7 per cent so far in 1983 . Latest average earnings index (April) shows 8.2 per cent increase (underlying increase 7¾ per cent) on year earlier; but this is still influenced by settlements in the last round, and also includes effect of 'drift' as well as settlements.

8. Pay settlements too high?

[Year on year growth average earnings 8.2 per cent in April, compared 4.0 per cent growth in RPI.]

Pay settlements have continued to come down in last couple of years, which is sign of greater realism. But inflation has come down more, and earnings over past year have risen much faster than prices. Improved employment prospects depend on lower earnings growth, and that means lower pay settlements.

9. 2-3 per cent settlements in next pay round?

[Report in The Times 28 June following PM's meeting with CBI previous day.]

Not yet been decided whether Government's plans for next financial year will be calculated on basis of explicit 'pay factor'. However there will be continuing need in next pay round for still lower pay settlements consistent with improved job prospects industry concerned. The lower pay settlements are, the better.

10. Recommendations of Review Bodies

[Press speculation on 1 and 2 July about proposals to be made by Government on MPs pay.]

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, are still under consideration.

E MONETARY AND FINANCIAL POLICY

[Monetary aggregates for June (provisional) to be published Tuesday 5 July]

1. What is Government's monetary policy in its second term?

Government continues to adhere to 1983 MTFS. Growth of M1, £M3 and PSL2 within last year's target range of 8-12 per cent. Target is 7-11 per cent for 1983-84.

2. What further changes in MTFS was Chancellor referring to in speech 29 June?

Chancellor made clear in his speech that substance of policy remains unchanged; 'to maintain the general thrust of a monetary policy to reduce inflation'. But also making general point that form of MTFS has evolved over past few years and may be expected to continue to evolve. (Hansard col 590).

3. Is the money supply out of control?

[M1, £M3 and PSL2 grew by 1.5 per cent, 0.8 per cent, and 0.8 per cent respectively in banking May (seasonally adjusted). Annualised growth rates of first 3 months of current target period produces rates of growth well above target range.]

Early days yet for new target range. First two months of target period affected by surge of public sector borrowing. Annualising rates of growth highly misleading when using only a few months figures. Target range is for a year as a whole, not particular months.

4. Is there a change in emphasis away from the money supply towards the exchange rate?

No. Government looks at whole range of factors in assessing financial conditions. This includes the exchange rate.

5. Does recent fall in base rates despite high monetary growth indicate a change in policy?

No. We look at a variety of indications of financial conditions. The evidence from real interest rates, inflation and the exchange rate is that monetary conditions remain sound.

6. Any prospect of a further fall in interest rates?

Sound monetary conditions and low inflation offer best basis for sustainable reductions in interest rates. Interest rate reductions are desirable, but only if not jeopardising this strategy.

7. Bank lending

[Rise of £0.9 billion in banking May after £0.2 billion in April and £0.6 billion in March banking months.]

Continues at levels well below levels reached last summer. Recent slackening continues.

8. Government view of mortgage rate increase?

[Building Societies Association announced 22 June changes in recommended interest rates, to take effect from 1 July. Mortgage rate will rise from 10 per cent to 11¼ per cent and ordinary share rate from 6¾ per cent to 7¼ per cent (basic rate tax paid).]

Sorry that mortgage rate has gone up but level of building society interest rates a matter for them, not Government. Societies have to decide their own rates in relation to demand for mortgages, which has been very strong in recent months, and level of other rates. (For effect on RPI see D3).

F EXCHANGE RATE AND THE RESERVES

1. Market developments

Compared last October, sterling has fallen 9 per cent in effective terms, 10 per cent against the dollar, 9 per cent against the D-Mark, 20 per cent against the yen. On 24 March, sterling touched 6-year low of 77.9 in effective terms; on 28 March reached record low against dollar of $1.4515. Sterling subsequently recovered with return of greater confidence about stability in oil markets. In run up to General Election £ strengthened, but has now fallen back to its effective levels in early May.

	October average	1 July noon	% change Oct - 1 July
$/£	1.6977	1.5336	-9.7
DM/£	4.2932	3.8906	-9.4
Y/£	460.12	366.22	-20.4
£ effective	92.5	84.2	-9.0

2. Exchange rate policy/Government wants lower exchange rate?

Government has no target for exchange rate although it is taken into account in interpreting domestic monetary conditions in Government's attitude to interest rate movements. Bank of England do intervene to seek to moderate excessive fluctuations and maintain orderly markets so far as is feasible, whether pound is rising or falling - though intervention cannot hope to prevent movement in face of strong market pressures or, by itself, influence rate in other than short term.

3. Overvaluation of sterling cause more than half rise in unemployment since 1979?

[TCSC 2nd report on international monetary arrangements: 'Chairman's draft' says only half rise in unemployment due to world recession but 'overvaluation of sterling was a major element'.]

No. Unemployment has risen more in UK than other countries over whole period since 1979 because our problems have been more deepseated than theirs. If UK wage bargainers had reacted quicker to outside events in 1979-81 - as wage bargainers in some other countries did - then certainly rise in unemployment would have been less.

4. Why not a joint real - or nominal - exchange rate and monetary target for future?

[Proposals appended to TCSC 2nd report on international monetary arrangements.]

The two would be bound to conflict. Which should take priority? Sensible policy is one Government has adopted. Performance of monetary aggregates is interpreted taking account of movement of exchange rate. This policy very similar to that operated in West Germany -

and quoted with approval in report. Would be wrong to try to turn this into some mechanistic rule.

5. 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 F7).

6. Jurgensen Report - significance?

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

Report covered only narrow topic of intervention. It aimed 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 noted 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 considered at Williamsburg; will be taken further in IMF.

7. Jurgensen Report - verdict on UK policy?

Report's findings confirmed 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.

8. Improve UK competitiveness directly by engineering further fall in exchange rate?

As previous Chancellor said in Budget Speech, devaluation brought about by monetary and fiscal laxity would be damaging and to seek it as deliberate act of policy - as some of Opposition propose - would be great mistake. Would be signal to world of willingness to accommodate rising inflation, an inflation that would undoubtedly be fuelled by demands for higher wages to offset effects. Confidence would collapse and jobs be destroyed. CBI at June Monthly Council meeting made no mention of devaluation but stressed need for less volatility.

9. <u>Non price competitiveness</u>

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. Thus for example between 1970 and 1980 West Germany's cost competitiveness deteriorated 20 per cent but she maintained her 20 per cent of main manufacturing countries' exports; Japan managed to increase her share over this period from 12 to over 15 per cent despite slight deterioration in cost competitiveness. UK industry equally capable of non-cost improvements - witness, for example, Jaguar cars: their drive for higher quality secured them an increase in overseas sales in 1982 of 56 per cent over previous year.

10. <u>Situation has been made less stable by abolition of exchange controls</u>?

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

11. <u>Join EMS exchange rate mechanism (ERM)</u>?

Difficulties over membership remain. In particular, sterling as major internationally traded currency is still being affected by oil and other factors in different way from D mark. Membership of ERM is a constraint, not a policy: it carries an obligation to take action to try to defend a particular rate.

~~12. Impact on inflation of movements in sterling?~~

~~See D3.~~

12. <u>Level of overseas debt</u>

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

1. May trade figures and current account

[Current account deficit just over £300 million in May, compared just over £100 million in April; cumulative current account surplus in first five months of 1983 £33 million, but £717 million surplus in last six months.]

Trade figures erratic month to month. Picture in May further confused because main reason for deterioration in current account was large increase (some £190 million) in imports of identifiable erratic items - precious stones, ships, aircraft and North Sea installations.

2. Trade in manufactures in deficit?

[Trade in manufactures was in deficit some £660 million in first quarter - on balance of payments basis. (NOT FOR USE Deficit on bop basis for year to May was roughly £1½ billion.) In 1982 trade in manufactures was £2½ billion in surplus.]

Deterioration in balance on manufactured trade not in itself cause for concern: a natural counterpart of improved oil balance we have enjoyed in recent years. Oil has enabled us to import more: if we had not done so it is true that we would have had even larger current account surpluses, but there would also have been larger offsetting capital outflows - is that what Opposition want? With low level of domestic inflation and prospects of reviving markets overseas, industry now has opportunity to increase level of exports and to improve market shares at home and abroad - provided costs kept under firm control.

3. Deteriorating oil balance?

Balance on trade in oil has fallen back to last autumn's levels following unusually high surpluses over the winter. Several reasons for high surpluses last winter; one was high level of domestic oil production, which has fallen back a bit since the spring; others were milder than usual winter weather and heavy drawing on stocks by UK companies, both of which tended to reduce imports and divert domestic production into exports.

4. Export trends

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

5. Import trends

Having shown little change during 1982, imports have risen in 1983. Recent rise in imports and form it has taken is consistent with other indications of economic revival. Increases seem to be concentrated in goods for use by industry (materials, fuels, capital equipment) rather than for consumption. May figures are in line with this overall view.

6. Import prices

Welcome news on inflation front is that non-oil import prices fell in May after increasing in recent months. Improvement probably reflects sterling's recovery since March.

7. 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.

8. Abolition of exchange controls has led to huge capital outflows?

The net capital outflows in recent years simply reflect - as a matter of arithmetic - the large current account surplus. Just as a country in deficit has to borrow abroad, a country in surplus improves its international balance sheet. Our balance between overseas assets and liabilities is in a better state than it has been for years - and this will provide a useful source of overseas revenue for the future. [Our net overseas assets were £37.7 bn at the end of 1982 compared with £12.7 bn at the end of 1979.]

9. Portfolio investment overseas continuing at a high level?

Most overseas portfolio investment is made by the institutions who invest money on behalf of people who contribute to pension funds and life insurance. It is their duty to seek to earn the best possible return on the sums with which they are entrusted. They will be prepared to invest more in the UK if the profitability of doing so improves. And that means continuing to increase productivity and control costs.

10. Overseas direct invetment replaces UK investment?

Overseas direct investment does not involve funds being drained from the country. Those who wish to sell sterling for foreign currency to invest abroad have to find someone else who wishes to invest in Britain to purchase sterling in return. If investors choose to invest abroad, that is because there is, as the Wilson Committee found, a lack of profitable opportunity at home. Nothing, including exchange controls, will force people to invest in Britain if they are going to lose their money.

11. Current account 1983 forecasts

[FSBR forecast £1½ billion current account surplus in 1983 (down from £4 billion in 1982.]

Net forecast to be published will be in Autumn, as usual. Will incorporate Treasury's latest assessment of prospects for current account at time when outlook will have become clearer. [NOT FOR USE: Treasury are updating Budget forecast but not for publication.]

12. If current account surplus slumps this year, how will the flow of overseas investment be financed?

[Current account surplus of only £33 million in first 5 months of 1983.]

Investment overseas can be financed in a variety of ways. Some is financed in foreign currency borrowed overseas and out of the earnings of overseas subsidiaries. To the extent that it is financed by capital flows from the UK these will be offset by capital inflows and the current account.

TRADE POLICY

13. 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 P~~6~~7.] 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.

14. 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.

15. 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

1. Does Government plan to tighten/weaken fiscal policy?

[Chancellor's speech in Debate on Address reaffirmed need to reduce monetary growth and keep PSBR low.]

Policy evolves but commitment to overall strategy is unchanged.

2. Progress on fiscal 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.]

Have made progress. PSBR has been reduced (but see H5 and 7-8). Continuity, firmness and stability of policies have made major contribution to reducing inflation and interest rates.

3. Government's financial strategy has replaced monetary targets with PSBR target?

No. Have always emphasised need for consistent fiscal and monetary policies.

4. PSBR/interest rates link discredited?

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

5. Why did 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.]

6. Public expenditure out of control?

No. Simply less underspending on plans than was assumed at Budget time. No question of any failure of public expenditure control system. Only two extremely minor breaches of cash limits and year ended with large part of the Contingency Reserve unspent.

7. PSBR overshooting this year - tax increases or expenditure cuts in the offing?

[Budget forecast £8.2 billion, 2¾ per cent. As result of last year's overshoot and high figures for CGBR recently, many - but not all - outside forecasters now predict an overshoot. In 29 June Debate Chancellor said: '... we shall be watching the course of borrowing closely in the coming months, and I stand ready to take action if our objectives are endangered.]

Too early to form new view about prospect for this year. Next official forecast will be published with Autumn Statement. Government intend to continue firm control of public spending and borrowing.

8. But high CGBR in April and May surely means PSBR overshooting?

[CGBR in April to May £2.9 billion compared with £1.9 billion in 1982-83.]

Too early to say. Budget forecast is £8.2 billion - next forecast at time of Autumn Statement.

9. Do PSBR overshoots mean higher interest rates?

Yes, lower PSBRs do lead to lower interest rates. But effect of overshoots limited because they do not signal change of strategy. PSBR over a run of years is what really counts.

10. PSBR uncertainty exposes inadequacy of Government's strategy?

No. Strategy not based on fine-tuning the PSBR. PSBR is not a target.

11. 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.

12. UK fiscal policy tightest in world?

[IMF report said UK fiscal contraction over last 3 years was largest of any major country; OECD calls for prudent fiscal relaxation.]

Agree we have had more success in controlling borrowing than many other countries. They are now trying to emulate us. IMF and OECD support our commitment to cutting inflation and interest rates.

J TAXATION

1. Government's tax objectives?

Manifesto said that further improvements in allowances and lower rates of income tax remain a high priority, together with measures to reduce the poverty and unemployment 'traps' (see also J15). Manifesto also referred to encouraging wider ownership, through lower taxes on capital and savings, encouraging individuals to invest directly in company shares and encouraging the creation of more employee share schemes. Objectives will be pursued within framework of responsible fiscal and monetary policies; without firm control of public expenditure there will be no room for significant tax cuts.

2. Summer Finance Bill

New Finance Bill published 1 July. Since it is hoped that House will complete consideration of the Bill before Summer Recess, Bill does not contain all those proposals contained in original Finance Bill that were not enacted before General Election. Bill restores original Budget proposals on higher rate tax thresholds and investment income surcharge threshold (both increased by 14 per cent), increase in limit for mortgage interest relief (to £30,000), increase in CTT threshold and rate bands, and increase in profits limits for 'small companies' rate of corporation tax. Bill also contains small number of essential provisions. Budget proposals on oil taxation that were not enacted in Finance Bill 1983 will be contained in an Oil Taxation Bill to be introduced in the autumn.

3. What happens to proposals announced in Budget but not in summer Finance Bill?

New Finance Bill deals with some important matters which need to be settled before Recess. Would have been unreasonable to ask House to consider remaining proposals - given their length and complexity - in same timescale. But new Treasury Ministers will be urgently considering these. Will examine detailed issues that have arisen on various proposals since Budget and consider representations received on measures in original Finance Bill. Where appropriate will publish draft clauses -or revised draft clauses - so that 1984 Finance Bill can be prepared with benefit of fullest possible consultation.

4. All benefits of new Bill go to the well-off?

Need to be seen in context of Budget proposals as a whole. Bill does no more than apply same percentage increase (14 per cent) to higher rate bands and investment income surcharge threshold as to personal allowances. No bias in favour of higher paid tax - cut at all income levels.

5. Increase in mortgage interest relief limit unnecessary?

£25,000 limit was set in 1974 by Labour Government. Increasing evidence that old limit was beginning to hinder growing number of families who want to buy their first home or move. (In London about a quarter of first-time buyers with new building society mortgages have mortgages of over £25,000 - Q4 1982 figures.) Increase will also help construction industry.

6. Increase in mortgage interest relief limit increases competition for funds and pushes up interest rates?

[Points made by Mr Richard Wainwright during short debate on 30 June on Resolutions for Finance Bill.]

First increase since £25,000 limit introduced in 1974. Had that figure been increased in line with RPI it would now stand at around £80,000. If parties opposite don't want to help house buyers, they should say so openly.

13. Increasing subsidies to home owners while reducing them to council tenants?

True that subsidies to local authorities have dropped. But direct help to tenants (ie including Housing Benefit) has more than doubled since 1979 - increase of over £1 billion.

8. Government's tax record?

Over period 1979-83 Government cut basic and higher rates of income tax, achieved a 6 per cent real increase in income tax allowances, cut NIS from 3½ per cent to 1 per cent, reformed CGT, CTT and DLT regimes, greatly improved the tax arrangements for profit sharing and share option schemes, introduced new reliefs for investment in unquoted companies (Business Expansion Scheme), improved incentives for charitable giving and cut tax bureaucracy. Not a bad start.

9. 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 and need for responsible fiscal and monetary policies. 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.

10. Government's own figures prove average family now pays more tax than in 1978-79?

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 net of child benefit in 1983-84 than they did in 1978-79.

11. Budget benefits for lower paid

Budget provided 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 will also benefit from 11 per cent increase in Child Benefit to highest real level since its introduction, and from generous increases in FIS.

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

[NICs rose in April by 0.25 per cent of earnings for the contracted in, and 0.6 per cent for contracted out. Following is based on 1983-84 earnings levels taking, for illustrative purposes, the 6½ per cent earnings increase for 1983-84 used by Government Actuary.]

Tax reductions will be greater than effect of increase in NICs for all but a small minority. [IF PRESSED: Those who will lose out are married contracted out at about 1½ times average earnings and single contracted out at between ¾ and 1½ times average earnings.]

13. RPDI figures belie Government claim that after-tax incomes rising?

[RPDI in 1983 Q1 published 29 June]

Important distinguish between take-home pay of those in work from RPDI which includes income from other sources. Moreover, latest RPDI figures relate to period before effects of last Budget had been felt.

14. 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 (see J15). 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.

15. 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. Prime Minister said (23 June) during Debate on Queen's Speech that Government hoped to abolish NIS (cost £1.2 billion in full year) during present Parliament.

16. What action is planned to reduce poverty and unemployment traps?

[Draft Meacher committee report, not approved by full TCSC, published on 16 June.]

Committee has produced long, detailed and generally thorough draft report, which recognises that the traps have grown up over many years, are not unique to UK and are not amenable to easy solutions. Manifesto (see J1) accorded high priority to the traps, and Government will be examining draft report with care. Long-term solution to traps is best achieved by maintaining public expenditure restraint, thus allowing tax thresholds to be increased (as in Budget), and by sustained improvement in economic performance leading to higher real earnings.

17. 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.

18. Unitary taxation developments in US?

Recent Supreme Court judgement that unitary taxation is legitimate applies only to US domestic companies: position of foreign multinationals has not yet been considered by Supreme Court. Government remains opposed to unitary taxation of British companies and will study Supreme Court judgement to consider what action is appropriate.

19. Rossminster

Attorney General in Written PQ on 30 June said that no criminal proceedings were to be brought following the raids on Rossminster by Inland Revenue officials four years ago. Inland Revenue will deal with liabilities for tax, interest and penalties that have come to light in course of the investigation.

K PUBLIC EXPENDITURE AND FINANCE

PUBLIC EXPENDITURE PLANS

1. Further cuts in public expenditure?

[Press speculation 1 July about tough public expenditure survey. Chancellor pressed in interview 3 July. See also M5.]

Present expenditure plans cover next 3 years only. These plans as revised by Budget show steady decline in ratio of public spending to GDP. They are starting point for current public expenditure survey. Proposals for increases or reductions to plans being looked at during survey.

2. What are implications for spending plans of ½ per cent growth assumption just circulated to NHS?

Health authorities have been told to draw up their 10 year strategic plans on assumption that resources for hospital and community health services will grow at rate of around ½ per cent a year in real terms. Has been made clear that this is not a commitment and that their plans must be flexible enough to cope with more or fewer resources. Government will be reviewing all plans for next 3 years, including those for health, in the public expenditure survey.

3. 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 with last year's plans reflects fact that those plans were not realised.

4. Over-run on spending plans for 1982-83 suggests failure of public spending control?

No. (See H6).

5. 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 1983-84 or about appropriateness of figures for public expenditure shortfall and Contingency Reserve published with Budget.

6. Spending running above intentions in current year?

Spending in first couple of months only slightly above profile. Too early draw conclusions. Updated expenditure analysis will be published with Autumn Statement.

7. Policy on contracting out

Government encouraging further use of private sector contractors by public bodies where this will increase economy, efficiency and effectiveness, eg intention is to allow Government Departments and health authorities to reclaim VAT on contracted out services thus removing a disincentive to contracting out.

8. IMF conjuring trick?

Hamish McRae's column in Guardian 24.6.83 criticised present classification of UK's increased contribution to the IMF]

No conjuring trick - classification follows agreed national accounts conventions. But Guardian got it wrong in saying that if IMF lent our money to eg National Enterprise Board (NEB) there would also be no public expenditure effects:- public expenditure would be increased (planned total includes market and overseas borrowing of NEB).

LOCAL GOVERNMENT

9. Local authority overspending?

Local authority current expenditure in England some £¾ billion in excess of guidance issued by the Environment Secretary. (About half of overspending due to GLC and ILEA. All of the eighteen highest overspenders in Labour control). Overspending approximately £1 billion in GB overall. Local authorities were warned at the time of the last Rate Support Grant (RSG) settlement that such overspending would lead to holdback of grant. Details will be announced shortly.

10. RSG settlements 1984-85?

Government recognises that authorities need long notice of broad features of settlement; accordingly early announcements of grant quanta and planning totals are intended.

11. LA capital underspending

[Report by Alan Budd published 27 June offered suggestions for boosting capital spending]

Latest estimates suggest local authorities capital cash limits underspent by a little under £1 billion in 1982-83. Disappointing because it follows underspending of £¾ billion in 1981-82, but represents significant improvement on £1½ billion underspending forecast last autumn. Steps then taken to reduce underspend: PM wrote to local authority associations;

local authorities invited to apply for extra allocations (about £½ billion issued), and allowed to spend without limit on improvement grants. These measures seem to have been very successful. Steps taken to reduce risk of underspending in 1983-84: new rules on receipts (measures announced on Budget Day by Environment Secretary to ease transitional problems, LAs can spend above allocations on improvement grants, and eligible expenditure limits raised in Budget by 20 per cent, also new 'enveloping' provisions announced in Budget.

12. 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 provision.

13. Control of local authority rates

Bill will be introduced early in 1984 giving power to curb rate increases of selected overspending authorities in England and Wales from 1985-86. Selection will be on basis of past performance. Powers already exist in Scotland. Bill will also provide fall-back powers to be used if it proves necessary for general limit on rate increases. Wide consultation will precede legislation. Will publish White Paper shortly.

14. Business Rates

Rates now biggest single tax paid by industry. Excessive increases damage jobs. Bill (see K 13) will also require authorities to consult representatives of non-domestic ratepayers before setting rates, and will derate empty industrial property. In meantime, considering reducing statutory maximum non-domestic empty premises rate. Also, rate level below which business ratepayer may pay by instalments will be raised.

15. Other rates reforms

Propose to make each main rating and precepting authority provide annual statement to each ratepayer. Council tenants paying inclusive rents will receive separate advice of rates level.

16. Reform of Local Government Structure

Propose to simplify structure by abolishing upper tier in London and areas of metropolitan counties. Functions to be transferred to lower tier or assumed by new joint boards comprised of nominated elected members of lower tier. ILEA also to be replaced by joint board. Special arrangements for London Transport. White Paper with details this autumn. Wide consultation, including staff, before legislation. Bill to be introduced early next Session; aim for changeover on 1 April 1986.

FALKLANDS EXPENDITURE

17. What has defending Falklands cost so far and foreseeable future cost?

[£215 million to be spent on new airport - announcement on 27 June]

Costs of operation, of replacing equipment lost during conflict, and of garrison, were about £730 million in 1982-83. 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). Cost of new airport will be contained within this provision.

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

Too soon to say. Work has begun on restoration of essential services. About £10½ million spent in 1982-83; further £5 million expected to be spent 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.

19. Cost of paying compensation for war damage

No final figure as claims still being processed. But bulk of claims for civilian compensation settled in 1982-83 at £2.3 million. Remainder expected to be settled in 1983-84. Total expected to be in region of £3½ million.

L CIVIL SERVICE MANPOWER AND PAY

1. Size of civil service

Since May 1929, 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. Privatisation?

Civil Service Unions say that Government services and establishments are being 'privatised' to meet arbitrary manpower targets, and that more than a third of fall in Civil Service numbers by 1984 will be accounted for by privatisation or 'hiving-off'. In fact, privatisation and hiving off will only account for about 15 per cent of total manpower savings. Departments have been asked to look at scope for further privatisation and contracting out. (See also K~~8~~7.)

3. Civil service efficiency?

Civil Service unions say 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. 630,000 target not arbitrary: Departmental targets have been adjusted according to needs. Great savings already made with little effect on provision of services. No conflict between central manpower control and Financial Management Initiative (see 6 below).

4. Manpower policy after 1984

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

5. Management and Personnel Office

MPO now part of Cabinet Office. Lord Gowrie, Privy Council Minister of State and Arts Minister responsible for day to day issues, Mr Barney Hayhoe, Treasury Minister of State, answers in the Commons. Prime Minister, as before, in charge.

6. 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. Departments now moving into first stage of implementing action. Government is committed to publish a central report on the initiative by July 1983.

7. 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. Agreement will increase pay, London Weighting and pay related allowances by 4.86 per cent on average. Cost is to be met from within provision already made for Civil Service administrative expenditure.

8. Claim for industrial civil servants

Claim for industrial grades has been received and acknowledged. [It seeks: (i) "substantial" increase 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.] An opening offer will be made at a meeting with the unions arranged for 8 July.

9. Civil Service pay in 1984-85?

[Press speculation about possible civil service pay cash limit.]

No decision has been taken on provision for pay in central government cash limits for 1984-85.

10. 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.

11. Top Salaries Review Body and the higher civil service

See D~~9~~.
10

M SOCIAL SECURITY

1. Next November's uprating?

[Under Social Security and Housing Benefits Act, passed at end of last Parliament, Government has reverted to 'historic' method of uprating. Uprating still made in November, but no longer based on inflation forecast, but on actual inflation in year to May. Social Services Secretary put detailed proposals to Parliament on 23 June.]

Under legislation passed at end of last Parliament, uprating no longer based on inflation forecast - which proved inaccurate 5 times out of 7 - but on actual inflation in year to May - which was 3.7 per cent. Social Services Secretary gave detailed proposals to Parliament on 23 June for individual benefits. (Public Service pensions, under current legislation, will be uprated in line with State retirement pension.) Certain benefits - like Child Benefit, to be increased by substantially more.

2. 3.7 per cent uprating fails to price-protect pensions?

[Opposition will argue that inflation in year to November was forecast at 6 per cent at Budget time (although signs we are doing slightly better than this).]

No. Pensioners and other beneficiaries retain 2.7 per cent real increase in pensions given at November 1982 upratings. In last Parliament, Government made clear that had old forecast method been used there would have been adjustment to reflect this. Full adjustment would have implied 6 minus 2.7 = 3.3 per cent uprating. So beneficiaries better off under new system. In addition, under historic method, inflation in year from May 1983 automatically taken into account in 1984 uprating.

3. Supplementary benefit uprating?

[Last November supplementary benefit uprated for first time in line with RPI broadly adjusted for housing costs, yielding increases ½ per cent lower than for other benefits. This year supplementary benefit uprated similarly by increase in RPI less housing in year to May.]

As in last uprating, supplementary benefit will be uprated in line with increase in RPI less housing in year to May. This means an uprating of 4.3 per cent, ie 0.6 percentage points higher than for most other benefits.

4. Cost of upratings?

Improvements Government has announced will add about £1½ billion to social security budget in full year but are within Government's expenditure plans as announced in last Budget.

5. Future price protection?

[Manifesto renewed undertaking given for period of last Parliament to 'continue to protect retirement pensions and other linked long term benefits against rising prices'. Pledge does not cover other benefits, most importantly supplementary allowance, unemployment benefit, housing benefit, child benefit. Speculation in Observer and Sunday Times 3 July about de-indexing unemployment benefit and Chancellor pressed on 'Face the Press' programme].

Manifesto renewed pledge, which was more than fulfilled over last Parliament, to protect pensions and linked long term benefits against inflation. Imprudent in present circumstances to promise more. But in November 1983 uprating both 'pledged' and 'unpledged' benefits will be price-protected. And in last Parliament most 'unpledged' benefits increased by more than rate of inflation: some, such as Family Income Supplement, Mobility Allowance, substantially so.

6. Future of Child Benefit?

There are, as Social Services Secretary said on 27 June, no plans to change child benefit. However, as with all benefits, it must remain subject to examination for efficiency and effectiveness.

7. Improvements in 1983 besides uprating?

[These include:

Families

(i) 11 per cent increase in child benefit to £6.50 a week, highest ever real level, similar increase for one parent benefit;

(ii) £1 increase in children's needs allowance in housing benefit from April 1984, on top of 50p in November: helps 700,000 low paid families with children;

Unemployed

(iii) restoration of 5 per cent abatement of unemployed benefit;

(iv) higher long term rate of supplementary benefit to be available to unemployed men over 60 from June;

(v) men between 60 and 65 no longer need to 'sign on' to safeguard pension entitlement;

(vi) main supplementary benefit disregard up from £2,500 to £3,000; single payments disregard up from £300 to £500; new separate £1,500 disregard for life assurance policies;

Sick and disabled

(vii) abolition of 'invalidity trap' (ie inability of invalidity pensioners to qualify for long term supplementary benefit rate): pensioners over 60 get long term rate immediately, ofter after 1 year. Helps 55,000 sick and disabled;

(viii) therapeutic earnings limit - amount disabled and chronic sick can earn with doctors' approval before benefit withdrawn - up from £20 to £22.50 per week;

(ix) new mobility supplement for war pensioners;

Pensioners

(x) 14 per cent increase in pensioners' earnings limit - up from £57 to £65 per week.]

Substantial and wide-ranging improvements designed to aid most groups of beneficiaries.

N EUROPEAN COMMUNITY

1. UK refunds for 1983

Stuttgart European Council agreed to net refunds of some £440 million in respect of 1983. This produces average refund rate over four years 1980-83 of nearly two-thirds. Appropriate figures will be entered in 1984 draft budget.

2. Deal is conditional, surely this is bad?

Nothing conditional about 1983 agreement. The sums will be entered in and paid from 1984 budget.

3. No risk-sharing arrangements for 1983?

No. The arrangement provides for a fixed net refund.

4. Longer-term budget negotiations

European Council agreed that they would reach conclusions in December on Community's future financing, including ways of limiting expenditure on CAP, accommodating enlargement, and solving problems of budgetary imbalance. Commission will prepare proposals in these areas. UK will negotiate on them in constructive spirit.

5. UK objectives on EC budget for longer-term?

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 modest scale.

6. Will UK agree to new 'own resources'?

HMG remains unconvinced of case for increasing the Community's 'own resources'.

7. Reforms in Common Agricultural Policy?

European Council invited Council of Ministers to consider number of reforms to operation of CAP designed to reduce its cost. UK will be in forefront of those arguing for implementation of measures to achieve effective control of agricultural expenditure and observance of strict guidelines on its rate of growth. Key measures remain price restraint and curbs on surplus production.

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

Commission has right to invite these advances. We agreed, in view of current cash position, that an advance of £113 million should be made on 20 June. This decision and the necessary arrangements were announced in Parliament on 23 June (Hansard WA 3 and 4).

9. 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.

10. Policy for CAP reform

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

11. 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.

12. European Monetary System exchange rate mechanism

See F11.

P INDUSTRY

1. What is Government's view of future role of National Economic Development Council?

As PM said in her written answer to Mr Craigen on 29 June, the National Economic Development Council will continue to be a forum where the Government, the CBI, the TUC and certain others can meet on a regular basis to discuss economic and industrial issues of mutual interest.

2. Latest statistics of output and investment?

See Section B and Commentary at end of Brief.

3. 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 £2 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

[In 1983 Q1 gross trading profits of industrial and commercial companies (ICCs), net of stock appreciation and excluding oil, were nearly 20 per cent above their average 1980 and 1981 levels; 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.

4. Company insolvencies

[Total bankruptcies in 1982: 5,700 - up 11 per cent on 1981. 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.

5. 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.

6. 'Battle looming between Treasury and DTI over cost of export credits?

[*Observer* 19 June speculation.]

There is no dispute: but of course the whole range of Government payments to industry is always subject to continuous assessment.

7. 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.

8. Loan Guarantee Scheme?

[Nearly 10,400 guarantees already issued - about half to new businesses. Total lending under scheme over £340 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.

9. 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. Approach to improving nationalised industries' performance?

Reform of nationalised industries is central to economic recovery. Best way to improve performance in long term is to expose the industries to market forces, through reduction of monopoly, and through privatisation. Meanwhile, tight financial framework ensures that disciplines commonplace in private sector are also imposed on State industries. Challenging performance aims are being set and top class managers have been appointed. Rolling programme of Monopolies and Mergers Commission investigations set up in previous Parliament will continue.

2. EFLs for 1982-83 and 1983-84?

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. EFLs for 1983-84 currently total £2.5 billion.

INVESTMENT

3. 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.

4. 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

5. Nationalised industries' prices

[Increase in NI prices water charges and London Transport fares over 12 months to May 1983 5.9 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.

6. 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.

7. 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

8. Why privatise?

Privatisation key element in economic strategy which will be pursued with renewed vigour in this Parliament. It opens up new areas to disciplines of market forces, promotes competition and efficiency, and improves the quality of service to consumers. Already substantial record of achievement; British Aerospace, Cable and Wireless, National Freight Consortium, Amersham International, Britoil, Associated British Ports, International Aeradio, some British Rail subsidiaries and certain NEB holdings, including Ferranti and Faireys, have been transferred to private sector. So far, privatisation programme has brought in receipts of over £2 billion.

9. Future privatisation?

Wytch Farm oil field sale to be completed this year. British Telecom, Rolls Royce, British Airways, BGC's offshore oil interests, substantial parts of British Steel, of British Shipbuilders and of British Leyland, and as many as possible of Britain's airports, will become private sector companies. We will prepare for introduction of private finance into Royal Ordnance Factories. We will continue to identify and prepare other potential candidates for privatisation. We aim to introduce substantial private control into the National Bus Company and increase competition in, and attract private capital into, the gas and electricity industries.

10. Special asset sales in 1982-83?

Estimated outturn for 1982-83 around £500 million. Full details of receipts will be published shortly.

11. What sales included in special asset sale targets for future years?

[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.

12. Action in this Session of Parliament?

Queen's Speech specifically refers to re-introduction of British Telecom legislation and proposals to transform Royal Ordnance Factories into Companies Act companies as precursor to introducing private capital. British Telecom largest privatisation ever. Legislation to permit other privatisations will be introduced as and when needed.

13. Employee share-ownership?

Many shares in previous privatisations have been bought by companies' own employees and managers which is truest public ownership of all. Around 100,000 employees have taken up shares in privatised companies. Employees, for example, given free offers of shares (British Aerospace, Cable and Wireless, Amersham, Britoil, ABP); preference in allocation of shares (BAe, C&W, Amersham, Britoil, BP, ABP); provision for matching shares - one for each share subscribed for - (BAe, Amersham, Britoil, BP, ABP). Most radical initiative taken by consortium of managers and employees who bought National Freight Company (NFC). 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. North Sea oil prices?

[BNOC reported to have agreed with companies on no change in N. Sea prices in Q3.]

Unchanged BNOC prices in third quarter reflects stability restored to oil market since OPEC March agreement. Whether this stability continues will depend on OPEC. North Sea prices a matter for BNOC who 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. If oil prices were to fall further, Chancellor remains ready to take appropriate action. Position would need to be reviewed in light of circumstances at the time.

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? Effect on revenues?

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 impact on economy of falling North Sea output. Effect of falling output on revenues will be muted because of tendency of revenues to lag behind output.

5. What remains of Budget proposals on oil taxation?

Phasing out of Advanced Petroleum Revenue Tax, doubling of oil allowance, and immediate Petroleum Revenue Tax relief for exploration and appraisal drilling were all included in the truncated Finance Act. Bill to abolish royalties on future fields has been reintroduced. Provisions for PRT expenditure relief on shared assets will be reintroduced in autumn.

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

Without North Sea revenue taxes would be higher or public expenditure lower. 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. Will thus provide income for day when oil runs out. But keep revenues in perspective. Estimated at about 6 per cent of total General Government receipts in 1983-84.

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

We are clearly better off for North Sea oil than we would have been without it. At today's prices, the cost of extracting it is far below the cost of buying oil on the world market. But this was not always true. At pre-1974 prices, it would have been cheaper to import oil and devote resources used in developing the North Sea to produce exports.

8. Revenues from oil being frittered away on consumption/unemployment benefits?

[Opposition spokesman on trade, Mr John Smith MP, has repeatedly accused Government of 'frittering away' on unemployment benefit the £20½ billion on North Sea revenues received since May 1979.]

No. We are using the oil revenues to reduce the PSBR and interest rates, leaving more room for the private sector to borrow and invest: an essential step towards creating a strong and growing economy.

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. IMF's World Economic Outlook

[IMF's World Economic Outlook published 16 June; concerning IMF's forecasts see T4.]

IMF give further support to the consensus reached at successive international meetings and most recently at Williamsburg upon need to pursue prudent monetary and fiscal policies to consolidate progress made in reducing inflation and to help reduce interest rates. The IMF also stress that any change to more expansionary policies would risk kindling inflationary expectations.

3. 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.]

UK will play full part in considering with our partners conditions for improving international monetary system. UK view is that prudent policies among major countries offer best prospects for stable and durable system. Premature conference which ended in disagreement would be damaging.

4. World recovery under way?

[Encouraging signs of recovery particularly in US and Canada where industrial production rose sharply in first quarter and housing starts have risen. In Europe, industrial production also rose slightly in first quarter, and business confidence has improved. IMF now expect about 2 per cent growth in seven major economies and 1 per cent rise in world trade this year, broadly comparable with FSBR forecast.]

Welcome signs of recovery particularly in those countries which have successfully reduced inflation (notably US, Germany and UK). Most forecasters expect recovery to accelerate during course of this year (with output rising by perhaps 1½-2 per cent) and to continue into next year.

5. Latest inflation figures

[Consumer price inflation down from a year ago in all major economies apart from Italy on latest available figures: US (from 6.7 to 3.5 per cent), UK (9.5 to 3.7 per cent), Japan (2.8 to 2.0 per cent), Canada (11.8 to 5.4 per cent) France (13.8 to 9.0 per cent), Germany (5.3 to 3.0 per cent), Italy risen slightly (from 15.2 to 16.4 per cent).]

UK performance in bringing down inflation in past year one of the best among our major trading partners. Lower inflation has helped lay basis for signs of recovery being seen both in UK and rest of world this year.

6. Prospects for US economy?

[Administration have revised upward (for second time) their short term forecasts. Now expect growth of 5½ per cent in year to 1983 Q4 compared 4.7 per cent expected previously. Preliminary estimates suggest that GNP rose strongly by about 1½ per cent in second quarter after rising ½ per cent in first quarter and by fall at end of 1982.]

Welcome further signs of strengthening activity in US. Essential for world recovery that this trend continue. But uncertain outlook deficit continues to threaten recovery in medium run.

7. US Budget

[First budget resolution for FY 84 has now been passed by both Houses of Congress. This provides for 5 per cent growth in defence spending and additional taxes of $12 billion contributing to budget deficit of $170-179 billion compared with Administration's initial proposals of $190 billion, though this does not take account of faster growth than expected. Proposals by House of Representatives to limit benefit from 10 per cent cut in income tax scheduled for July (last of three) has been rejected by Senate, so alternative way will have to be found to finance expenditure increased in the budget resolution.]

Share widely expressed concern over size of potential budget deficit. Disappointed that so far Administration and Congress failed to agree exactly how budget deficit should be reduced. Essential that prospective fiscal deficits put on convincing downward path over medium term otherwise emerging recovery may be jeopardised by higher interest rates.

8. US has relaxed monetary policy?

[M1 has grown very rapidly in recent weeks following slight fall in April 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, Fed is keen to sustain recovery but remains solidly committed to preventing any resurgence of inflation.

9. Chancellor's meetings with Messrs Volcker and Larosiere?

Discussed matters of mutual interest and outlook for world economy.

10. International Debt

[Many developing countries have faced considerable financing difficulties due to falls in commodity prices, high interest rates and strength of dollar.]

Glad to see many of largest debtors now undertaking adjustment programmes, often with IMF assistance. Although some short term financing difficulties may remain, (eg Brazil) falls in interest rates since last summer, recent rises in commodity prices and expected growth in world trade during this year will help to improve underlying conditions.

11. Why is legislation on quotas/GAB needed?

[On 23 June the International Monetary Arrangements Bill was introduced in UK Parliament and draft IMF (Increase in Subscription) Order laid.]

IMF Interim Committee agreed in February that quotas should be increased by 47.5 per cent. Earlier, Ministers of Group of Ten had decided that commitments under IMF General Arrangements to Borrow should be increased. The draft legislation presented to Parliament implements our share of these decisions.

12. What is timetable?

Interim Committee urged implementation of decisions increasing IMF resources by end of 1983.

13. Fund running out of money?

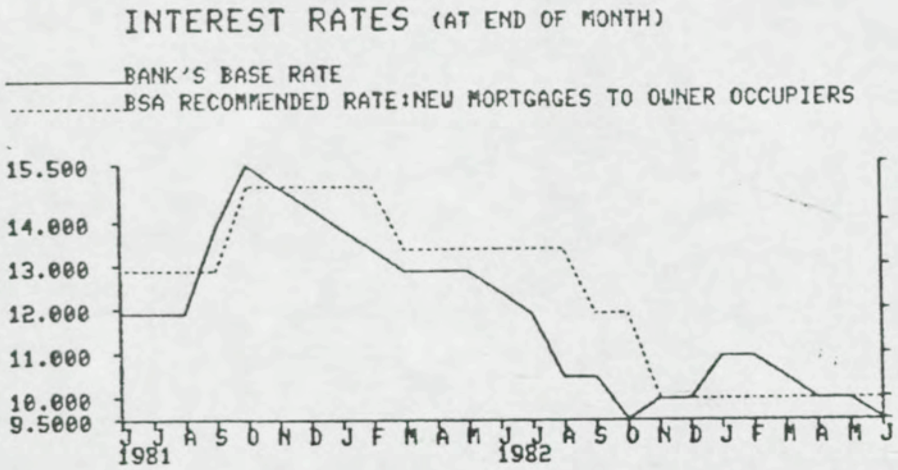
[The Times 27 June suggested Fund would need to raise additional resources to meet commitments over next few years.]

Fund still has undisbursed resources. New resources from Eighth Quota Review, brought forward under chairmanship of previous Chancellor, should be available early next year, together with enlarged GAB if conditions warrant.

COMMENTARY ON RECENT UK ECONOMIC DEVELOPMENTS: 4 JULY 1983

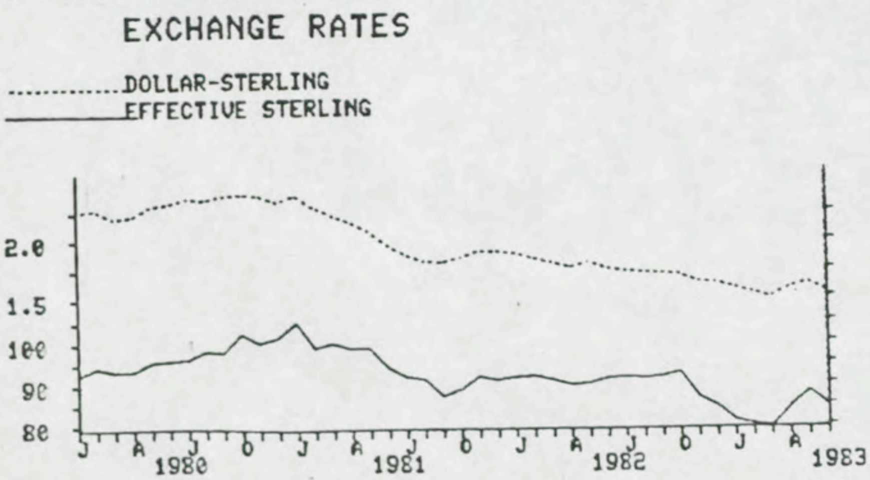
Financial Conditions

1. Bank base rates were reduced to 9½ per cent on 15 June. They are now at their lowest level for five years, apart from the period last autumn when they briefly fell to 9 per cent. Long-term rates have also registered slight falls. The Building Societies announced on 22 June a 1¼ per cent increase in the mortgage rate, to 11¼ per cent, effective from 1 July. This reflected a realignment of their competitive position rather than a new trend in interest rates . . Building Societies were facing shortages of funds with their inflows insufficient to meet heavy mortgage demand. Apart from the last six months, mortgage rates are still at their lowest level since the summer of 1978.



2. Although the target monetary aggregates rose more slowly in banking May, there have been large increases in the first three months of the new target period, reflecting the high level of government borrowing. Other indicators such as real interest rates, the exchange rate and inflation suggest that overall financial conditions remain sound.

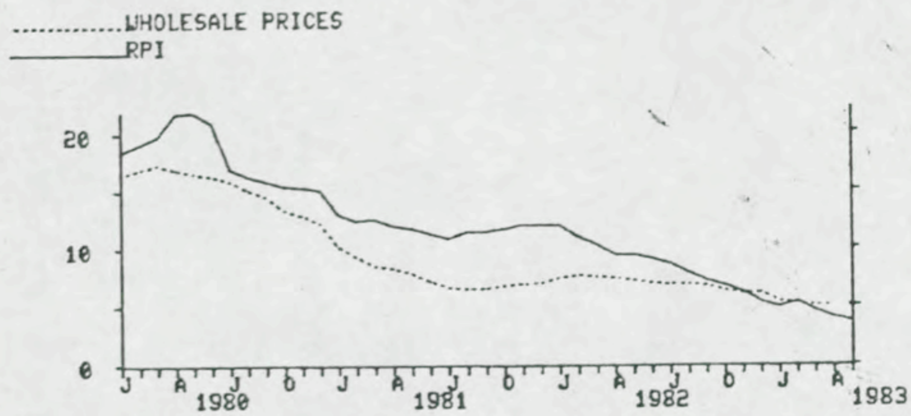
3. The effective exchange rate is now around 84 (1975 = 100), somewhat lower than the 90-91 range occupied for most of the period summer 1981-autumn 1982.



Inflation, real incomes and consumer spending

4. Inflation continues to fall. The 12-monthly increase in retail prices was 3.7 per cent in May, its lowest level for over fifteen years. Other measures of inflation tend to show somewhat larger increases (the RPI has been benefitting from exceptionally low increases in food prices and previous cuts in mortgage interest rates), though still a declining trend. RPI inflation will tend to rise slightly through the second half of the year as some of the favourable influences are removed from the 12-monthly comparison. The mortgage rate increase will add about 0.4 per cent to the July RPI (published in August).

INFLATION(12 MONTHLY % CHANGES)



5. Average settlements in manufacturing are currently running at about 5-6 per cent some 1½ per cent lower than in the 1981-82 pay round, but still significantly above the level of price inflation. The underlying 12-monthly increase in average earnings was 7¼ per cent in April and continues the steady fall since the beginning of the 1980/81 pay round.

6. In the first four months of 1983 average earnings grew around 3 per cent faster than both the RPI and the TPI suggesting large improvements in both gross and net real earnings. On a longer term comparison the growth in real take-home pay has been more modest as has the movement in per capita real personal disposable income (which includes the net income of those out of work as well as those in work).

7. Much of the recovery in total domestic demand during 1982 reflected the growth i consumer spending, partly reflecting lower inflation and the summer 1982 abolition o HP controls. The slight fall in real personal disposable income in 1982 was offset by a fall in the savings ratio. Consumers' expenditure fell back slightly in 1983 Q1 but is still somewhat higher than a year ago. And retail trade remains buoyant.

CONSUMER SPENDING (VOLUME)

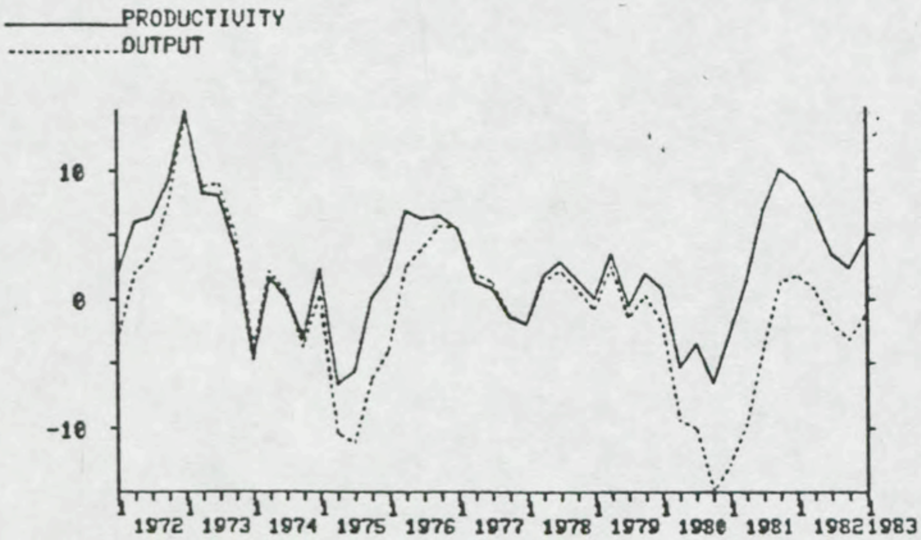
Year-on-year % changes

		Consumers' Expenditure	Retail Sales
1982	H1	0.0	0.9
	H2	2.2	4.2
1983	Q1	3.0	4.3
3 months to May		na	5.8

Costs, Company Finances and Investment

8. In the three months ending April manufacturing output per head was up by 4½ per cent on a year earlier, and some 6½ per cent above its trough level at the end of 1980 - an impressive improvement for this stage of the economic cycle. Continued productivity gains, coupled with further wage moderation, have brought down the increase in manufacturers' unit wage and salary costs to around 3½ per cent in the year to 1983 Q1. The increase would be lower still if a broader labour costs measure were used which incorporated the cuts in the National Insurance Surcharge. Industrial (non-oil) commodity prices (in SDR's) have risen strongly since the autumn according to the Economist index, but world oil prices have weakened and, after allowing for the lower exchange rate, prices of materials and fuels purchased by manufacturers are only some 3 per cent higher than in the autumn.

MANUFACTURING PRODUCTIVITY(4 QTR % CHANGES)



Housebuilding has been particularly buoyant although, as expected starts have fallen back in April and May from their high first quarter level. This followed a change in the unusually favourable weather conditions at the beginning of the year. An additional factor may be the tightness of building societies' funds and much reduced bank lending.

9. Nominal profits (for both oil and non-oil firms) of industrial and commercial companies were little changed in the first quarter and are well up on their 1980 and 1981 levels though the improvement is from a historically low level and following real declines because of inflation. This improvement is reflected in small increases in pre-tax real rates of return and in a strengthening of the company sector's financial position.

REAL NET PRE-TAX RATES OF RETURN

	Non-North Sea ICC's	Manufacturing
1960-70 (average)	11	10
1980	4	3½
1981	3½	2
1982	4	na

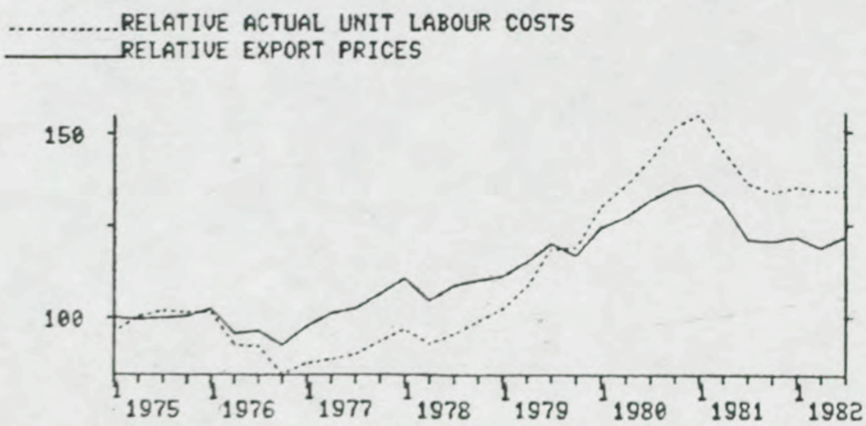
The latest DOI Survey of Company Liquidity showed a marked improvement in 1983 Q1 in the liquidity of the 200 large companies covered. It is now at its best level since the middle of 1979 and the greatest improvement was in manufacturing.

10. Total fixed investment rose sharply in the first quarter of 1983. Upward trend in distribution and services have offset the continued fall in manufacturing. After substantial destocking (over £700 million at 1975 prices) in the second half of 1982 modest restocking (of £95 million) resumed in the first quarter of this year. Manufacturers reduced stocks further in 1983 Q1, but at a much slower rate than in 1982 H2.

Competitiveness and Trade

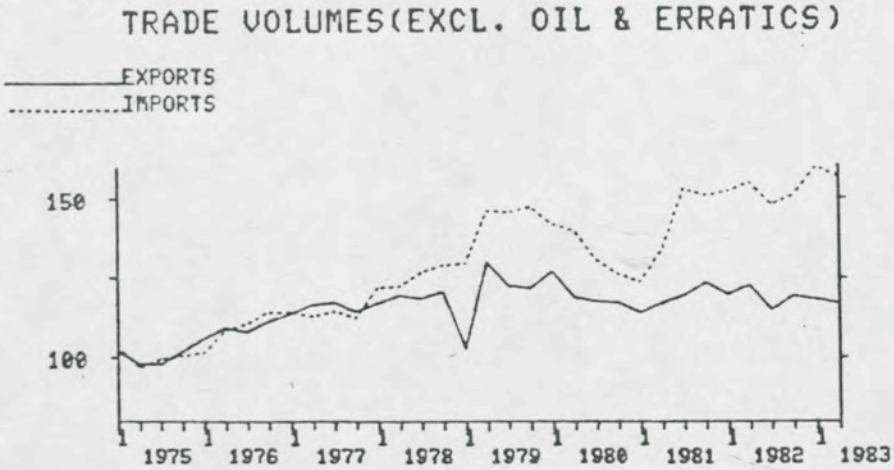
11. Manufacturing trade competitiveness can be measured in a number of ways althoug the commonly used indices concentrate on "cost" or "price" rather than "non-price" factors. Cost competitiveness (on the basis of an effective exchange rate of 84) is estimated to have improved by some 20 per cent since early 1981 (largely reflecting the lower exchange rate) though remaining substantially worse than in the mid-1970s.

MEASURES OF MANUFACTURING TRADE COMPETITIVENESS



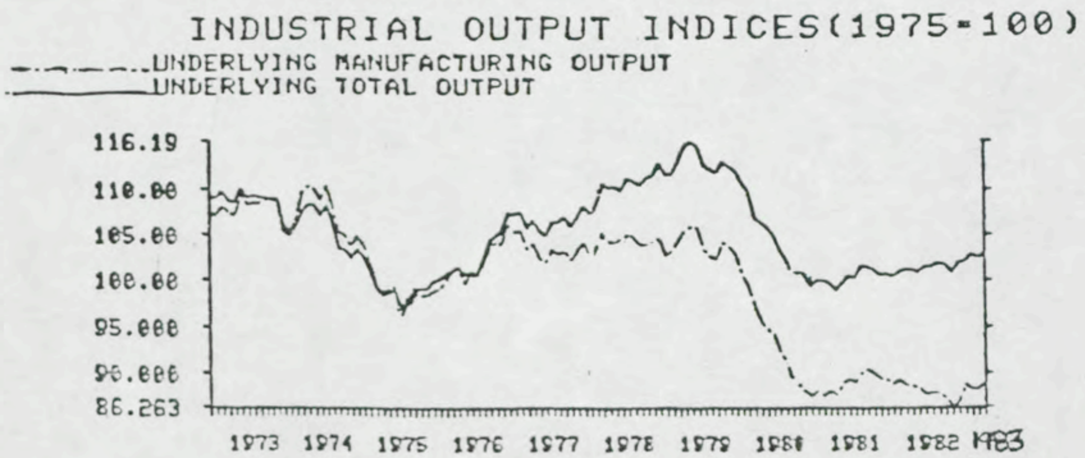
NB. Upward movements in the indices represent lower competitiveness.

12. The deficit on the current account increased from a revised £110 million in April to £302 million in May. However, the figures remain very erratic and it is hard to discern any clear trends. The main reason for the deterioration was the large increase in imports of erratic items (precious stones, ships, aircraft and North Sea installations) and of oil. Though this was partly offset by a marked reduction in imports of finished manufactures - particularly consumer goods other than cars. The underlying volume of non-oil exports has remained broadly flat in the last six months. Recent rises in import volumes are consistent with the turnround in stockbuilding and the underlying increase in output.

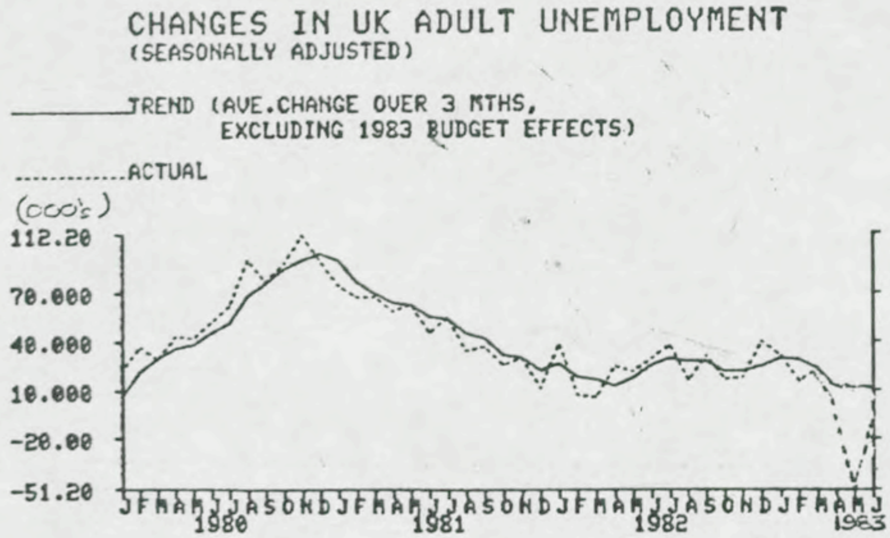


Demand, Output and Unemployment

13. In 1982 real domestic demand - using the expenditure components of GDP - was almost 3 per cent higher than a year earlier. In the first quarter of this year there was growth of almost 2½ per cent largely resulting from the turnround in stockbuilding. There is also growing evidence that a modest recovery in domestic supply is underway. Total output (GDP(O)) rose by ½ per cent between 1982 Q4 and 1983 Q1; GDP(A) is now 3½ per cent above its trough (reached in 1981 Q2). The underlying level of industrial output is some 3½ per cent above its spring 1981 trough, with about half this growth due to increased North Sea activity. Manufacturing output, which was on a declining trend during 1982, now also appears to be recovering.



14. However, the underlying level of unemployment is still rising - though the upward trend may have eased slightly. In June, the UK total (not seasonally adjusted) was 2.98 million (12.5 per cent). Adult unemployment (seasonally adjusted) was 2.97 million (12.4 per cent). However, the figures are distorted by the effects of the measures announced at Budget-time (automatic credits and long-term supplementary benefit for men over 60). Allowing for these measures, the adult total rose by 19,000. Notified vacancies rose by 8,000 in June to 139,000 and remain on a slowly rising trend. The trend in manufacturing employment continues downwards but the CBI's April Quarterly Trends Survey points to some slowdown in the rate of demanning in the near future.

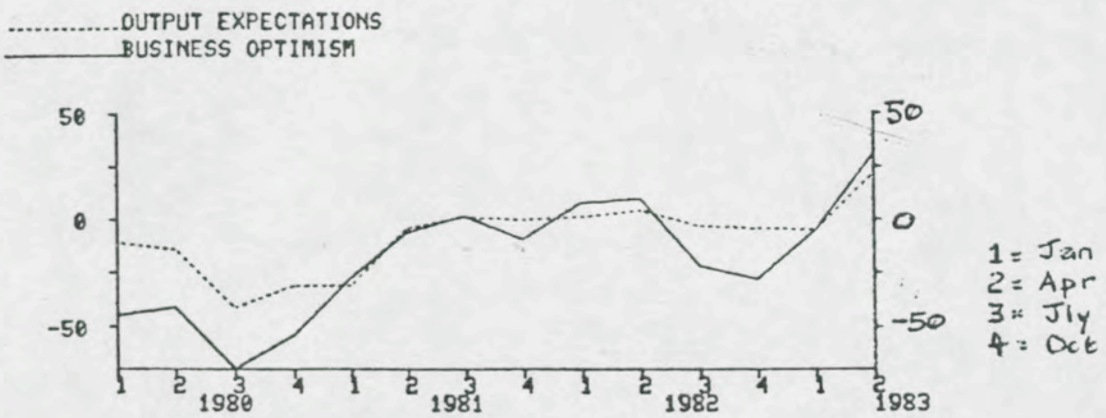


Recent forward indicators

15. The CSO's indices of cyclical indicators, taken together, point to a continued upswing in the business cycle. However, specific indicators confirm the patchiness of the recovery. In the three months to May car production increased by 18 per cent compared to the previous three months. On the same comparison steel production was 20 per cent higher but remained 4½ per cent below the rate of production achieved in the same period a year earlier. Total engineering orders fell 1 per cent in 1983 Q1 compared with the previous quarter, but export orders rose by over 26 per cent on the same comparison and latest forecast published by the Engineering Employers Federation expects mechanical engineering output to rise by around 7 per cent between mid-1983 and the end of 1984. The volume of new construction orders fell back 3 per cent in the three months ending April. Total housing starts have fallen since February but in the three months to May were 8 per cent higher than a year earlier.

16. The CBI's April Industrial Trends Survey contained encouraging signs with improved business optimism (the highest net balance since 1976), order books and output expectations, and investment intentions. The results also pointed to a slowdown in destocking and job shedding. This message was further confirmed in their May and June Enquiries which showed encouraging improvements in total and export order books (former now stronger than in any Survey since November 1979). The net balance of firms expecting an increase in output has been positive for five successive months and recently these balances have been the highest recorded since June 1979. The proportion of firms expecting an increase in average domestic selling prices is still higher than towards the end of 1982 but remains low by historical standards while the net balance of firms reporting excessive finished stocks is now at its lowest level since November 1979. The June Enquiry contained encouraging results for consumer goods industries whose recent production had not matched the buoyancy of consumer spending.

CBI SURVEY INDICATORS(% BALANCES)



The DOI's investment intentions survey (May) suggests a 4 per cent fall in manufacturing investment between 1982 and 1983 although the underlying trend is expected to turn upwards later this year. Other components of investment (distribution and services) are more encouraging and overall the survey indicates a rise of 3-4 per cent in investment in both 1983 and 1984.

17. The Government forecast published with the Budget expected inflation to stabilise around the 6 per cent level by the end of 1983 and GDP growth of 2 per cent between 1982 and 1983. Since Budget-time prospects for this year have improved (Chancellor, 29 June, put GDP growth at "up to 2½ per cent" for this year and RPI inflation at "5 to 6 per cent by the end of the year." Recent outside forecasts are in broad agreement expecting GDP growth of around 2-2½ per cent in 1983 with some recovery in the world economy and inflation around 6 per cent by the end of the year. Consumers' spending and stockbuilding are the main

expansionary influences but overall the expected improvement in activity is insufficient to prevent further expected increases in unemployment. For 1984 the outlook is less clear but all groups expect continued GDP growth, though possibly at a slower rate than in 1983.

<u>Key indicators to be published in week ending 8 July</u>

Mon	4:	Retail Sales (May final)
	:	Credit Business (May)
	:	Housing Starts and Completions (May)
Tues	5:	Monetary Aggregates (June provisional)