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Michael

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TREASURY WEEKLY BRIEF

Attached is the latest version of this Brief. Changes from the previous Brief, of 4 July, are sidelined.

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RA

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11 July 1983

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01-233-5503

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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. Shift in policy 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 need is 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. Chancellor's expenditure statement 7 July: Why not abandon Summer Finance Bill instead?

[Chancellor announced measures to prevent overspending in 1983-84; (i) reduction of 1 per cent in 1983-84 pay and central government administration cash limits; 2 per cent in remainder; reduction of 2 per cent in nationalised industry EFLs; effect to remove £500 million of spending beyond planned total, (2) increase in asset sales programme by further £500 million; (3) new scheme for end-year cash limits flexibility which could reduce spending by some £100 million in current year.]

Bill fulfils firm Manifesto commitment. To abandon it would increase the tax burden and require recovery of tax from a large number of people already beginning to benefit from its provisions. 7 July measures not 'savage cuts'; designed to bring total public spending closer to planned path. Not to have taken these measures would imply a lack of Government commitment to its own financial strategy, and undermined recovery. [See also Section J].

5. Haven't markets given the measures the thumbs down?

No. Not taking any action would have been irresponsible and seen as such by the markets. Moreover, recent market developments should be seen in the context of major worries about foreign developments such as US interest rates.

6. Government deliverately engineered pre-Election boom?

There was no pre-Election boom. For 1982-83, though less underspending than expected at Budget time, only two extremely minor breaches of cash limits, and year ended with large part of Contingency Reserve unspent. Budget measures themselves involved only relatively small increase in public expenditure for 1983-84 compared with February White Paper, and did not add to planning total - met entirely from Contingency Reserve. So far as wider economy is concerned, pace of recovery has been moderate not excessive.

7. £1 billion package of measures too small when PSBR set to overshoot by £3 billion?

[Times has alleged that internal Treasury forecast shows PSBR for 1983-84 over £11 billion; and speculates on further cuts in autumn of up to £2 billion.]

For obvious reasons Treasury does not comment on speculation about internal forecasts. Not sensible to publish revised forecasts of PSBR so early in financial year - average margin of error on Budget forecast £4 billion in either direction - autumn will be the time to do this. Nevertheless, indications that spending and borrowing are running higher than expected has been unsettling markets; need for some corrective action was clear. Developments in spending and borrowing will continue to be monitored closely, so that further action can be taken if necessary.

8. Why were measures announced now rather than before 9 June? When did need become evident?

In early June we did not have sufficient information on which to make a judgement. Since then a clearer, though obviously still uncertain, picture has emerged - on public spending, borrowing and money supply - and we judged that the time was right to reassure markets that Government remains firmly committed to its financial strategy.

9. Dogmatic pursuit of monetary targets?

No. This is a strictly pragmatic solution to a real problem. If we had not acted to bring public expenditure and borrowing closer to the Budget figures, strong upward pressure on interest rates could have developed.

10. Measures deflationary? Effect on jobs?

Short term adjustments may be necessary on some programmes. But the effect will be much less than the damage which would be caused by allowing public expenditure to rise above planned levels.

11. Were 7 July measures in 'secret Manifesto'?

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

12. Further cuts ahead?

See K11.

13. Tax revenue shortfall expected? Meaning more cuts?

Cannot comment on speculation about internal Treasury forecasts.

14. 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 and CSO cyclical indicators - also 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.)

15. '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. [On latest LBS forecast, see B4.]

16. New Chancellor's view of international consensus on economic policy? US deficit?

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. Within this context, US deficit is a major problem. Important therefore that US administration and Congress should agree on measures to cut deficit. (See also T7.)

17. Chancellor's first meeting with NEDC marks change of emphasis?

Chancellor regards NEDC as important forum with continuing valuable role to play, but does consider some change in emphasis is needed - away from discussion of broad macro-economic issues towards more scrutiny of specific industrial issues.

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.

- 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 sunder 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 (GB) 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

[See also Commentary on recent UK economic developments - at end of Brief. NB Industrial production in May to be published Wednesday 13 July.]

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 A1~~7~~5.]

4. Latest LBS forecast?

[July forecast expects : 2-2½ per cent growth in 1983 and over 2½ per cent in 1984; inflation to remain moderate at around 6 per cent throughout period; unemployment to show slight downward trend from mid-1984.]

Latest LBS assessment is broadly representative of recent independent forecasts for this year and supports Chancellor's statement (20 June) that this year should see total output growth of 'up to 2½ per cent'.

5. Latest (June) CBI Industrial Trends Inquiry

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.

6. 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.

7. 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 2-2½ per cent), modest price inflation (around 6 per cent by end 1983) and further growth in 1984.

8. 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.

9. 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.

10. 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.

11. 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.

12. 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).

13. 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.

14. Productivity growth falling off in manufacturing sector?

Slight drop in productivity growth last year. But output per head gains still impressive - up 4½ per cent in year to three months ended April 1983; and overall improvement of around 16½ 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 give grounds for cautious optimism about unemployment prospects.

2. How can Chancellor say jobs are plentiful?

[Chancellor said in 'Face the Press' 5 July: 'I think there are many jobs of an unskilled nature which .... are available to be done at a particular wage.']

Although unemployment is high it would be wrong to think that job opportunities do not exist. Total job changes are running at around 6 million a year - about 25,000 per working day. [NB These include movements of people from one job to another as well as the unemployed taking up jobs.] Number of people ceasing to be unemployed is averaging about 377,000 a month [NB most of them to take up jobs, though some for other reasons eg taking retirement.]

3. 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.

4. 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.

5. 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.

6. 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.

7. 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 estimates too low, and says estimates incorporating an allowance - assuming unchanged rate of under-estimation - will be published alongside basic figures.

8. 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. Guardian 31 May: Mr Lawson reported as saying '... in my judgement 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.]

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.'

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 Worse because of overvaluation of sterling?

See F~~3~~4.

11. 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.

12. Exchequer cost of unemployment

Unemployment and supplementary to people counted as unemployed currently expected to total about £57 billion in 1983-84 (provisional DHSS estimate in 1983 PEWP).

13. 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.

14. Unemployment benefits disincentive to job seeking? Going to be cut in real terms?

See M7.

D PRICES AND EARNINGS

PRICES

[NB June figures for RPI and TPI to be published Friday 15 July.]

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 matter of simple arithmetic likely to be increase in 12 month change over corresponding period in 1983. 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 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 exchange rate/higher mortgage rates/petrol price rises on RPI?

[1½ percentage points increase in mortgage interest rate (to 11¼ 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 since 1 July 4.6p a gallon will add only around 0.1 per cent to RPI.]

Exchange rate/mortgage rate/petrol price rise 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 in April 8.2 per cent, compared 4.0 per cent 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

[Continuing Press speculation about proposals to be made by Government on MPs pay.]

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

11. Government and wages councils?

Government has frequently made clear that has serious misgivings about perpetuation of minimum wage fixing machinery. Scope for action constrained (until 1985-86) by International Labour Organisation Convention 26. Not our practice to dishonour international treaty obligations. However, Government is continuing to look searchingly at operation of wages councils and will consider all options for future of the system.

E MONETARY AND FINANCIAL POLICY

[Provisional figures for target monetary aggregates show growth in banking June of 1.7 per cent in £M3 and M1 and 1.1 per cent in PSL2 on the new seasonal adjustments. Annualised rate of growth 15.8 per cent, 17.6 per cent and 17.8 per cent respectively against a target range of 7-11 per cent.]

1. How can you say you are pursuing sound financial policies, when the money supply is growing fast?

We are determined to maintain our financial policy to reduce inflation. High level of growth in money supply seems largely a result of a surge in public borrowing since the turn of the financial year. Chancellor's Statement of 7 July was a prompt and resolute response to this problem. Judgement about financial conditions based on a range of indicators (including exchange rate and real interest rates) do not suggest policy is unduly lax.

2. Why did you cut interest rates last month when it is clear the money supply is growing rapidly?

The reduction in the Bank's dealing rates last month followed a fall in market interbank rates. These adjustments were warranted by wider evidence of financial conditions.

3. Is the money supply out of control?

Early days for new target range. Target range for year as a whole not just a few months. Chancellor had taken steps to meet the problem of high public sector borrowing. Represents evidence of his commitment to financial rectitude.

4. Will interest rates go up?

We do not expect them to.

5. Will Government be able to continue appropriate funding policy without rise in interest rates?

Not the practice to comment on operations in gilts.

6. How have markets responded to 7 July statement?

See A 5

7. Is bank lending quickening?

[Advances by LCB pa r ents and subsidiaries rose £830 million in banking June-rather higher than the previous month. This represents only part of total sterling lending.]

Last month's figure could be erratic. On a longer view, lending this year has clearly slowed since last summer. [IF PRESSED: Some upturn in corporate borrowing to be expected as recovery gathers pace: lending to persons has been relatively stable in recent months.]

F EXCHANGE RATE AND THE RESERVES

1. Market developments

Following General Election sterling fell on profit-taking and in reaction to the fall in base rates. After 7 July statement and expectations that tight monetary and fiscal policies will be maintained, it has recovered.

	28 March (oil crisis 'low')	31 May (pre Election 'high')	8 July noon
$/£	1.4535	1.6061	1.5404
DM/£	3.5361	4.0525	3.9630
Y/£	348.72	383.79	370.31
£ effective	78.1	87.8	85.2

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. Fall in reserves in June?

Underlying fall ($178 million) over month when effective rate of £ fell from 87.8 to 84.3 roughly matches underlying rise of $233 million in May when £ rose from 84.2 to 87.8. Demonstrates evenhandedness and modest nature of our intervention policy.

4. Overvaluation of sterling caused 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.

5. 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.

6. 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.

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

[Article discussing competitiveness will be published in June EPR on 13 July.]

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.

8. Non price competitiveness

Government has stressed need to improve design and quality, to meet delivery dates, and improve after-sales service. Such factors cannot be easily measured but are at least as important as cost competitiveness. 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.

9. Situation has been made less stable by abolition of exchange controls?

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.)

10. Join EMS exchange rate mechanism (ERM)?

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.

11. Level of overseas debt

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

G BALANCE OF PAYMENTS AND TRADE POLICY

BALANCE OF PAYMENTS

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. Important to remember level of manufactured exports: every day about £120 million worth of British manufactured goods leave for markets all over world.

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 had been in particularly large surplus (£1.1 billion) in 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 investment replaces UK investment?

Overseas direct investment does not involve funds being drained from the country. If investors choose to invest abroad, that is, as the Wilson Committee found, because of 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 need to be offset by capital inflows and the current account.

TRADE POLICY

13. Protectionism

[Foreign Secretary pressing US on attitude to steel.]

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

14. Expectations from Trade Ministers meeting in Leeds Castle?

Meeting is an informal conference arranged by Trade Policy Research Centre which is not an officially sponsored body. But UK Trade Minister is expected to be attending and so will CST in personal capacity as a former Trade Minister.

15. 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.

16. 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.

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 M7). 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: in view of action on public expenditure, why not drop Bill to save money?

See A4.

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

As Chancellor indicated in Debate on Address, Government urgently reviewing these proposals so that can announce as soon as possible and in as much detail as possible what action intend to take on each of them. Question of commencement dates is being considered as part of this review.

4. What will happen on freeports?

Government remains committed to establishment of freeports in UK on experimental basis. An announcement inviting applications from potential operators will be made before the Recess and all bids will be fully and carefully considered. Legislation will be included in a future Finance Bill, and there will be no delay in the eventual establishment of freeports.

5. 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.

6. 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.

7. 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.

8. 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.

9. 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.

10. 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.

11. 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.

12. 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.

13. 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.]

14. 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.

15. 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.

16. 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.

17. 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.

18. 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.

19. Unitary taxation developments in US?

Government totally opposed to this method of taxation, which is contrary to international practice, and are taking immediate steps at highest level to press US Government for legislation to prevent its application by individual States to British companies operating in US.

20. 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.

21. Treasury VAT deal to buy heritage bodies' silence?

[Guardian and D Telegraph stories 5 and 6 July.]

Government made it clear to heritage 'lobby' from outset that this relief not precursor of any wider relief for heritage items. This was fully appreciated by the bodies most directly concerned.

H FISCAL POLICY AND THE PSBR

[See also Section A]

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. 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. PSBR out of control? New measures reflect Treasury panic?

[Press reports of internal forecast pointing to £3 billion PSBR overshoot this year. LBS forecast £1.9 billion spending overrun this year (before 7 July statement).]

See A.

7. What is new PSBR forecast?

See A.

8. <u>£600 million spending package too small relative to PSBR forecasting errors and likely size of overshoot</u>?

[FSBR quotes £4 billion margin of error on Budget forecasts for PSBR. <u>Guardian</u> 8 July talks of £3 billion overshoot in internal Treasury forecast.]

See A.

9. <u>What do latest CGBR figures mean for PSBR</u>?

[CGBR in April to June £5.5 billion compared with £3.1 billion in 1982-83.]

Too early to say. Budget forecast is £8.2 billion. Next published forecast in the autumn.

10. <u>Do PSBR overshoots mean higher interest rates</u>?

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.

11. <u>PSBR uncertainty exposes inadequacy of Government's strategy</u>?

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

12. <u>Cyclically adjusted PSBR better guide to policy</u>?

Government fiscal policy <u>has</u> 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.

K PUBLIC EXPENDITURE AND FINANCE

PUBLIC EXPENDITURE PLANS

1. Chancellor's announcement 7 July - what caused the problem?

[Announcement 7 July of measures to counter possible overspending in 1983-84.]

A number of factors. Net provision for shortfall in the Budget now looks excessive. In part, may be caused by corrective action last October, to increase capital expenditure. But that was only part of the story. Cumulative effects of three years of squeezes in a cash planning system may have something to do with it.

2. Why pick on cash-limited programmes, when the trouble seems elsewhere?

Because it is the best way of achieving results. Do not mean to exclude action on the demand-determined programmes. Where Ministers can take action should do so. But the biggest problems are on agricultural support, Family Practitioner services and on social security benefits. Even if we decided to do something in these areas, they take time to respond.

3. Does this mean laying off staff?

Will be for each department to decide how to implement cuts. But large-scale redundancies unlikely. Laying off staff takes time (6 months notice) and actually adds to first year costs (redundancy etc). Should be possible to do by reduced recruitment, and reduction in casual staff.

4. Given margins of error on PSBR, put at £4 billion either way in FSBR, isn't the £600 million too small - and could easily be in wrong direction?

Have to take best judgements in uncertain world; indications not confined to expenditure, but also from borrowing and money supply. Dangers in waiting too long.

5. Capital/current split. Will this make the situation worse?

It may do. But we are exempting local authority capital and 2 per cent elsewhere is not a great deal. Every area has to make a contribution.

6. End-year flexibility: why capital only not current?

Make haste slowly. Most of the pressure arises on capital, because it is more difficult to predict exact timing of expenditure.

7. Special problems of defence?

With a budget of £16,000 million this year MOD has far more room for manoeuvre than others, it has grown by over 20 per cent real terms since 1979 and cannot be absolved from wider economic considerations. Even after a cash limit cut of this order, defence expenditure (Falklands exclusive) should increase this year by more than 3 per cent in real terms. Our defence effort is surpassed by none of our European allies. In absolute terms our annual spend is second only to the US; as a proportion of GDP and per capita, UK defence expenditure is higher than any other major European ally.

8. 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.

9. Implications of Chancellor's statement for later years? More cuts on way?

Government has taken action to bring expenditure in 1983-84 closer to course laid down in White Paper. Measures to improve financial control have also been taken. Decisions in survey will also take account of latest developments. Wrong to draw conclusions that corrective action this year means expenditure out of control.

10. Effects of end year flexibility on 1984-85?

Will be bigger than this year because Departments will carry forward unspent balances. Will be taken into account during this year's Public Expenditure Survey.

11. Effect of Summer Supplementary Estimates on total public expenditure in 1983-84?

[Supplementaries presented 8 July: article in The Times 9 July.]

Summer Supplementary Estimates totalling just over £1 billion increase public expenditure by only £335 million. Balance met within existing planning totals (as in PEWP 1983) or charged to Contingency Reserve. Not all expenditure on Votes for demand-determined programmes adds to planning total. Payment to European Community Budget only an advance payment which will be completely offset by lower payments direct from Consolidated Fund. Social Security Votes (see also M) only partly add to planning total, while part charged to Contingency Reserve following Budget measures - eg child benefit uprating - or contained within existing provision.

12. 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.

LOCAL GOVERNMENT

13. Local Authority overspending, and grant penalties

Local authorities were warned last year that 1983-84 rate support grants would be held back from overspenders. Action now being taken by respective Secretaries of State: in England budgets exceeded guidance figures by £¾ billion and Supplementary RSG Report has been laid proposing holdback of £280 million of RSG: in Wales budgets exceed guidance by £21 million and Supplementary Report proposes holdback of £12.6 million; in Scotland under selective action four authorities have been directed to reduce their rates because of excessive and unreasonable budgets and general grant abatement may also be prposed. Note GLC is not included in English holdback - GLC budget is so high in relation to assessed need to spend that it loses all grant under normal distribution arrangements before holdback calculation.

14. Grant penalties reaction to money supply/public expenditure overshoot?

Government has intended all along to take holdback action as appropriate on basis of budgets before Summer Recess. Holdback arrangements were integral to RSG settlements and action now being taken holds no surprises for local authorities. The significance in coincidence of timing with money supply figures/chancellor's public expenditure statement.

15. End-year flexibility: why exclude local authorities?

Because the case for including them is much less strong. Individually they already have more flexibility than we are now proposing to give to central government departments. and inclusion would mean a higher cost.

16. 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.

17. Why not cut back local authority capital spending?

Because we do not want to hurt the construction industry, particularly in the housing sector. Allocations were increased accordingly.

18. LA capital underspending

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.

19. 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.

20. Business Rates

Rates now biggest single tax paid by industry. Excessive increases damage jobs. Bill (see K 19) 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.

21. 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.

22. 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

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

[£215 million to be spent on new airfield - 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 airfield will be contained within this provision.

24. 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.

25. 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 1979, 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 K14.)

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. 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. With General Election intervening now uncertain whether original target of July 1983 for publication can be met.

6. 1983 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.] A meeting of the Joint Co-ordinating Committee has been arranged for 14 July, at which it is expected that an offer will be made which the trade unions will be prepared to recommend to their members.

7. Civil Service pay in 1984-85?

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

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

8. 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.

9. Top Salaries Review Body and the higher civil service

See D10.

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. Supplementary benefit will be uprated in line with increase in RPI less housing ie 4.3 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. 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.

4. Summer Supplementary Estimates totalling over £500 million?

[Following Budget announcement of reversion to historic basis for upratings then CSD promised Parliament that revised social security Estimates would be presented. Four Supplementaries now presented totalling £507.6 million (including £202 million on supplementary benefit and £215.6 million on housing benefit).]

In light of decision to revert to historic basis for uprating benefits, whereas main Estimates had been based on conventional Public Expenditure White Paper assumptions about upratings and prices, we promised to issue amended Estimates. This now done. We have taken opportunity to incorporate Budget and other changes.

5. Future price protection and uprating of benefits for the unemployed?

[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; Chancellor pressed on 'Face the Press' programme; issue raised again with PM at Question Time 5 July.]

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 eg by extending pledge. 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. Unemployment benefit will be increased by 8.2 per cent, and worth more than at General Election 1979. Question of what November 1984 rates will be does not arise till next year.

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. Present level of unemployment benefit disincentive to work?

[Question put to Chancellor on 'Face the Press' 3 July. Further discussions in Sunday Press 10 July.]

In certain circumstances benefits paid to unemployed can exceed net earnings they can expect to receive when in work. This must be matter for concern. Situation not solely caused by level of unemployment benefit, but must be borne in mind when considering future increases in that benefit.

8. Pensions to cost more than expected?

[Government Actuary's Report on cost of 1983 uprating, issued 5 July, says pensions living longer than expected. No details about numbers, but could be additional half million pensioners by end decade.]

1981 Census data shows that pensioners are living longer than actuaries expected. This affects benefit expenditure; nevertheless in 1983-84 National Insurance Fund deficit now expected to be £49 million less than calculated in November 1983. Implications for future years will be examined in course of this year's Public Expenditure Survey.

9. Improvements in 1983 besides uprating?

Substantial and wide-ranging improvements, including restoration of UB abatement, removal of 'invalidity trap' and increase in Child Benefit to highest ever real level, designed to aid most groups of beneficiaries.

N EUROPEAN COMMUNITY

[NB Finance Council meeting Monday 11 July.]

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 F1/0

P INDUSTRY

1. Latest statistics of output and investment?

See Section B and Commentary at end of Brief.

2. Company Sector

(i) Company liquidity ratios

[D. Industry's survey of 200 large companies shows continued trends to improved liquidity between 1982 Q4 and 1983 Q1. Total current assets rose by over £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.

3. 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.

4. Government help for small firms

Measures enacted in shortened Finance Act provided further measures to help enterprise and small businesses, increasing the number of measures taken so far from which small firms can benefit to over 100. Enterprise and small firms package included further reduction in weight of corporation tax; further increases in VAT registration limits; increases in global amount available for loans under Loan Guarantee Scheme (see below); introduced new Business Expansion Scheme to replace Business Start-Up Scheme. These measures designed to encourage start-ups and existing firms. In total, measures to assist enterprise and small firms introduced since 1979 have full year revenue cost of around £500 million.

5. Buying British

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

6. Loan Guarantee Scheme?

[Nearly 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.

7. New Enterprise Zones

Eleven zones have now been in existence since 1981. Thirteen second-round zones, now agreed for UK and Northern Ireland, are going through necessary pre-designation stages. These zones will come into operation during summer (Wellingborough on 25 July being one of first). Research so far on first round of enterprise zones has shown that in general they 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. (but see 3 below)

3. 2 per cent cut in EFLs

[Chancellor's statement on 7 July included reduction of 2 per cent (£57 million) in total provision for EFLs of nationalised industries in 1983-84, allocated in proportion to their turnover.]

Nationalised industries must make their contribution to keeping public expenditure within planning total. This reduction will encourage the industries to increase efficiency and make further improvements in control of current costs. Effect of reduction for individual industries will be announced as soon as possible.

INVESTMENT

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

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

5. Continuing undershoot on investment plans?

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

PAY AND PRICES

6. Nationalised industries' prices

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

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

CBI's recent report on comparative energy prices confirms that vast majority of gas and electricity consumers pay comparable prices to their European competitors. Some disparities exist for limited number of intensive users of electricity. Cannot expect disparities to be closed entirely especially where due to different costs of supply. Sole way of reducing real electricity costs is by containing costs of generating electricity.

8. Prospects for gas and electricity prices in 1983?

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

PRIVATISATION

9. 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.

10. 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.

11. Special asset sales in 1982-83?

Receipts totalling nearly £½ billion (£488 million). Major sales included Britoil (£334 million receipts in 1982-83 and £293 million in 1983-84) and Associated British Ports (£46 million).

12. What measures included in increase in asset sales programme in 1983-84?

[On 7 July Chancellor announced increase of £500 million in Special Sales of Assets target for 1983-84. New target is thus £1250 million.]

Not practice to disclose details of composition of targets for special sales of assets, because price information is commercially sensitive and timing of sales dependent on market conditions. Government's privatisation plans are outlined in the Manifesto [see also 10 Future Privatisations].

13. What plans included in special asset sale targets for future years?

[PEWP 1983 has targets of £1500 million in 1984-85 and £500 million in 1985-86.]

See 12 above.

14. 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.

15. 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 have proposed no change in N. Sea prices in Q3.]

BNOC proposal of unchanged 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 decline might have on economy. Effect 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. Bill containing provisions for PRT expenditure relief on shared assets will be introduced 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

[OECD Economic Outlook July 1983 being published 11pm Tuesday 12 July]

1. Williamsburg Summit 28-30 May

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

2. New 'Bretton Woods'?

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

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.

3. World recovery under way?

[Encouraging signs of recovery particularly in US (see ~~T6~~ T5) and Canada; also in Europe, where industrial production rose slightly in first quarter, and business confidence has improved. Expect IMF about 2 per cent growth in major industrialised countries this year.]

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 2 per cent) and to continue into next year.

4. Latest inflation figures

[Consumer price inflation down from a year ago in all major economies apart from Italy on latest available figures: US (from 6.7 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.

5. 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 concerning budget deficit continues to threaten recovery in medium run.

6. 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.

7. US has relaxed monetary policy?

[Level of M1 fell in most recent week by about $3 billion but nonetheless has risen at annual rate of over 12 per cent since 1982 Q4 - well above 4-7 per cent target range. M2 and M3 remain at the top or just above their target range.]

Federal Reserve following firm but flexible policies in face of distortions affecting monetary aggregates; Fed is keen to sustain recovery, has successfully reduced inflation to only 3½ per cent and remains solidly committed to preventing any resurgence.

8. US interest rates

[Although the growth of M1 has slowed recently it is still well above target having grown at an annual rate of about 12 per cent since its Q4 b[illegible] compared with its 4-7 per cent target. Consequently widespread concern been expressed that Federal Open Market Committee at its meeting this week will have to tighten policy possibly leading to higher interest rates in order to slow the growth of M1. Despite policy stance remaining broadly unchanged 3 month interest rates have risen by about 1 per cent over the last 2 months.]

Difficult to foresee future level of interest rates which are largely determined by developments in markets. Have to await outcome of FOMC meeting. Fed following firm but flexible policies in face of continuing distortions (especially affecting M1). However, M2 and M3 now within, or just above, their target ranges. Lack of agreement over ways to reduce budget deficit is continuing cause for concern over future interest rate trends.

9. 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.

10. Brazil about to default?

[IMF programme for Brazil suspended. As result some commercial bank facilities have been suspended and repayments to BIS postponed.]

We have always recognised that adjustment would be difficult for many debtors. Even although Brazil has not met IMF's performance criteria. Many improvements have already been made. Negotiations between Brazil and IMF are in progress. No reason to believe that satisfactory agreement will not be reached.

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.

2.37

COMMENTARY ON RECENT UK ECONOMIC DEVELOPMENTS: 11 JULY 1983

Financial Conditions

1. In the four months to June the monetary target aggregates have grown at a rate well above the 7-11 per cent range, partly reflecting high public borrowing.

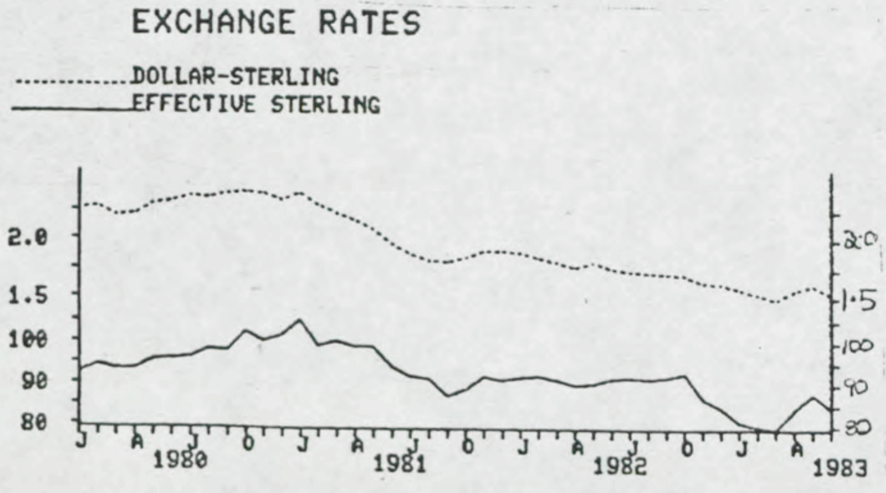
Banking Months — % changes, seasonally adjusted

	M1	£M3	PSL2
March	1.2	1.0	1.7
April	1.1	1.7	2.1
May	1.5	0.6	0.6
June	1¾	1¾	1
<u>Annual % change (to June)</u>			
Target period	17½	15¾	17¾
Last 12 months	14½	11¾	12

On 7 July the Chancellor announced a set of public expenditure measures which would reduce this year's likely public expenditure outturn by over £1 billion. These measures do not imply any reduction in the PEWP planning total of £119.6 billion but rather an adjustment to bring actual spending closer to the planned path. The provisional estimate of the CGBR in June is £2.5 billion bringing the cumulative total since April 1st to £5.5 billion.

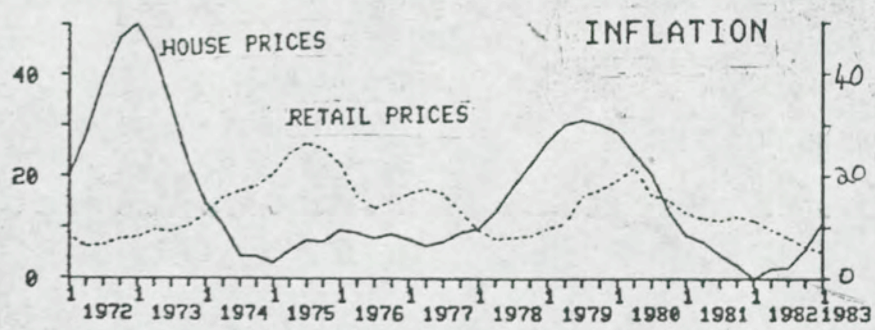
2. Bank base rates were reduced to 9½ per cent on 15 June. They are now at their lowest level for five years, apart from the period last autumn when they briefly fell to 9 per cent. The Building Societies announced on 22 June a 1¼ per cent increase in the mortgage rate, to 11¼ per cent, effective from 1 July. Apart from the last six months, mortgage rates are still at their lowest level since the summer of 1978.

3. The <u>effective exchange rate</u> is now around 85 (1975 = 100), somewhat lower than the 90-91 range occupied for most of the period summer 1981-autumn 1982.



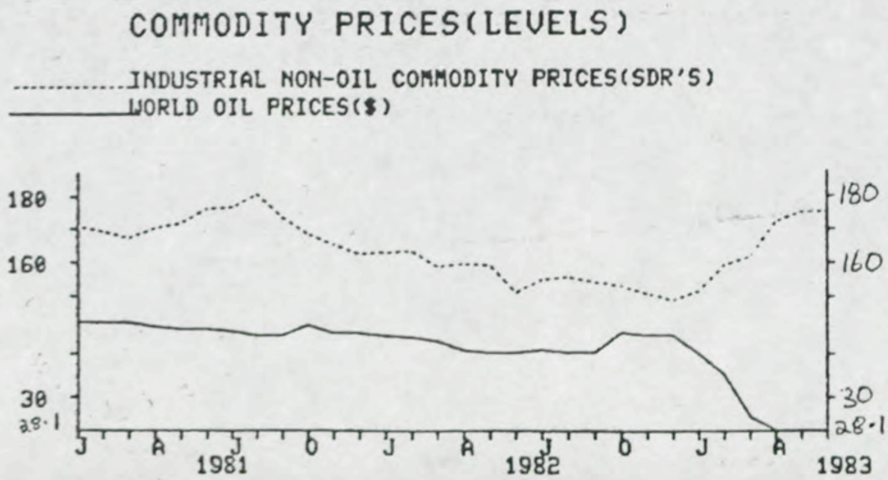
Inflation and Costs

4. RPI inflation was 3.7 per cent in May, its lowest level for over fifteen years. UK inflation is also lower than the 'Major 6' average although remains higher than in West Germany (3 per cent) and Japan (2 per cent). As some of last year's favourable influences are removed from the 12-monthly comparison inflation is expected to rise to 5-6 per cent towards the end of the year. The mortgage rate increase will add about 0.4 per cent to the July RPI (published in August). Although some companies announced petrol price rises of 8p there are indications that less than half of this will stick which would add only 0.1 per cent to the RPI. In the year to June wholesale output prices (excluding petroleum products) rose by 5.7 per cent. Materials and fuel prices rose by 4.4 per cent. The prices of assets such as houses have shown more rapid increases but these are not high by historical standards.



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 7½ per cent in April and continues the steady fall since the beginning of the 1980/81 pay round. Wage moderation, coupled with productivity gains (in the three months ending April manufacturing output per head was 4½ per cent higher than a year earlier) have brought down the increase in manufacturers' unit wage and salary costs to around 3½ per cent in the year to the three months ending April. The increase would be lower still if a broader labour costs measure were used which incorporated the cuts in the National Insurance Surcharge.

6. Industrial (non-oil) commodity prices (in SDR's) have risen strongly since the autumn according to the Economist index though the increases in May and June were relatively modest. World oil prices appear to have stabilised in the last few months.



Company Finances

7. 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 an 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

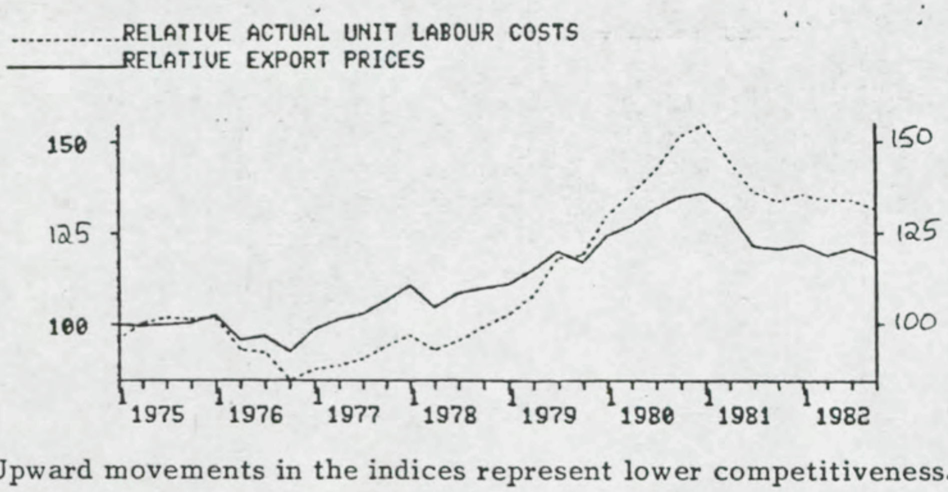
	Non-North Sea ICC's	Manufacturing
1960-70 (average)	11	10
1980	4	3½
1981	3½	2
1982	4	na

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.

Competitiveness and Trade

8. Manufacturing trade competitiveness can be measured in a number of ways although 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.

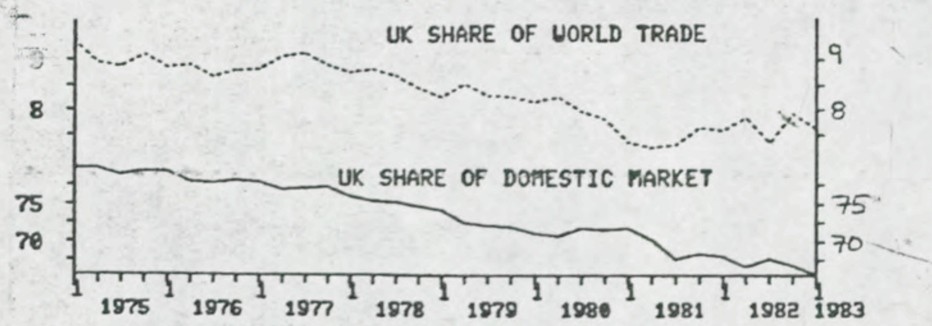
MEASURES OF MANUFACTURING TRADE COMPETITIVENESS



NB. Upward movements in the indices represent lower competitiveness.

9. 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. Trade performance in manufactures in overseas and domestic markets is illustrated in the chart below.

TRADE SHARES IN MANUFACTURES



Domestic Demand

10. 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.

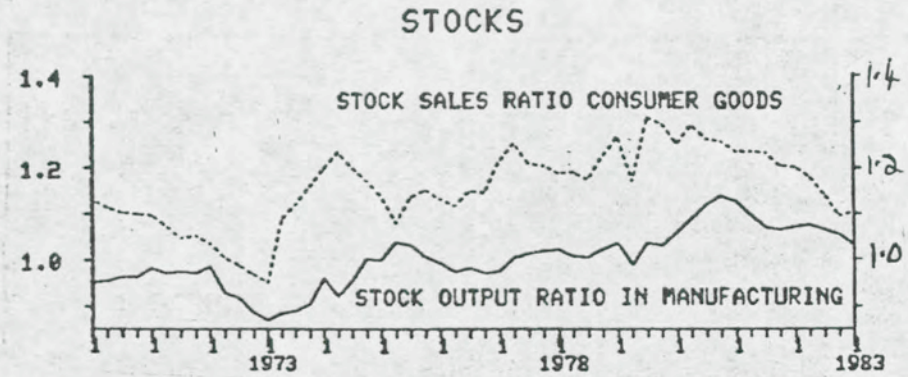
11. Much of the recovery in total domestic demand during 1982 reflected the growth consumer spending, partly reflecting lower inflation and the summer 1982 abolition of HP controls. The slight fall in real personal disposable income in 1982 was offset by a fall in the savings ratio. Consumers' expenditure 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

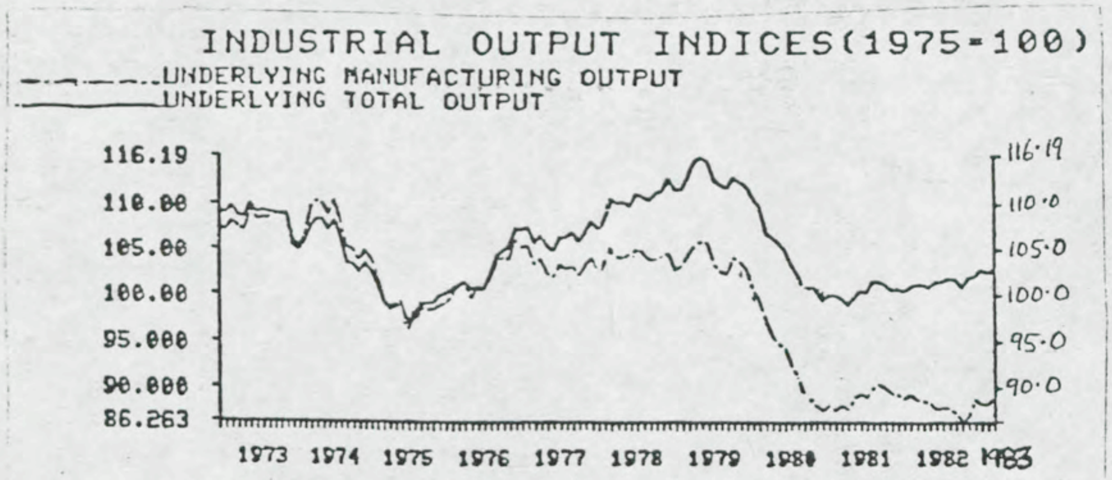
		Consumers' Expenditure	Retail Sales
1982	H1	0.0	0.9
	H2	2.2	4.2
1983	Q1	3.0	4.3
3 months to May		na	5.8

12. Total fixed investment rose sharply in the first quarter of 1983. Upward trends 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.



Output and Unemployment

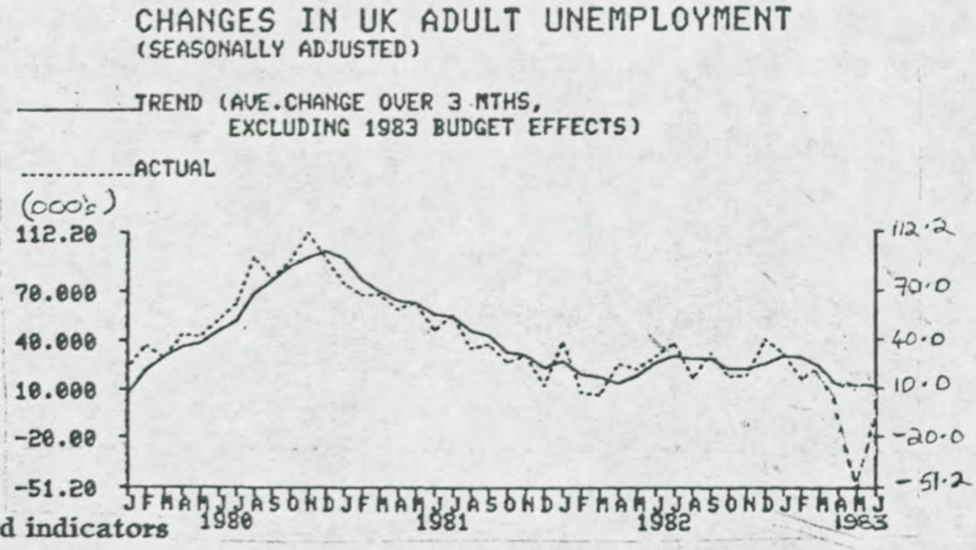
13. Total output (GDP(O)) rose by ½ per cent between 1982 Q4 and 1983 Q1; GDP(A) is now 3½ per cent above its trough (reached in 1981 Q2). The underlying level of industrial output is some 3½ per cent above its spring 1981 trough, with about half this growth due to increased North Sea activity. Manufacturing output, which was on a declining trend during 1982, now also appears to be recovering.



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 favaourable weather conditions at the beginning of the year. An additional factor may be the tightness of building societies' funds and much reduced bank lending.

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.

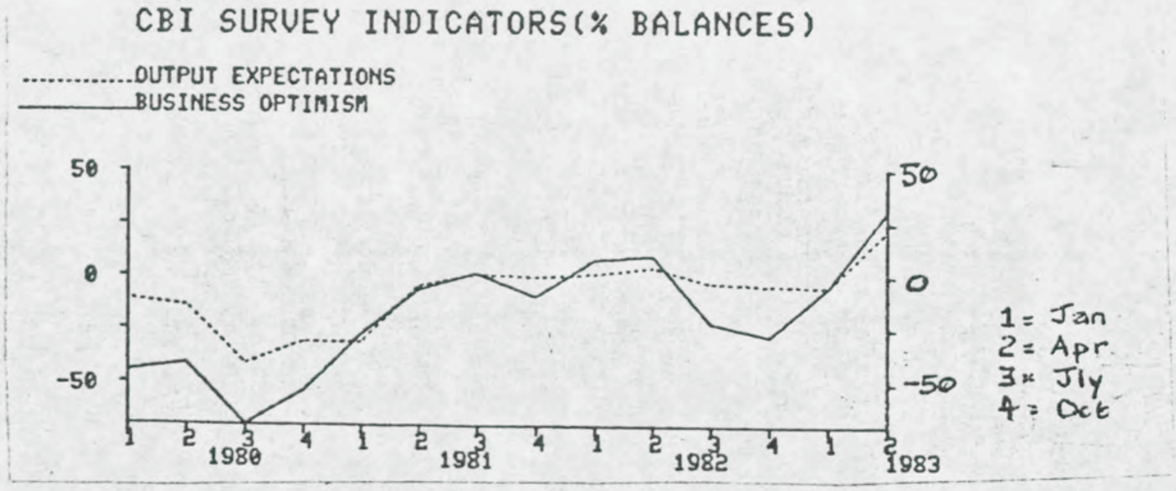


Recent forward indicators

15. The CSO's indices of cyclical indicators, taken together, point to a continued upswing in the business cycle. Total engineering orders fell 1 per cent in 1983 Q1 compared with the previous quarter, but export orders rose by over 26 per cent 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.

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.



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.

Key indicators to be published in week ending 15 July

Mon	11	:	Wholesale Prices (June)
		:	CGBR (June)
Tues	12	:	Car production (June provisional)
		:	Building Societies figures (June)
Wed	13	:	Industrial production (May)
Thurs	14	:	Monetary aggregates (June final)
Fri	15	:	Retail Price Index (June)
		:	Tax and Price Index (June)