NBPM

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

22 November 1983

Murdo MacLean Esq
No 12 Downing Street
London SW1

Dear Murdo,

We spoke about the Motion for Thursday's Debate. The Chancellor would be content with the following wording:-

> "That this House approves the Autumn Statement presented to Parliament by the Chancellor of the Exchequer on 17 November; welcomes the continuing prospect of low inflation and steady growth; and congratulates Her Majesty"s Government on keeping the public expenditure planning total for 1984-85 unchanged at the level published in the 1983 Public Expenditure White Paper (Cmnd 8789)."

Equally, if the Chief Whip were to prefer a shorter Motion, the Chancellor would be content if only the first two lines of this formula were used.

Copies of this letter go to David Hayhoe and Andrew Turnbull.

Yours ever,

John Kerr.

J O KERR

Lib/SDP Leave out from House to end and add "deplores the Autumn Statement on the economy; regrets the widespread hardship caused by cut in housing benefit; notes with concern the continuing failure to maintain, let alone improve, public assets; and urges the Government to foster sustained recovery by lower interest rates, competitive energy charges, increased capital expenditure and a realistic sterling exchange rate.

Steel Owen.

COVERING SECRET

cc BZ
T/F
Backup

No need to retain

17

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

16 November 1983

Andrew Turnbull Esq
No 10 Downing Street
London SW1

Dear Andrew,

AUTUMN STATEMENT: 17 NOVEMBER

You have a copy of the proof of the printed Autumn Statement. I am not sure that I shall be in a position to send you tonight a copy of the final corrected version: I shall try, and if I fail I shall certainly send copies early tomorrow morning.

... Meanwhile, I attach a copy of the latest draft of the Chancellor's oral statement in the House tomorrow afternoon. The Chancellor has already devoted a good deal of attention to it, and I am fairly clear that any further changes are likely to be pretty minor.

Yours ever,

John.

J O KERR

COVERING SECRET

THE ECONOMY

1. With permission, Mr Speaker, I should like to make a statement.

2. As my predecessor did last year, I am laying before the House today an Autumn Statement which brings together certain matters customarily announced at this time of the year. The Statement contains the Government's outline public expenditure plans for 1984-85, proposals for National Insurance Contributions for next year, and the forecast of economic prospects for 1984 required by the Industry Act.

3. In response to firm monetary policies the past year has seen falling inflation, renewed growth and solid evidence of our continuing recovery from world recession. Progress both on inflation and on growth this year has been better than expected at the time of the Budget.

4. Since the low point of the recession in early 1981, output has grown by about 5 per cent, inflation has fallen from double figures to around 5 per cent, and there have been significant gains in productivity, competitiveness and profitability. Employment appears now to be rising, and unemployment to be levelling off.

5. Output this year is expected to be about 3 per cent higher than in 1982, and the Industry Act Forecast points to continuing growth next year. Recovery in the rest of the world, so far hesitant outside North America, is now widely expected to show some improvement. With higher exports offsetting some slow-down in

the growth of domestic demand, overall UK output is forecast to rise by a further 3 per cent in 1984. With inflationary pressures remaining weak, inflation is likely to edge down again next year to a rate of around 4½ per cent by the fourth quarter.

6. Downward pressure will continue to be exerted on public borrowing. Despite the measures I announced on 7 July it is clear that this year's PSBR is likely to be ~~well~~ above the £8 billion expected at the time of the Budget. The outturn is, of course, still uncertain but is now forecast to be £10 billion, mainly as a result of public expenditure running higher than planned, as I indicated to the House on 7 July.

7. For next year, 1984-85, the forecast makes the ~~usual~~ conventional assumptions that the direct taxes and excise duties are both revalorised in line with prices, and that the PSBR is held next year to the £8 billion assumed at the time of the last Budget in accordance with the Medium Term Financial Strategy. On this basis the forecast implies the need for some net increase in taxes in next year's Budget. As the House will recognise, this is, of course, at this stage, subject to a wide margin of uncertainty, and will need to be reviewed, with other relevant factors, in the light of more up-to-date information, before I come to make my Budget judgement.

8. Following this year's public expenditure review, the public expenditure planning total for next year, 1984-85, will remain at £126.4 billion. The House will recall that that was the provisional figure for 1984-85 published in the Public Expenditure White Paper

in February this year. It is also broadly the same in real terms as the likely outturn for this year, 1983-84. So, with the economy expanding, public expenditure should continue to fall as a percentage of GDP next year.

9. Within the unchanged total for 1984-85 there have inevitably been changes in both directions in individual programmes. The details are contained in the Autumn Statement itself. In broad terms, it shows increases in spending for health and personal social services, social security, education, law and order, agricultural support, arts and libraries, and for a number of other programmes. The social security programme provides for an uprating in November 1984 based on the rise in prices in the 12 months to May 1984; but there will be reductions in the coverage of help with housing costs, particularly housing benefit.

10. These increases are offset by higher receipts from council house sales and by a reduction in planned spending on home improvement grants, defence, employment, trade and industry, and several other programmes - including the aggregate external financing limit of the nationalised industries. Net receipts from special sales of assets are forecast to increase by some £400 million reflecting, among other factors, the fact that the privatisation of Enterprise Oil is now expected not this year but in 1984-85.

11. As the House will be aware, the February White Paper provided for a provisional Contingency Reserve of £3 billion. That figure remains intact.

12. The 1983 review of expenditure plans has, of course, also covered 1985-86 and 1986-87. Details of the plans for both years will be published in next year's Public Expenditure White Paper.

13. The Government has also reviewed its manpower requirements for the years up to 1988. My RHLF the CST is today publishing details of our new plans for a continued steady reduction in the size of the Civil Service. Numbers will come down to 593,000 by 1988, a fall of 6 per cent below the existing target of 630,000, which we expect to be achieved on or before 1 April 1984.

14. I come, lastly, to National Insurance Contributions. As the House knows, these are reviewed every autumn in the light of advice from the Government Actuary on the prospects for the National Insurance Fund in the coming financial year.

15. As usual, the earnings limits, which define the range of earnings on which contributions are payable, will need to be increased. The lower earnings limit will rise to £34 a week, in line with the single rate retirement pension, and the upper earnings limit will rise to £250 a week, broadly in line with the increase in earnings. We are also taking this opportunity to reduce the taxpayers' contribution to the fund - the so-called Treasury Supplement - from 13 per cent to 11 per cent. Finally, in each of the last four years we have had to increase the National Insurance Contribution rate itself. I am glad to say that we shall not need to do so for 1984-85. So the full Class 1 rate will remain at 9 per cent for employees and 10.45 per cent for employers.

16. As is customary, my rt hon Friend, the Secretary of State for Social Services, will this afternoon announce details of the changes in the Social Security (Re-rating Contributions) Order and will lay before Parliament the accompanying report by the Government Actuary.

17. As my RHF The Leader of the House has already announced, the House will have an opportunity next week to debate the Autumn Statement, which is now available from the vote office.

18. Mr Speaker, for the first time for many years we are now enjoying low inflation combined with steady growth. Our task now is to sustain this ~~beneficent~~ a [illegible] combination, by holding - and indeed reinforcing - the policies which have brought it about.

PRIME MINISTER

Autumn Statement

Attached are a draft of the statement the Chancellor will make in the House tomorrow and a copy of the printed document.

To note:

(o) Growth of 3 per cent in 1983 and 1984.

(i) The PSBR in 1983/84 is put at £10 billion (Para.1.49).

(ii) Public expenditure in 1984/85 is shown as £126.4 billion, and a further fall in public expenditure as a percentage of GDP is projected (Page 23). The contingency reserve is intact at £3 billion (Para. 2.32).

(iii) Taxes might have to be raised next year by £½ billion, though the Chancellor stresses the small size of the judgment in relation to the margin of error and the fact that this does not preempt his budget judgment (Para. 1.45).

(iv) Inflation should be around 5½ per cent in May, 1984, the relevant month for uprating pensions (Para. 3.04). By the 4th Quarter inflation should be down to 4½ per cent (Para. 1.50).

(v) Unemployment is assumed to remain stable at 2,850,000 (Para. 3.04).

(vi) No change in NIC rates (Para. 3.02).

(vii) Current account ½ billion in surplus this year and in balance next (Para. 1.50).

AT

16 November, 1983

ANDREW TURNBULL

10 DOWNING STREET

Prime Minister

The main subject of the bilateral will be the Autumn Statement. The draft is very clear. The points of difficulty could be

(i) higher PSBR, though market expects this
(ii) hint of higher taxes
(iii) energy prices - Chancellor could report state of play.

Other items for meeting, if not resolved before

(i) black economy
(ii) offshore life assurance.

AT 16/11

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

With the Compliments

of

ADAM RIDLEY

Special Adviser

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

[illegible]

AUTUMN STATEMENT [AS]

NOVEMBER 18 1983

As in 1982 an Autumn Statement is being published to present to the House speedily and conveniently the Government's decisions about public spending, national insurance rates for 1984-5 and the short-term economic forecast required twice a year by the Industry Act.

Numbered references in brackets are to paras, tables or charts in the AS text.

THE ECONOMY: PERFORMANCE AND PROSPECT

General

2. Part 1 of the AS describes the economy's recent development and the outlook to the end of 1984. The picture is of continued progress in the battle against inflation; and better-than-expected output growth, as the following comparison shows:

Successive Treasury
Projections of real GDP growth in 1982, '83;
% increase year on previous year

	AS 1982	1983 Budget	AS 1983
1982	+ $\frac{1}{2}$	+$\frac{1}{2}$	+2
1983	+1$\frac{1}{2}$	+2	+3

(all figures rounded to nearest $\frac{1}{2}$%)

However, the immediate fiscal prospect has become more difficult. Whereas the Budget forecasts suggested a positive £$\frac{1}{2}$ billion fiscal adjustment in 1984-5 and, therefore, scope for modest tax cuts over and above indexation, the latest estimate is negative, suggesting real net tax increases of the same size.

Main features of the Industry Act Forecast

3. World trade and output, which fell in 1982 and the earlier part of 1983, appear to be expanding and should match or exceed their 1975-82 growth rates in 1984 (Table 1.1).

Demand in the UK economy will continue to expand briskly (3% up in 1984) as it has done since the second half of 1981. (Table 1.3).

Output in the UK in 1984 is also set to grow by around 3%, as in 1983. This will mean that for the three years 1981-4 UK growth will have been close to or faster than that of our major competitors. An achievement without precedent for decades. (Tables 1.1 and 1.4).

Consumption spending is likely to continue to grow, though less quickly than in 1983, with a further small fall in the savings ratio and growth in real incomes after tax. (Chart 1.9 and Table 1.3).

Total investment which, contrary to general expectation, has been growing since 1981 Q 3, is expected to grow by 4% in 1984, with manufacturing contributing to that increase. (Table 1.3).

Trade: Total Exports, which grew in 1982 and 1983 despite the fall in world trade, are also projected to grow by 4% as world trade recovers. Imports of manufactures will continue to grow strongly as the economy expands.

The current account is expected to be in modest surplus in 1983 and broad balance in 1984.

This picture of continuing recovery is confirmed by the CBI's surveys of industrial trends and the DTI's surveys of investment intentions.

4. Turning to costs, employment and monetary developments:

Inflation, as measured by 12 monthly increases in the Retail Price Index will be about 5% by the end of 1983, less than the 6% projected at Budget time; and is forecast to rise briefly to about 5½% before falling to around 4½% by the end of 1984.

Relative unit labour costs in manufacturing fell by over 20% between their peak in the first half of 1981 and the first half of 1983. This was due partly to the fall in the exchange rate, reductions in the National Insurance Surcharge, and to a 15% increase in productivity which has gone well beyond what is normal as output recovers. (Chart 1.3 and Table 1.6).

Business finance and profitability have strengthened considerably from their very low 1981 base. With the domestic recovery and growth in overseas demand, they should continue to do so. Excluding the oil sector, industrial and commercial company profits (less stock appreciation) rose by no less than 22% between the first halves of 1981 and 1982, and 24% between the first halves of 1982 and 1983. In the year to mid 1983 companies ran a substantial financial surplus and their borrowing requirements fell sharply. In addition companies have been able to raise substantial sums in new equity and bond issues for the first time in many years - nearly £3 billion by the end of the third quarter of 1983.

Monetary growth in the target period February 1983 to April 1984 has slowed significantly and has been coming back toward the target range, thanks in part to a successful funding programme.

Interest rates have continued to fall. At the short end Bank base rates are 7% below their October 1981 peak and at their lowest level for 5½ years. Long rates have also moderated and, strikingly, have recently been lower than in the USA, in marked contrast to past experience. (Chart 1.11).

Employment prospects are getting better. Manufacturing employment is declining much more slowly. The numbers in work outside manufacturing are rising and the fall in total employment seems to have ended. These trends, and indicators such as job vacancies, suggest that unemployment may be levelling off. (Para 1.38).

REVIEW OF NATIONAL INSURANCE CONTRIBUTIONS

5. The main points to note about the review and the decisions arising from it are:

- No change in the employer and employee contribution rates, for the first time since 1979-80.
- As the law requires, the upper and lower earnings limits have been reviewed. When inflation is high, these adjustments lead year by year to substantial increases in contributions in cash, if not in real terms. But as inflation is now low, the extra cash burdens on employees and employers attributable to the changes in the earnings limits are very small (£70m and £80m next year respectively). Nearly all of such cash increases as there are will be the direct consequence of higher earnings. (Table 3.1).
- The burden on employers of National Insurance Contributions and Surcharge payments in 1984-5 is expected to rise by less than 3% in cash terms, and therefore to fall significantly in real terms.

The effects of the changes now proposed are clearly summarised in Part 3 of the AS; and described in greater detail in the order the Secretary of State for Social Services is laying before Parliament on November 17.

6. Further points to note are that:

- the lower earnings limit is to rise from £32.50 to £34 a week, in line with the uprating of the single person's basic retirement pension;
- the upper earnings limit is to rise by 6½% from £235 to £250 a week, broadly in line with the increase in prices and earnings.
- the "Treasury supplement", a general subsidy from the taxpayer to the National Insurance Fund, is to be reduced from 13% to 11%. As spending on non-contributory social benefits (which are financed from general taxation) has long risen faster than on the contributory benefits financed from the National Insurance Fund, this reduction helps restore the balance between the proportion of total social security spending met by the general taxpayer and by contributors;
- the overall effect of the changes proposed is expected to add about £200 million to the accumulated balance in the fund. This will leave its size unchanged in real terms;
- in preparing his annual report on the prospects for the NI Fund, the Government Actuary has been instructed to adopt as working assumptions figures of 2.85 million unemployed (excluding school leavers) in 1983-4 and 1984-5.

PUBLIC SPENDING

General

7. As far as the outlook and decisions for 1984-5 go:

(1) The decisions on individual programmes have been kept within the £126.4 billion cash total in the February 1983 Public Sector White Paper (Cmnd 8779). This is the second successful survey in which the planning total has not been added to in the subsequent survey.

(2) Given this unchanged cash planning total, the level of real spending (measured in constant prices, in 1984-5 is likely to be little different from what it was in 1983-4; while the GDP share of the planning total should fall, from around 42½% to 42%, making 1984-5 the third financial year in succession in which the share has fallen from its 1981-2 peak of 44%.

(3) In confirming the 1984-5 planning total of £126.4 billion, the Government has not, as some suggested, increased the risks of spending ultimately overshooting, by drawing on the contingency reserve set out in the March White Paper. It remains at £3 billion.

8. Turning to developments in 1983-4;

(1) As was already clear in the summer, the level of public spending in 1983-4 is above that expected at the time of the Budget. This is due principally to extra outgoings on demand-determined programmes such as assistance to Agriculture under the CAP, Health & Social Security, debt interest, and Local Authority overspending on current account.

(2) With little change in projected revenues, the result is a PSBR now put at £10 billion, some £2 billion above the Budget estimate. However wide margins of error surround estimates of both revenue and spending and hence the PSBR until very late in the financial year.

Detailed changes

9. The figures agreed for programme totals in 1984-5 (and the 1983-4 figures corrected for Budget and other changes) are set out fully in Table 2.1 and Chapter 2 of the AS. The major changes in programme totals are:

REDUCTIONS IN PLANNED SPENDING

	£m cash
Nationalised Industry External Financing limits (EFLs)	-666
Environment - Housing	-497
Defence	-260
Employment	- 68
Trade & Industry	- 60

INCREASES IN PLANNED SPENDING

Agriculture - Intervention Board (IBAP)	+422
Education	+175
Social Security	+163
Home Office	+ 92
Health & Personal Social Services	+ 86
Energy	+ 86
Environment - Property Services Agency	+ 24

Such totals are net figures which reflect a variety of increases and reductions in programme constituents. In programmes such as Local Authority spending, the planning total figure is net of receipts from sales of assets such as council houses. So neither the level nor year-to-year trend is necessarily a good guide to the underlying level of gross spending, or changes in it.

10. Turning to individual programmes, it should be noted that for 1984-5:

Defence: cash provision is 8.2% up on 1983-4, allowing both for real growth of 3% over that year plus a substantial addition for Falklands costs.

FCO: extra spending on the BBC External Services and the British Council.

Agriculture: the increase in IBAP spending is uncertain (depending on weather, markets, etc), and mainly on activities entirely financed by the European Community.

EC Contribution: the unchanged figure is the conventional estimate shown in the February White Paper.

Trade & Industry: extra spending on launch aid, R & D and redundancy, more than offset by lower regional aid and reduced spending on individual industries and BL.

Energy: most of the £86 million increase is extra support for the Coal Industry.

Employment: the net reduction of £68 million reflects lower costings of the Youth Training, Job-Splitting and Young Workers' Schemes; and the extension of the Enterprise Allowance.

Housing: gross capital spending will be much the same next year as this in cash terms. The reduction in net provision is mainly due to higher receipts for council house sales; and the ending of the temporary home improvement grant measures introduced in the 1982 Budget.

Other DOE programmes: provision for higher PSA spending will assist the special programme to up-grade Unemployment Benefit offices and other substandard Government offices.

Home Office: the increase provides an extra £32 million for prisons and £19 million for the police, as well as for the start of the Cable Authority.

Education & Science: the increase is mainly Local Authority current spending.

Health and Personal Social Services: the increases honour Election and other pledges, and provide for extra capital spending. They also provide resources to meet fully demographic pressures on the NHS and the growing demand for Family practitioner services.

Social Security: the £163 million increase is the net effect of substantial demand-determined increases (mainly Supplementary and Housing Benefit), only partly offset by policy changes, principally on Housing Benefit. The latter now goes to some 7 million households - no less than 1 in 3 - some of which will have incomes above average earnings. The changes proposed are designed to limit to this better-off group the bulk of the reductions in benefits.
N.B. Benefit upratings come into effect on November 21 at a cost of around £1½ billion, including the 11% increase in child and one-parent benefits announced in the Budget.

Local Authorities' current spending: the £600 million increase provided in current spending relevant for RSG support reflects continued overspending by the authorities. At the same time provision has also been made for grant hold-back where authorities exceed their targets.

11. Other noteworthy features of the latest review are:

Asset Sales: estimates are particularly uncertain and reflect a variety of changes since the February White Paper, including the slippage of the sale of "Enterprise Oil" into 1984-5. Sale of shares in BT is still scheduled in the Autumn of 1984.

Manpower: the new targets for the size of the Civil Service in the year to 1988 provide for a further reduction of 37,000, from the 630,000 target which will be achieved for April 1984 to 593,000. Almost half of this 6% drop will be accounted for by the change proposed in the status of the Royal Ordnance factories. Detailed figures are given in the written PQ answered by the Chief Secretary on November 17.

Nationalised Industry EFLs: increases are provided for the NCB, BSC, CAA and British Shipbuilders. All the other industries have lowered requirements. Details of the industries' investment and policy plans are not yet settled. But overall their price rises in 1984-5 are expected to be at or below the rate of inflation, and the levels of investment achieved in 1982-3 and 1983-4 should be maintainable hereafter provided current costs are properly restrained. Further fuller notes on the Gas and Electricity industries are in the Annex.

Tax Ready Reckoners

13. As in 1982 the last part of the AS includes a "ready reckoner" for the direct revenue effects of possible tax changes in the financial year 1984-5. The effects of indexing income tax thresholds, allowances and bands and revalorising excise duties are set out in some detail, assuming an illustrative 5% inflation. In using these estimates it needs to be borne in mind that:

- the first-year and full-year costs often differ;
- some changes illustrating indexation and valorisation will differ slightly from 5% due to conventional rounding to convenient cash sums;
- income tax changes are costed separately, but interact if several are undertaken at once;
- most changes can be scaled up or down proportionately within a reasonable range, but not for "large" changes;
- direct revenue effects are not the same as fully-worked out PSBR costs. These are not unique for a given tax change, since they depend on other assumptions about economic policy, particularly monetary control.

PJC/ANR/SN
November 17 1983

ANNEX

BACKGROUND NOTE ON EFLs IN THE GAS AND ELECTRICITY INDUSTRIES

1. When the Government negotiates and agrees EFLs with the industries, two basic principles are followed: that the industries should achieve demanding but realistic targets for costs and productivity; and that prices should be set in line with the prices a competitive market would generate ("economic pricing"). The industries decide their prices themselves.

2. Economic pricing means covering all the costs of meeting additional demand, including a 5 per cent return on capital. When prices are set in this way, there is no sense in which they can be said to contain an element of taxation. This approach has been endorsed by successive Governments, including the last Labour Government.

3. Where prices are below economic levels, the investment (eg a power station) will make a loss; or materials are bought in and sold on for less than they cost, as BGC already have to do with expensive Norwegian gas. There is a clear waste of resources in either case. The borrowing requirement and interest rates will be higher as a result.

4. Across-the-board restraint of prices below economic levels (eg to help firms whose international competitiveness is sensitive to energy prices) is not only wasteful but inefficient, as those helped will only account for a small part of total energy consumption.

5. The Electricity industry was investigated by Coopers & Lybrand in 1982. Their findings suggest that electricity prices are now approaching economic levels, but are not above them. The Gas industry was studied by Deloitte's in 1983. They showed that even in 1982/83 most gas prices were well below economic levels. The shortfall has since widened considerably because costs of energy production have continued to rise both here and abroad.

6. There is a widespread but incorrect belief that the costs of energy to British firms are generally higher than on the continent. Yet UK industrial gas prices should be in line with continental ones in 1984/85. So, too, will be industrial electricity prices for most consumers, except in comparison with France which has a lot of low cost nuclear capacity. Prices to domestic consumers will remain lower in the UK, for gas very markedly so.

7. Much nonsense is talked about the "enormous profits" of the energy industries. In truth what is enormous is the amount of capital invested: £9 billion in Gas and a staggering £32 billion in Electricity. The profitability of these assets is in fact rather poor. Though the profit figures for the industries are large in absolute terms, the 4½ per cent return on capital in gas - let alone the return of under 2 per cent in electricity - are modest by normal private sector standards.

8. Even more nonsense is talked about the "need" for low energy prices to industry. Every firm and household would like to pay less for what it purchases. But to say as much tells us nothing about what to do when a good or service is scarce and expensive to produce. To ensure the supply purchasers need, economic pricing is necessary. And subsidising supply to make it possible to hold prices below proper levels inevitably imposes costs and burdens which hold back profits and growth in the rest of the economy.

9. The increases in gas and electricity prices over the coming year are expected to be below the rate of inflation.

10. Domestic Gas prices have not increased since October '82. Industrial gas prices have gone up by less than 4 per cent since the end of 1980. Electricity prices have not increased since the spring of 1982.

11. It is also worth recalling that since 1979 many important measures have been taken to help the less well-off with energy bills: the new disconnection codes; the provisions for abatement of standing charges for small consumers; and very substantial increases in real terms in the assistance given to the needy through "heating addition" and other Supplementary Benefits.

Has the Prime Minister seen the figures quoted by the Chief Secretary that public sector capital expenditure has fallen by 50% in cost terms between 1973-74 and 1982-83?

If my hon. Friend had read the speech in full he would have noticed the substantial qualifications which the Chief Secretary made to the figures. On the very next page he said:

> "... what is meant by "capital" spending in the public sector differs from capital spending as it is understood in commercial accounting. Ignoring these differences can be misleading both about the amount of public sector investment which is actually going on and about the merits and demerits of different types of spending."

For example, the figures net of sales of council houses which reduced overall capital spending last year by over £2 billion and the White Paper figures do not include capital spending by the nationalised industries, merely their borrowing.

Autumn Statement 17 November

THE ECONOMY

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/In response

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4. Since the low point of the recession in early 1981, output has grown by about 5 per cent, inflation has fallen from double figures to around 5 per cent, and there have been significant gains in productivity, competitiveness and profitability. Employment appears now to be rising, and unemployment to be levelling off.

/Output

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/Downward

6. Downward pressure will continue to be exerted on public borrowing. Despite the measures I announced on 7 July it is clear that this year's PSBR is likely to be above the £8.2 billion expected at the time of the Budget. The outturn is, of course still uncertain but is now forecast to be £10 billion, mainly as a result of public expenditure running higher than expected, as I indicated to the House on 7 July.

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As the House will recognise, this is, of course, at this stage, subject to a wide margin of uncertainty, and will need to be reviewed, with other relevant factors, in the light of more up-to-date information, before I come to make my Budget judgement.

/Following

8. Following this year's public expenditure review, the public expenditure planning total for next year, 1984-85, will remain at £126.4 billion. The House will recall that that was the provisional figure for 1934-85 published in the Public Expenditure White Paper in February this year. It is also broadly the same in real terms as the likely outturn for this year, 1983-84. So, with the economy expanding, public expenditure should continue to fall as a percentage of GDP next year.

/Within the

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/These increases

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/As the House

11. As the House will be aware, the February White Paper provided for a provisional Contingency Reserve of £3 billion. That figure remains intact.

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of our new plans for a continued steady reduction in the size of the Civil Service. Numbers will come down to 593,000 by 1988, a fall of 6 per cent below the existing target of 630,000, which we expect to be achieved on or before 1 April 1984.

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15. As usual, the earnings limits will need to be increased. The lower earnings limit will rise to £34 a week, in line with the single rate retirement pension, and the upper earnings limit will rise to £250 a week, broadly in line with the increase in prices and earnings. The taxpayers' contribution to the fund - the so-called Treasury Supplement - will be reduced from 13 per cent to 11 per cent. Finally, in each of the last four years we have had to increase the Class I National Insurance contribution rate itself.

/I am glad

I am glad to say that we shall not need to do so for 1984-85. So the full Class 1 rate will remain unchanged at 9 per cent for employees and 10.45 per cent for employers.

16. As is customary, my rt hon Friend, the Secretary of State for Social Services will this afternoon announce details of the changes in the Social Security (Contributions, Re-rating) Order and will lay before Parliament the accompanying report by the Government Actuary.

/As my RHF

17. As my RHF the Leader of the House has already announced, the House will have an opportunity next week to debate the Autumn Statement, which is now available from the vote office.

18. Mr Speaker, for the first time for many years we are now enjoying low inflation combined with steady growth. This is a winning combination. ∴ Our task is to keep that winning combination by sticking to - and indeed reinforcing - the policies which have brought it about.

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FROM: M T FOLGER
16 November 1983

1983 AUTUMN STATEMENT BRIEFING: FINAL VERSION

I attach the final version of thebriefing for tomorrow's statement. This supersedes all previous drafts which should now be destroyed.

MTF

M T FOLGER

5 L.

Distribution list for briefing attached to Mr Folger's 16 November submission to the Chancellor

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NOVEMBER 1983 AUTUMN STATEMENT: BRIEFING

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A1 KEY POINTS AND SUMMARY

This brief is divided into the following sections:

I KEY POINTS

1. 1984-85 Total of Public Spending Plans Held to £126.4 Billion Previously Published. The Government has again succeeded in stopping plans creeping up. Essential part of the Medium Term Financial Strategy to keep inflation under control and set conditions for sustainable economic growth. Public spending as percentage of GDP expected to fall back further in 1984-85, to 42 per cent, continuing downward path since 1981-82 peak of 44 per cent.

2. Forecast shows economic growth of about 3 per cent for both 1983 and 1984. Recovery in output which began in 1981 will continue into 1984. And this consistently with inflation edging down: 12 month figure for RPI expected to be about 4½ per cent by end 1984.

3. Possibly less room for maneouvre now on fiscal policy for 1984-85. So net reduction in tax burden in 1984 Budget now less likely. Current forecast (highly uncertain) is that there may need to be a small net increase in taxes, of £½ billion. But picture could change a good deal by the Spring. Fruitless to speculate now on 1984 Budget judgment.

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A1 Cont.

II SUMMARY OF EXPENDITURE AND CHANGES IN NATIONAL INSURANCE

		Change in 1984-85 £ million
Public expenditure		
Public Expenditure Planning Total		
- in 1983 PEWP (Cmnd 8789)	126,400	
- 1983 PEWP with Budget changes etc	127,100	
- as now announced	126,400	
- net charge since Cmnd 8789		nil
National Insurance Contributions		
Additional revenue to Fund from increases in earnings limits		150
National Insurance Surcharge		
Additional tax revenue from increases in earnings limits		10

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A1 Cont.

III INDUSTRY ACT FORECAST (see also brief B3)

	1983 on 1982	1984 on 1983
(i) Output		
GDP (% change)		
- 1983 Budget Forecast	2	2½*
- Autumn IAF	3	3

*first half to first half

Points to make

(a) UK output has been growing at about 2½ per cent a year since low point in first half of 1981. Initially led (as in past recoveries) by consumer spending; increasing future contribution expected from investment and exports. So recovery becoming more broadly based. Note that total investment has already increased 7 per cent between 1981 first half and 1983 first half.

(b) Recovery in output since early 1981: steady and soundly based; views of the more pessimistic commentators on 1981 Budget and since are now seen to be without foundation. Recovery has come without artificial fiscal stimulus.

(c) Recovery stronger than rest of Europe.

(d) Recovery in UK since 1981 has come despite disappointing performance in rest of world. Better prospects for UK now that world is showing signs of recovery.

(e) Current account of balance of payments to remain broadly in balance.

(ii) Inflation

	1983Q4 on 1982Q4	1984Q2 on 1983Q2	1984Q4 on 1983Q4
RPI (% increase)			
1983 Budget Forecast	6	6	Not forecast
Autumn IAF	5	5½*	4½

*(the assumption for May 1984 given to Government Actuary)

Points to make

(a) 1983 again likely to see inflation in UK below previous forecast. Now forecasting further decrease to below 5 per cent by the end of 1984. Inflation rate lowest since 1960s.

(b) Good news for consumers and business, and the right background for further progress on interest rates. Interest rates already 7 percentage points below 1981 peak.

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A1 Cont.

(c) Clear success in breaking inflationary expectations. An important condition for achieving sustainable growth. Ultimate aim is stable prices; shows Government determination to end problem of inflation

(iii) Unemployment

No government has published forecasts for unemployment. Government Actuary has been instructed to adopt working assumption of average level of 2.85 million for both 1983-84 and 1984-85 (GB excluding school leavers etc)

Points to make

(a) Unemployment may now be levelling off (see para 1.38 of the AS). Underlying increase in 6 months to October averaged 9000 per month compared with 28,000 per month in previous six months.

(b) Outside manufacturing (which is about 25 per cent of total employment) there has already been some increase in employment.

(c) Second quarter of this year saw estimated 18,000 increase in employed labour force (employees and self-employed) the first for four years. Vacancies rising.

(d) Most effective contribution towards lower unemployment will be lower inflation and continued deceleration in pay settlements.

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A1 Cont.

IV PUBLIC FINANCES (see briefs A2, C1)

	£ billion 1983-84	1984-85	
PSBR			
1983 Budget	8	8	(as indicated in MTFS, after fiscal adjustment + $\frac{1}{2}$)
Autumn IAF	10	8	(as indicated in MTFS, but now implying fiscal adjustment -$\frac{1}{2}$)

Points to make

(a) Figures take account of measures announced in AS and assume conventional revalorisation of direct taxes and specific duties by 5 per cent. For further discussion see brief A2.

(b) No simple reason for £1 billion deterioration in 1984-85 fiscal outlook since Budget FSBR:

- General government receipts up £$\frac{1}{2}$ billion to £137$\frac{1}{2}$ billion.
- General government expenditure up £1$\frac{1}{2}$ billion to £146$\frac{1}{2}$ billion. Reflects less central government underspending than previously expected, new estimates of demand-determined programmes and higher interest payments consequent on increased borrowing in previous years.
- Note how small changes have been in relation to big flows on both sides of account. Present assessment subject to error (average error from previous forecasts is £5 billion on autumn forecasts of PSBR for following financial year).

V PUBLIC EXPENDITURE AND MANPOWER (see briefs E1, E2)

(i) Public Expenditure (£ billion)

	1983-84	1984-85
Planning total (cash)	119.8	126.4
Cost terms	114.1	114.6
(percentage of GDP)	(42 ½)	(42)

Points to make

(a) Spending in 1984-85 and 1985-86 to be held to planned figures in last PEWP (Cmnd 8789); and for 1986-87 to about same level in real terms; ie keeping to totals on which Election was fought.

(b) Intend to maintain firm control of public spending.

(c) Capital expenditure. Too early to give figures: no current/capital breakdown by programme will be available until PEWP.

(d) RPI implications of economic pricing policy for energy are small and have been taken fully into account in Industry Act Forecast (see brief F3). ~~[Other public spending decisions have not implications for RPI.]~~

(ii) Manpower

	1984	1985	1986	1987	1988
Target (thou)	630	608	605	601	593

NB Figures will be published in a written PQ reply on 17 November and not given in the Statement itself.

Points to make

(a) 14 per cent reduction in Civil Service will be achieved by April 1984. Total will then be 630,000, down from 732,000 in 1979. Have already achieved smallest Civil Service since WWII.

(b) Programme 1984-88 will be further reduction of 6 per cent taking numbers down from 630,000 to 593,000.

(c) During 1984-85 numbers will be reduced by 22,000 (3.5 per cent); of this 18,500 is because of change of status of Royal Ordnance Factories to Companies Act Company.

(d) Manpower figures for later years take into account spending plans to 1986-87, which will be published in the PEWP, once finalised.

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A1 Cont.

VI NATIONAL INSURANCE CONTRIBUTIONS AND NATIONAL INSURANCE SURCHARGE (see briefs D1, D2)

(i) NIC

	1983-84	1984-85
Lower earnings limit £ per week	32.50	34
Upper earnings limit £ per week	235	250
Treasury Supplement	13%	11%
Class I standard rates of contribution:		
employee	9%	9%
employer	10.45%	10.45%

Points to make

(a) No increase in contribution rates for employees or employers.

(b) LEL being increased, as required by statute, in line with pension uprating.

(c) UEL rising broadly in line with earnings. Right that contributions should rise so that better off contribute appropriately to growing benefit expenditure.

(d) UEL remains within statutory boundary of between 6½ and 7½ times LEL ~~(and in fact UEL ratio falls from 7.35 to 7.25 times the LEL)~~.

(e) No deficit on Fund, no need to raise contribution rates.

(f) (if pressed). Increase in UEL will raise subsequent entitlements to pensions ~~and benefits.~~

(g) Reduction in Treasury Supplement stabilises projected balance in the Fund, which would otherwise rise. Helps to contain shift to taxpayer of overall burden of benefit expenditure. (Non-contributory benefits, financed by taxpayers and not through Fund, have been growing fast.)

(ii) NIS

Since 1982 Government has reduced NIS rate from 3½ per cent to 1 per cent (worth about £2 billion a year to private sector). Would like to go further, but not prepared to take risks on borrowing, with the implications of that for interest rates. (Increase in UEL leads to small (£10 million) increase in NIS payments. Regrettable but unavoidable.)

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A1 Cont.

VII IMPLICATIONS FOR BUSINESS (see also D1, D2, F3)

Points to make

(a) Changes in limits within which NIC and NIS are paid in 1984-85 will raise private sector employers' liabilities by only some £90 million. This minor change and should be compared with the way in which NIS has been cut and business largely protected from NIC increases in recent years.

(b) NIS payments by private sector now running £2 billion a year lower as a result of previous cuts in rate. Since 1979 employee NIC has risen by 2½ percentage points, whereas employer NIC has risen by only 0.45 percentage points.

(c) 1984-85 payments of NIC by employers are projected to rise, by some £620 million, reflecting assumed increase in earnings. But this is in effect only "indexation" of employer payments. Total contribution from employees also goes up as earnings increase.

(d) Government intends to stick to Medium Term Financial Strategy for reduction of public borrowing and progressive restraint of monetary growth. Offers best prospect for continuing reduction of inflation, increasing profits and sustainable increase in output and employment.

(e) Looking ahead to 1984, economic prospects for industry are encouraging. Increase in exports and home demand expected to sustain recent increase in profits and lead to 3 per cent increase in GDP over 1983. This follows expected 3 per cent increase in GDP 1983 over 1982. Investment expected to increase, with total fixed investment (economy-wide) rising 4 per cent.

(f) Nationalised energy industries will keep to "economic pricing". No "tax" on industry arises from decisions on 1984-85 EFLs.

VII IMPLICATIONS FOR PERSONS

Points to make

(a) Living standards and tax burden will depend on progress of the economic recovery and tax decisions in 1984 Budget. Most employees unaffected by the NIC changes.

(b) Increase in NIC payments (through higher UEL) only affects on those on high earnings (over £12,00 per year). Reasonable that those in work should support those not. Maximum increase in NIC payments is £1.35 per week.

(c) Public spending decisions, affect different groups in different ways. Not possible to standardise for "average effect."

Contact Point: D Norgrove (CU) 233-8737

A2 AUTUMN STATEMENT IN RELATION TO THE BUDGET

1. **General**

(i) The Autumn Statement this year again brings together a number of announcements which fall to be made in the autumn. It is not an occasion for a general restatement or updating of the economic strategy, which is primarily for the Budget. But it does allow the public spending plans for the year ahead to be set in the context of a fresh economic forecast.

(ii) The 1983-84 borrowing figures and the fiscal prospect for 1984-85 are likely this year to attract particular attention. However the large margin of error and the limited role of the Autumn Statement in relation to the Budget need to be kept in mind.

(iii) Monetary developments are discussed in Brief C2.

2. **1983-84 PSBR**

1983 Budget forecast	£8 billion (2¾% GDP)
1983 AS forecast	£10 billion (3¼% GDP)

Reasons for change in the forecast

Higher expenditure, despite July 7 measures, arising from lower than expected shortfall and higher service of the national debt, as well as more overspending by LAs. Receipts slightly down (higher North Sea receipts being offset by lower customs taxes, LA rates, etc).

Line to take

(i) The forecast PSBR is higher than we would have liked, though the July 7 measures will have helped to reduce it.

(ii) As always, there is a wide margin of error around the PSBR forecasts, and the eventual outturn could well be different from the figure being published.

(iii) The higher forecast reflects in part some of the same factors that accounted for the late surge in last year's public expenditure - ie reduced shortfall on central government programmes and higher borrowing by local authorities.

(iv) Although the PSBR is forecast to be higher than originally expected, growth in the monetary target aggregates has moderated since earlier in the year. Other indicators suggest monetary conditions consistent with policy. [See brief C2 on monetary conditions.]

(v) The important thing is to keep the trend of borrowing moving down over a period of years; that matters more than the outturn for any individual year.

(vi) Note continuing progress on inflation (12 month rate now about 5 per cent, compared with 7 per cent a year ago) and interest rates (bank base rates down 2 points this year). Government maintaining firm financial policies and objectives of progressive reduction of public borrowing over medium term.

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A2 Cont.

3. <u>1984-85 PSBR</u>

Forecast incorporates the assumption in the 1983 MTFS of a PSBR next year of £8 billion or 2½ per cent GDP. At the time of the Budget this was expected to allow a positive fiscal adjustment of £½ billion. It is now expected to require a negative fiscal adjustment - net increase in tax in real terms - of £½ billion. (Figures already take into account 5 per cent revalorisation of personal allowances and specific duties.)

<u>Reasons for change in the forecast</u>

Much the same as in 1983-84. Higher expenditure due to lower estimate of underspending, higher interest payments (itself in part a reflection of higher than forecast levels of borrowing in 1982-83 and 1983-84). Receipts in total little changed (higher N Sea taxes; lower customs taxes + LA rates).

<u>Line to take</u>

(i) Much too early to say what 1984 Budget will contain, but will need to look at AS alongside Budget measures in assessing fiscal position for 1984-85.

(ii) Prospects for borrowing, and hence size and direction of implied fiscal adjustment, affected by uncertainties on both sides of account. Present forecast suggests that net reduction in the tax burden next year now less likely, and that some increase may be necessary. <u>But</u>

(iii) Note that even though the forecast already includes the small real terms increase in taxes to bring PSBR projection back to the MTFS path, it still shows a continuing healthy recovery (GDP up about 3 per cent in both 1983-84 and 1984-85) so there is no question of knocking the recovery on the head.

(iv) It is much too early to conclude that taxes will need to rise next year; forecasts can change substantially.

(v) Decisions to be taken - including the MTFS path and the tax decisions - are for the Budget; no point in trying to anticipate them now.

(vi) Important not to see the AS and 1984-85 in isolation, but set in the context of the MTFS, which is designed to reduce inflation and create conditions for sustainable growth of output and employment.

<u>Contact Point:</u> D Norgrove (CU) 233-8737

B1 RECENT DEVELOPMENTS IN UK ECONOMY

Factual

(i) Monetary developments, policy (Brief C2); PSBR (Brief C1); World developments (Brief B2).

(ii) Inflationary pressures remain subdued. Retail price inflation (5 per cent Oct) slightly above Major 6 OECD average (4.5, September) but a little below EC average (7¼, August).

UK, year on year percentage changes.

	1980 on 1979	1983 Q1	1983 Q2	1983 Latest Month	
Underlying whole economy average earnings	21	8	7½	7¾	(Sept)
Unit wage costs) whole economy	20.9	3.5	2.5		
) manufacturing	21.5	2.7	3.4	2.8	(3 mths) (to Sept)
Producer output prices	14	5.3	5.6	5.5	(Oct)
RPI	18	4.9	3.8	5	(Oct)

(iii) Basic wage settlements on downward path; average earnings still rising in real terms. In manufacturing, output per head up by around 20 per cent since end 1980, unit wage costs rose only 2½ per cent between 1982 Q3 and 1983 Q3 cost competitiveness improved over 20 per cent between 1981Q1 and 1983Q2 (NB. mostly because sterling fell).

(iv) Profits and finances of companies improved since last year. ICC profits (oil and non-oil) up 25 per cent between 1982 H1 to 1983 H1, after similar rise 1981H1 to 1982H1 (from very low base). ICC's pre-tax real rate of return (excluding North Sea) 4½ per cent in 1982 (4 per cent in 1981); rate for manufacturing 3½ per cent in 1981 and 1982. Over year to mid 1983 ICC's ran financial surplus of over £5 billion, reflecting stock run down in 1982H2 and increase in profits. Net borrowing requirement fallen sharply. ICC's have cut back bank borrowing, increased equity issues and overseas borrowing.

(v) Recovery since 1981 H1 trough has been dominated so far by consumers' expenditure (lower inflation, lower savings ratio, HP relaxations), and stock turnround.

Percentage contributions to growth 1981 H1 to 1983 H1.

Consumers Expenditure	+	Public Consumption	+	Invest-ment	+	Stocks	+	Net Trade	=	GDP(E) growth
+2.5		+1.0		+1.1		+2.7		-2.1		+5.2

Consumers' expenditure up further ½ per cent in Q3. Retail sales three months to October (prov) up 1½ per cent on previous three months and 5½ per cent up on year earlier. Total investment up 7 per cent since 1981 H1. Manufacturing investment increased 2 per cent in Q3. Destocking by manufacturing, distributors in Q3 still provisional, partly associated with high car sales in August.

(vi) Output (GDP(A)) up around 5 per cent from 1981H1 to 1983H1. Growth in UK (GDP(A)) faster than average of major 6 overseas economies 1982H1 to 1983H1. Output of production industries up 2 per cent Q3 on Q2. Most sectors of manufacturing recovered since 1981 Q1, but none yet back to previous peaks. Oil/gas extraction up 32 per cent between 1981 Q1 and 1983 Q3. Construction output remains below 1981 trough. Service sector output less affected by recession, now above previous peak.

(vii) UK current account in estimated surplus of £½ billion in first 9 months of 1983 (cf FSBR forecast £1½ billion for whole year).

(viii) Labour market responding to continued recovery. Service sector employment up over 140,000 in 1983 H1, more than fall in manufacturing employment. Employed labour force rose in 1983 Q2, first time for four years. Adult unemployment (s.a.) fell 10,000 in October to 2.941 million (12.3 per cent). Underlying trend may be levelling out. Vacancies risen steadily since mid-1981; short time working less than a quarter of level two years ago.

(ix) October quarterly CBI Survey of manufacturing showed continued increase in business confidence, expectation of increased output with little upward pressure on prices. Investment expected to increase 5 per cent during 1984.

(x) CSO cyclical indicators (to September) point to continued recovery into 1984 [NB. New figures released 18 November; given uncertainties, best not to stress existing figures].

Positive

(i) Inflation now below EC average, but still well above Germany (2.6 per cent) and Japan (0.7 per cent) who are important competitors.

(ii) Recovery firmly underway; on latest CSO figures (11 November) GDP(A) growing 2½ per cent a year since 1981H1.

(iii) GDP growth over year to 1983 H1 faster than average of major six overseas economies.

(iv) Labour market conditions improving; service sector employment rising, vacancies up, underlying unemployment may be levelling out.

Defensive

(i) Recovery faltering, too narrowly based?

Pace of recovery consistent; GDP(A) up 2½-3 per cent in year to 1983 H1, after 2 per cent rise in previous year. Quite usual for consumers' expenditure to take leading role in early stages of recovery. Indications are that increasingly broad based recovery will continue - CBI see 5 per cent increase in manufacturing investment in 1984. Institute of Directors see recovery 'firmly in progress'.

(ii) But why isn't unemployment falling?

Unemployment always responds to activity with a lag. Underlying adult unemployment may be levelling out. Employment has increased in many industries (service sector + 144,000 in 1983 H1), and vacancies have risen steadily since mid-1981.

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(iii) Government should act to strengthen, sustain recovery?

Under powerful influences of lower inflation, lower interest rates signs are that recovery will continue into 1984. No shortage of demand. Government will maintain firm monetary, fiscal policies - only viable policy for sustainable non-inflationary growth, and will encourage efficiency and enterprise.

(iv) Follow US example and reflate?

If US recovery to prove durable and not to be dissipated in rising inflation and interest rates, US budget deficit will need to be curbed. US Administration committed to achieving that.

Contact point: A Smith (EB) 233-8661

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B2 RECENT DEVELOPMENTS IN THE WORLD ECONOMY

Factual

(i) World trade and output fell last year. Output rose in all major economies in first half 1983. US GNP is estimated to have risen about $4\frac{3}{4}$ per cent since end 1982 but growth slowed slightly in the third quarter. Recovery in continental Europe more subdued.

(ii) Recovery forecast to continue in 1984. IAF forecasts stronger growth next year, sees world trade and UK markets continuing to recover. Overall GNP in 6 major industrial economies expected to rise $3\frac{1}{2}$ per cent, following $2\frac{1}{2}$ per cent this year.

(iii) Unemployment in major European countries has stabilised recently; it continues to fall in North America. For 1984 OECD expect unemployment in US to continue to fall, but further though slower rise in Europe.

(iv) Consumer price inflation in major countries declined from 12 per cent in 1980 to about 4 per cent in year to September. Depressed demand led to lower oil prices earlier this year. Non-oil commodity prices have risen from their low point late in 1982. Inflation may pick up slightly through next year but no rapid acceleration expected.

(v) Reduction in short-term interest rates in US last year followed by other countries though to lesser extent. US interest rates rose in summer as Fed tightened policy, reaching nearly 10 per cent in August. Since then interest rates have eased back slightly. Rates in Japan also fallen recently, but rates in Germany have risen.

(vi) Exchange rates remain volatile. Dollar strengthened until August reaching new highs against European currencies. It then weakened slightly, particularly against the DM and yen, but has strengthened again most recently. Large emerging US trade deficit could put further downward pressure on dollar. Japan's trade surplus and recent US/Japan accord could help strengthen yen.

(vii) Monetary policy complicated by distortions/shifts in velocity. US Fed tightened policy mid year to curb rapid monetary growth. All aggregates now back within target (rebased for M1 and M2). In Europe monetary growth is still towards the top or above target range.

(viii) General government budget deficits forecast by OECD in July to rise to $4\frac{1}{2}$ per cent of GDP this year from $2\frac{1}{2}$ per cent in 1981, partly reflecting low level of activity in major countries and expansionary policies in US, and then fall slightly in 1984. Policy directed towards reducing structural budget deficits in Europe and Japan but not so far in US.

(ix) OECD estimated in July that about half of its members have decided to cut planned expenditure. Many also planning to increase taxes, contributions and charges.

Positive

(i) World recovery now underway helped by lower inflation and interest rates. Firm fiscal and monetary responses to second oil price rise vindicated. As a result prospects for sustainable growth now better than for many years.

(ii) Widespread agreement among forecasters that world recovery will gather momentum next year as growth in Europe and Japan picks up. Inflation is likely to remain moderate.

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(iii) Major countries agreed (cf Williamsburg Summit, IMF Interim Committee) on need to maintain counter inflationary policies while reducing growth in public expenditure and curbing budget deficits.

(iv) European Commission's Annual Economic Report shows UK coming out of recession earlier than rest of Community. Forecasts that in 1983 and 1984 UK will be fastest growing EC economy.

Defensive

(i) Tight policies to blame for recession? No. Failure of wages to adjust to tighter policy stance prime cause of profit squeeze, and fall in output and jobs. UK problems move entreached.

(ii) Interest rates too high? Further progress against inflation and lower budget deficits best way to achieve realistic and sustainable reduction in interest rates.

(iii) Fiscal policies ignore recession? Important to reduce medium term structural deficits but should take account of recession in setting pace.

(iv) UK spends less on social security/benefits higher than elsewhere in EC? Many EC countries have greater per capita GDP than UK. Different governments, different priorities.

(v) Inflation will accelerate as activity recovers? Provided major industrialised nations remain firmly committed to prudent economic policies, no reason to expect inflation to accelerate.

(vi) US recovery slowing down? US economy has recovered very strongly this year. Natural that pace of upswing should slow over next few months but recovery expected to continue.

(vii) Rapid US recovery result of bigger budget deficit? Increase in US deficit may have temporary effect on US activity, but recovery also reflects fall in inflation and lower interest rates. Disappointed that Administration and Congress so far failed to agree on ways to reduce budget deficit. If heartening recovery to prove durable and not be dissipated in rising inflation, interest rates, deficit will need to be curbed. US Administration committed to that.

(viii) Gloomy European prospects? European growth expected to be slower than in US or Japan. European prospects best (UK and Germany) where greatest progress has been achieved against inflation and budget deficits.

(ix) Japanese reflation? Different conditions from UK. Inflation very low, savings high.

(x) Excessive exchange rate volatility/US dollar? Market determines exchange rates. Right that major countries should take account of exchange rate in setting policy.

(xi) Debt crisis? Serious problems persist and further difficulties cannot be ruled out. Renewed growth, firm adjustment and adequate finance all necessary to solve debt difficulties. Recent pick up in commodity prices and emerging recovery in OECD will help improve prospects.

(xii) IMF quota increase? UK among first to ratify quota increase. By mid-November over 70 countries representing about 4.0 per cent of quotas had ratified. Concerned that Congress not yet agreed to ratify increase in US's quota but President has pledged his support.

(xiii) Need for international monetary reform? Welcome decision by industrial countries' finance ministers to carry out further work to identify where improvements in international monetary system might be sought. Must recognise, however, that inflationary policies led to breakdown of original Bretton Woods arrangements. Prudent policies offer best prospects for stable and durable system.

Contact Point: S King (EF2) 233 5761

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B3 INDUSTRY ACT FORECAST - SHORT TERM ECONOMIC PROSPECTS

Factual

(i) The Industry Act Forecast shows projections of GDP, manufacturing output, prices and the current account for the whole of 1984. It thus updates the FSBR forecast and extends it by a half-year. Attached table summarises latest forecast.

(ii) Main features of forecast.

(a) Underlying inflation likely to remain on downward path: year on year increase in RPI forecast at 5 per cent at end-1983 and 4½ per cent at end-1984. (IAF suggests temporary rise in first half 1984 as in assumption given to Government Actuary for year to May 1984 of 5½ per cent.)

(b) Total output expected to grow around 3 per cent 1984 on 1983. This follows expected 3 per cent rise 1983 on 1982, which is somewhat faster than envisaged at Budget time. [FSBR said 2 per cent 1983 on 1982.]

(c) Manufacturing output also forecast to rise by nearly 3 per cent in 1984.

(d) With prices tending to rise faster than costs, profitability expected to improve.

(e) Exports forecast to increase 4 per cent 1984, compared with ½ per cent 1983. Imports projected to grow 5 per cent in each year. Current account of balance of payments to show small surplus, £½ billion, in 1983 and to be in balance in 1984.

(f) All components of expenditure rise in 1983: growth in consumers expenditure particularly strong, 3½ per cent. Balance of demand expected to change in 1984. Consumers expenditure to rise at slower rate (2½ per cent) while exports (4 per cent) and fixed investment (4 per cent) expected to rise faster, ie recovery expected to become more broadly based. Total domestic demand to rise 3 per cent in 1984.

(g) PSBR for 1983-84 now expected to be around £10 billion, 3¼ per cent of GDP (see brief C1). For 1984-85, PSBR and monetary policy consistent with indications of MTFS.

(h) GDP in major 6 OECD countries expected to grow by 2½ per cent in 1983 and 3½ per cent in 1984. This follows a ½ per cent fall in 1982.

(i) World trade in manufactures (UK weighted) estimated to have fallen 3 per cent in 1982 and 1 per cent in 1983. Forecast to increase by 5 per cent in 1984.

(j) IAF does not provide explicit forecasts of pay or unemployment but mentions general factors in text (see Defensive (i) and (iv) below).

(k) the IAF assumes effective exchange rate to vary little from the average of the first three quarters of 1983.

(iii) IAF foresees faster growth (3 per cent) in 1983 than Budget FSBR forecast (2 per cent). Inflation at end-1983 now likely to be lower (at 5 per cent) than predicted in FSBR (6 per cent).

(iv) Summary of outside forecasters' views shown in Brief B4.

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Positive

(i) Total output in 1983 put at 3 per cent above 1982 level. Similar increase now foreseen for 1984.

(ii) Performance on inflation again seen to be better than previous forecast. And inflation expected to be reduced further by end-1984.

(iii) Given fall in world trade, exports did relatively well in 1982. Although export performance was less good in 1983, forecast to rise by 4 per cent in 1984.

(iv) Higher exports and increased investment (4 per cent increase forecast for 1984) will make recovery more broadly-based.

Defensive

(i) Outlook for unemployment bleak? Following practice of all previous governments no forecast of unemployment given but IAF test says "unemployment may be levelling off" and "forecast is for employment to rise". Working assumptions to 1984-85 given to Government Actuary. Assumptions for later years will be in PEWP.

Underlying rise in unemployment average of 9,000 a month in 6 months to October, compared with 28,000 a month in preceding 6 months. Fall in employment appears to be coming to an end (making allowance for self-employed, total employed labour force estimated to have risen 18,000 in Q2 1983). Together with recent monthly movements in unemployment, vacancies and hours worked, this suggests unemployment may now be levelling off.

(ii) Manufacturing sector still weak. Manufacturing output has recovered more slowly than total output though now 2½ per cent higher than at trough in early 1981. But with healthy growth in demand in prospect manufacturing production expected to rise at least at same rate as rest of the economy in 1984.

(iii) Total output still below peak levels in second quarter of 1979. Total GDP rather erratic in first two quarters of 1983. But average measure of GDP in first half of 1983 now higher than in first half of 1979. Since trough of recession (first half 1981) output has grown by 2½ per cent a year on latest CSO revised figures (see vii).

(iv) Earnings growth to rise again. IAF text suggests for next year "there should not be a reversal of the downward trend of earnings growth".

(v) Further 2½ per cent growth of consumers' expenditure in 1984 unrealistic. Is perfectly realistic. Real incomes of those in work will be rising. And saving ratio still coming down as inflationary expectations recede.

(vi) CBI business optimism deteriorating. Business optimism rose in October (if not as much as in July). Other CBI indicators also point to higher confidence about future. In October Quarterly Survey output and demand expectations rose further and investment intentions point to 5 per cent increase in manufacturing investment in 1984.

(vii) CSO downward revisions to GDP figures for first half 1983 (announced 11 November) were taken fully into account in this forecast. They affect the first half year only and 1983 as a whole expected to show growth of about 3 per cent.

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(viii) Misleading to use GDP "average" measure, GDP "output" measures more reliable. No. Although output measure generally preferred as a guide to quarter by quarter movements, average measure usually more reliable for longer periods of a year or so, with which IAF is concerned.

(ix) Real interest rates too high - will choke of recovery. Worldwide, real interest rates are too high - as Chancellor said at Mansion House. But in our economy we nevertheless expect 3 per cent growth in 1984, reflecting rising exports and final home demand together with improving company sector finances and low inflation.

(x) Resumption of heavy destocking in third quarter 1983. [Provisional figures for Q3, to be published on Thursday 17 November, show destocking of £400 million (1980 prices) by manufacturers and £270 million by distributors. Manuacturers destocking was mainly of cars and of materials and fuel.] Third quarter stockbuilding figures were taken fully into account in forecast. The figures include substantial destocking of cars, a natural consequence of very high car sales in August. Quarterly movements in stocks are frequently erratic. Other indicators, notably the healthy financial surplus of Industrial and Commercial companies recorded for the first half of 1983 and recent CBI Surveys, continue to suggest little pressure on firms for further substantial reductions in stock levels.

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The Prospects: summary

Table 1.10 presents a summary of the economic prospects.

Table 1.10 Economic Prospects(1)

		Percentage changes		
		1982 to 1983	1983 to 1984	Average errors(2) from past forecasts
A	Output and expenditure at constant 1980 prices			
	Gross domestic product (at factor cost)	3	3	1
	Consumers' expenditure	3½	2½	1
	General government current expenditure	2½	1	1½
	Fixed investment	2½	4	2½
	Exports of goods and services	½	4	3
	Change in rate of stock-building as a percentage of the level of GDP	1	½	1
	Imports of goods and services	5	5	3
		1983	1984	
B	Balance of payments on current account (£ billion)	½	0	3
C	Retail prices index (4th quarter)	5	4½	3(3)

(1) The forecast includes the effect of the fiscal adjustment in 1984–85.

(2) The errors relate to the average differences (on either side of the central figure) between forecast and outturn. The method of calculating these errors has been explained in earlier publications on Government forecasts, notably in the Economic Progress Report, June 1981. The errors are after adjustment for the effects of major changes in fiscal policy, where excluded from the forecast.

(3) The average error for inflation was calculated from a period of much higher inflation and probably overstates the margin of error at low rates of inflation.

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B4 OUTSIDE FORECASTS (see summary table attached)

1. WORLD ECONOMY

(i) Economic recovery continues in the OECD area bolstered by strong GNP growth in USA. Real GNP growth (OECD) rises from 2-2¼ per cent this year to 3-3½ per cent in 1984 (despite uncertainties over US deficit, international debt problems).

(ii) World trade outlook for 1984 more encouraging; after little or no growth this year, is expected to show some growth in 1984. Forecasts for 1984 vary: P&D expect 2¼ per cent growth (reflecting little or no contribution from non-oil LDC's and OPEC to world trade). Others such as NIESR and LBS expect stronger growth of 4-4½ per cent in 1984, reflecting higher OECD activity rates.

(iii) World consumer price inflation rises gradually from 5-5½ per cent this year to 6½-7 per cent next year (rise in non-oil commodity prices partially offset by low increases in unit labour costs).

2. FINANCIAL CONDITIONS

(i) Monetary and fiscal policies assumed to remain in line with MTFS guidelines although some groups point to danger of upward pressure on public expenditure.

(ii) Some expect 1983-84 PSBR of £9-9½ billion though decreasing to £8-8½ billion for 1984-85 (reflecting, in part, increase in public sector asset sales).

(iii) Many forecasters expect recent more moderate growth in the main monetary aggregates - £M3, M1 and PSL2 - will continue, bringing 1983-84 outturn close to top end of 7-11 per cent target range.

(iv) Most see gradual downturn in short-term interest rates from 9½ per cent to about 8½ per cent in 1984.

(v) Effective exchange rate lies between 83 and 85 by end of year, depreciating to 79-81 end-1984 (reflecting worsening current account).

(vi) Concern about public spending affects judgements on 1984 Budget, with some groups expecting little or no scope for tax cuts, apart from indexation of income tax allowances and specific duties.

3. INFLATION AND AVERAGE EARNINGS

(i) Retail price inflation rises gradually from 5½ per cent (1983 Q4) to 6¾ per cent by 1983 Q4. Some groups (LBS, Phillips and Drew) see inflation peaking early next year and slowing slightly thereafter. However LBS forecast inflation to accelerate to 7½ per cent in 1987, reflecting forecast pick-up in world inflation. Import prices may rise slightly next year, reflecting increases in commodity prices, but expected to remain low in relation to domestic costs.

(ii) Earnings expected to rise 7-8 per cent in 1983-84 payround, a little more than in 1982-83, partly reflecting higher price inflation and improving company profitability.

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4. COMPANY SECTOR FINANCE

Further growth (about 15 per cent) in ICC's profits expected 1984, reflecting higher level of activity. Improvement in profit margins also expected to continue, reflecting low unit labour costs and modest increases in raw material and fuel prices.

5. OUTPUT

GDP growth put in range $1\frac{3}{4}$-$2\frac{1}{2}$ per cent for 1983 and 1984 though some groups expect recovery to weaken a little in 1984, mainly reflecting slowdown in consumption.

6. DEMAND

(i) General agreement that consumer spending will rise less strongly during 1984. Real disposable incomes unlikely to change much. Rising inflation and higher level of consumer indebtedness suggest that further significant reductions in the savings ratio, a major contribution to recent growth in consumer spending, are unlikely.

(ii) Pattern of domestic demand is expected to change as growth of consumer spending weakens. Restocking continues (though contributing less to GDP growth in 1984 than in 1983) and fixed investment, particularly private sector investment, picks up.

7. OVERSEAS TRADE

(i) Most groups expect export volumes to grow $3\frac{1}{2}$-4 per cent in 1984, reflecting quicker pace of world recovery. Import volumes are seen as rising more slowly in 1984 than in 1983 (3-4 and $5\frac{1}{2}$-6 per cent), partly reflecting the weaker contribution of stockbuilding and consumer spending to recovery in domestic demand.

(ii) Balance of payments current account is generally expected to show a surplus of £$\frac{1}{2}$-1 billion this year. Views about 1984 differ - some (S&C) see current account improving, reflecting effect of gains in competitiveness on UK exports. Others (P&D) see deterioration in current account in 1984, reflecting a worsening in terms of trade.

9. UNEMPLOYMENT

Some groups (LBS, P&D) expect unemployment to peak early next year and decline slowly thereafter. Others see a continually rising trend. In medium term LBS expect 2.8 million 1987 while Cambridge expect 4.4 million 1990.

Positive

(1) Most major groups expect inflationary pressures to remain subdued next year.

(2) Current account generally remains in surplus next year.

(3) Interest rates expected to be $\frac{1}{2}$-1 per cent lower next year.

(4) More groups expect the MTFS guidelines to be ahered to. Growth of the main monetary aggregates is expected to remain within 7-11 per cent target range.

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Defensive

(i) Growth peters out next year? Many forecasts have yet to take on board the effects of rebasing the National Income statistics to 1980, which shows the recovery to have been stronger than previously thought. LBS expect sustained recovery of 2-2½ per cent in 1984 and 1985. Exports and private investment provide stimulus to growth in 1984.

(ii) Unemployment to increase? Unemployment forecasts subject to wide margins of error and uncertainty. No government has made forecasts. Most outside assessments expect slower rate of increase in 1984 while some expect a gradual fall.

(iii) Inflation set to accelerate? No. Most groups expect only a gradual rise, remaining under 7 per cent in 1984.

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SUMMARY OF OUTSIDE FORECASTS OF KEY INDICATORS

GDP (output)

(percentage change on year earlier)

	Consensus	Range	
1983	2.1	1.8 (LBS, CBI) -	2.4 (Simon & Coates)
1984	1.9	1.7 (NIESR) -	2.4 (LBS)

Note: On the expenditure measure of GDP, Liverpool are at to top end of the range in both years with 3½ per cent in 1983 and 3¼ per cent in 1984.

Retail Price Inflation

(Percentage change on year earlier)

	Consensus	Range	
1983 Q4	5.5	5.4 (Phillips & Drew, Henley) -	5.8 (Simon & Coates)
1984 Q4	6.7	6.3 (Phillips & Drew) -	7.5 (NIESR)

Unemployment

(UK adults, sa, millions)

	Consensus	Range	
1983 Q4	3.05	3.0 (Phillips & Drew) -	3.1 (LBS)
1984 Q4	3.12	3.0 (Phillips & Drew) -	3.2 (NIESR, CBI)

Note: Cambridge expect 3.5 million in 1984, but this figure is a yearly average, includes school leavers, and is on the old basis. At the bottom end of the range for 1984 Liverpool expect average of 2.7 million.

PSBR (£ billion)

	Consensus	Range	
1983-84	8.8	7.0 (Liverpool) -	10.0 (Henley)
1984-85	8.7	2.5 (Liverpool) -	10.5 (Henley)

C1 PSBR 1983-84 and 1984-85

Factual

(i) PSBR for 1983-84: outturn in first half of financial year £7 billion (£4¾ billion seasonally adjusted). This is somewhat higher than PSBR for the same period last year: £4½ billion (3¼ seasonally adjusted).

(ii) October PSBR was published on 16 November giving a cumulative PSBR of £7.1 billion for the first seven months of 1983-84.

(iii) PSBR for 1983-84 as a whole now expected to be around £10 billion, 3¼ per cent of GDP, some £2 billion higher than the Budget forecast.

(iv) 1983-84 forecast takes account of measures announced by the Chancellor on 7 July as well as other developments since Budget FSBR. Estimates of both expenditure and revenue have changed. Many factors involved, working in both directions. On central government main ones are higher supply expenditure and interest on extra borrowing incurred in 1982-83 and to date in 1983-84. Higher LABR due mainly to overspending on current account and lower than expected rate income.

[NOTE ON 1983-84 PUBLIC EXPENDITURE PLANNING TOTAL FORECAST OUTTURN: The FSBR put the 1983-84 public spending plans at £120.5 billion inclusive of the contingency reserve. After a shortfall allowance of £1.2 billion the estimated outturn was published as £119.3 billion. The AS plans for 1983-84 are lower, at £119.8 billion. But, because of longfall of £0.5 billion now expected, the estimated outturn is up at £120.3 billion. This is still within the plans implicit at Budget time. - THESE PRECISE DETAILS NOT TO BE REVEALED. Chancellor may well reveal £120.3 billion in rounded terms in the House. See E1 Defensive (iii).]

(v) PSBR for 1984-85 £8 billion, 2½ per cent of GDP. This is after fiscal adjustment of -£½ billion. Fiscal position has thus deteriorated by some £1 billion since Budget.

(vi) A small upward revision to projected 1984-85 receipts (£½ billion) is more than offset by a £1½ billion upward revision to general government expenditure. This is partly due to extra debt interest payments on higher borrowing in 1982-83 and 1983-84 but mainly lower shortfall and higher spending by local authorities.

(vii) PSBR percentages:

	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85
PSBR as per cent of GDP	4¾	5¾	3½	3¼	3¼	2½

Positive

Government borrowing amongst lowest in industrialised world. Essential to continue progress in getting borrowing down within MTFS framework if interest rates to be reduced further.

Defensive

(i) 1983-84 PSBR out of control?

No, but wide margins of error around PSBR forecasts (average error, from past forecasts is £4-5 billion for year ahead at Budget time). So outturns can differ substantially from plans in short run. Spending and borrowing do seem to be running higher than expected in Budget but have taken steps to bring spending back closer to planned path.

(ii) Why has 1983-84 PSBR forecast increased so much since Budget?

Higher than expected receipts from North Sea taxes have been offset by lower tax receipts elsewhere. Lower than expected underspend of central government expenditure plans in 1982-83 has continued into 1983-84, so total expenditure now expected to be higher. Main increases are on supply expenditure, higher service of the national debt. Local authority budgets indicate that higher local authority borrowing due mainly to current spending above forecast and rate income less than expected.

(iii) Government massaged Budget calculations?

Certainly not. FSBR "latest estimates" for 1982-83 and forecasts for 1983-84 were based on all information available at the time. PSBR, and the public sector transactions underlying it, are notoriously difficult to forecast (average error of previous forecasts is £4-5 billion for year ahead at Budget time).

(iv) 7 July measures not enough to get PSBR back on track?

7 July measures intended to bring spending back closer to the planned path and they have done that. Given margins of error in forecasting the PSBR, it would have been most unwise to do more. The PSBR figure is not a short-run target but a forecast based on information available at the time.

(v) 1984-85 PSBR

Autumn Statement shows a PSBR for 1984-85 of £8 billion, as provided in the MTFS. PSBR for next year will be considered again in the Budget.

(vi) Why has fiscal prospect for 1984-85 deteriorated since Budget?

1984-85 expenditure now forecast to be higher than thought at the time of the Budget because of higher debt interest payments and lower estimate of aggregate shortfall on planned expenditure. Receipts generally are only slightly higher than expected despite much higher receipts from North Sea taxes.

Contact Points:

Mr P Stibbard (GEP3)	233-8633	
Mr I Webb (GEP3)	233-7879	
Mr P Patterson (EA1)	233-3483	- particularly re 1984-85

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C2 MONETARY AND EXCHANGE RATE DEVELOPMENTS

Factual

(i) Target aggregates, M1, £M3 and PSL2, were within 1982-83 range. Growth accelerated at the beginning of the new target period, but in the last few months there has been a marked slowdown in most measures of money. £M3 is now back within the target range.

% change, seasonally adjusted

Monetary growth to mid October 1983 growth at an annual rate over past:	Target aggregates M1	£M3	PSL2	Mo
3 months	+9.1	+4.7	+8.2	+7.4
8 months (target period)	+12.7	+10.8	+13.1	+6.8
12 months	+11.2	+9.6	+11.9	+6.3

(ii) 1983-84 target range for M1, £M3 and PSL2 is 7-11 per cent.

(iii) UK short-term interest rates have been relatively steady over the year, continuing a gradual decline. Effective exchange rate has also been fairly steady since the election, although there have been larger movements in individual cross rates against DM and $, reflecting movements in those currencies.

	Exchange Rates			Interest Rates		
	£ Effective	£/$	£/DM	UK 3 month interbank	UK 20 year Gilts Yield	3 month Eurodollar
1982 Q4	89.1	1.65	4.13	10.0	10.8	10.0
1983 Q1	80.5	1.53	3.68	11.1	11.3	9.2
Q2	84.3	1.56	3.87	10.2	10.5	9.3
Q3	84.9	1.51	3.99	9.8	10.8	10.0
Oct	83.4	1.50	3.90	9.3	10.6	9.6
Nov 15	84.0	1.48	3.97	9.3	10.2	9.7

(iv) Clearing banks' base rates are now at their lowest level for 5½ years, back to their November 1982 level, and 7 points below October 1981 peak.

May 10 1978	9%
October 1 1981	16%
November 4 1982	9%
January 12 1983	11%
October 4 1983	9%

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(v) Since mid April PSBR has been more than matched by debt sales to non bank private sector, largely as result of exceptionally high sales of gilts.

(vi) Growth in bank lending (especially to companies) has slowed down. (Growth was 14½ per cent to mid-October 1983, compared with 31 per cent in year to mid-October 1982).

(vii) In his 20 October Mansion House speech the Chancellor summarised main points of his recent review of monetary policy:

(a) more attention may be paid to other measures of narrow money - notably Mo - besides M1.

(b) Over the medium term the aim is not to over - or underfund the borrowing requirement.

(c) The exchange rate is still taken into account in interpreting monetary conditions, but there is no target or mechanical formula for it.

Positive

(i) Prompt fiscal action and successful funding have helped to reduce growth of all the main aggregates (see 3 month growth rates); £M3 is now within its target range. Narrow monetary aggregates are growing more slowly (though still a bit faster than they were a year ago).

(ii) Other indicators - the stable exchange rate, falling inflation and inflationary expectations and lower interest rates - support the view that monetary policy is consistent with the Governments' objectives.

(iii) Clearing bank base rates are now at their lowest level for 5½ years, at 9 per cent, 7 points below their last major peak in October 1981.

(iv) High debt sales earlier in the year put us well ahead in funding higher PSBR now expected.

Defensive

A - CHANGES IN MONETARY POLICY

(i) Did Mansion House speech mark big policy shift?

No. Chancellor said he was considering "some changes of emphasis which represent merely a continuing evolution of a well-tried strategy"; changes relate to "technical aspects of operation of monetary policy "only - notably appropriate definition of money. Reference to funding PSBR by "external flows" does not represent any change in HMG's overseas borrowing policy.

(ii) Any change in target aggregates for this year?

No.

(iii) Targets 1984-85. Will be set in Spring. Precise targets will need to take account of structural changes but adjustments will be consistent with maintaining direction of policy. Whichever indicator we choose to emphasise, it is unlikely that it would be appropriate to maintain a single range for both broad and narrow aggregates, since the trend velocity of non-interest-bearing money is quite different from that of

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C2 Cont.

broad money. But there is nothing unusual about different target ranges for different aggregates - there are a number of examples overseas [eg USA].

(iv) Are you moving towards monetary base control?

No. All that is being considered is using the base as an indicator of narrow money.

(v) What's wrong with M1?

Nature of M1 is changing with rapid growth in interest-bearing deposits (many of which are "wholesale" deposits). Now less likely to respond unambiguously to changes in level of interest rates; and less reliable as measure of transactions balances.

(vi) Why so many M's?

No single monetary indicator has ever given complete picture of monetary conditions. Policy decisions have to be taken with an eye to both the growth of liquidity in the economy - as shown by broader measures like £M3 and PSL2 - and to the amount of money immediately available for current transactions -as shown by the narrower aggregates like M1, MO and notes and coin.

(vii) A special exchange rate - monetary growth index?

No. Role of exchange rate in assessing financial conditions remains unchanged, as the Chancellor explained in his Mansion House speech.

(viii) Should be an exchange rate target?

No. As Chancellor explained in Mansion House Speech, exchange rate can move for reasons unconnected with fundamental developments; its signals as to tightness of policy can therefore be misleading. But right to take account of it as one of range of indicators alongside monetary targets.

(ix) Join EMS exchange rate mechanism?

Possibility kept under review, but no early plans to join. Joining in wrong conditions would be damaging to EMS system as well as to domestic policy. As a major international currency, like the DM, sterling especially exposed to currency market pressures: sterling and other EMS currencies continue to be differently influenced by eg events affecting oil markets, and movements in dollar. In wrong conditions, membership would mean swapping exchange rate instability for interest rate instability, and as CBI have recently recognised this would not be helpful to British industry.

B - CURRENT MONETARY SITUATION

(x) Likely outturn for monetary growth in 1983-84?

Too early to judge, but recent month's figures are encouraging. The public sector contribution, which accounted for the rapid growth around the turn of the financial year, has moderated over recent months; and private sector demand for bank credit is growing much more slowly than a year ago.

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C2 Cont.

(xi) Monetary growth out of control?

No. Deceleration of recent months has brought £M3 back within target range along with a slowdown in M1 and PSL2. Rapid growth in M1 not unexpected.

(xii) Growth in real money supply excessive?

The rise in real money is largely the consequence of our success in reducing inflation, not due to laxity in nominal monetary growth. Nothing wrong with this: indeed a faster growth in the real value of money is one of the main mechanisms whereby reducing inflation contributes to economic recovery.

(xiii) Slowdown in monetary growth and bank lending to companies suggests faltering in recovery?

No. Recovery is continuing. All that has happened has been deceleration of monetary growth from very high levels in the Spring, bringing monetary aggregates back towards target range, and, in the case of £M3, within it. Slowdown in bank lending reflects improvement in company sector's financial position.

(xiv) Interest rates still too high? Prospects for further cut in rates?

Base rates now back at their lowest level for 5½ years, and 7 points below their peak in October 1981. October fall in rates welcome, but only reliable way to achieve further falls in interest rates is to stand by strategy set out in MTFS for sound financial conditions, low inflation and low PSBR.

(xv) Real interest rates too high - scope for reduction?

Real interest rates are high whilst the economy adjusts to new low level of inflation - just as real interest rates were negative when inflation was accelerating in the 1970s. Real interest rates in the UK are not unusually high by international standards. Now witnessing some fall in real interest rates in developed countries as inflation is brought firmly under control. Best way to securing further reductions is firm control of public sector borrowing here and abroad.

(xvi) Impact of revised PSBR on interest rates?

Have been able to fund PSBR so far this year without undue pressure on rates. Important thing is to keep trend of borrowing moving down over a period of years. That matters more than outturn for any individual year.

(xvii) Exchange rate too high/uncompetitive?

(See (ix) above). No magic way of influencing exchange rate. A lower nominal exchange rate brought about by monetary and fiscal laxity would benefit no-one. Any temporary gain to cost competitiveness would soon be lost in rising inflation. Prospects for growth and jobs would be diminished not improved. Only way to improve competitiveness, as industry has been doing since 1981, is through sensible wage settlements, further gains in productivity and improvements in non-price aspects of competitiveness.

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(xviii) £ should be lower against DM, higher against $?

Certainly not within HMG's power to bring about lower value of $ against DM.

Contact points: P Wynn Owen (HF3) 233-5871
C D Harrison (EF1) 233-8085 - exchange rate and competitiveness.

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D1 NATIONAL INSURANCE CONTRIBUTIONS (Detailed questions to DHSS)

Factual

(i) No change in Class 1 (employer and employee) contribution rates.

[Note: Between 1975 and 1979 - period of Labour Government - employees contributions rose 1.0 percentage points and employers by 1.5 percentage points. Between 1979 and 1984 - period of Conservative Government - employees contributions rose by 2.5 percentage points and employers by 0.45 points. When account is taken of NIS changes, employers payments will have fallen from 13.5 per cent in 1979-80 to 11.45 per cent in 1984-85 (contracted-in).]

(ii) Lower earnngs limit (LEL), which sets level at which contributions on earnings become payable, to increase from £32.50 to £34.00; in line with uprating of single person basic retirement pension. (Note once Lower Earnings Limit is reached contributions become payable from first £1 of earnings.)

(iii) Upper earnings limit (UEL), which sets ceiling up to which contributions are levied, to rise from £235 to £250 (in line with assumed increase in earnings). Those earning below £235 and contracted-in pay no more. Those earning above £250 pay maximum addition of £1.35 per week.

(iv) Treasury Supplement will be reduced from 13 per cent to 11 per cent of contributions.

(v) These changes will be implemented by Order.

(vi) Surplus of revenue over expenditure at end year expected to be £200 million; accumulated balance in Fund expected to be £4,480 million. Government Actuary has recommended a minimum balance of about $^1/_6$ (16.5 per cent) of benefit expenditure - expected balance will be around 21½ per cent.

(vii) Further background to be given by Secretary of State for Social Services on 17 November and in Government Actuary's report (also published on 17 November). Government Actuary's report will include certain economic assumptions - not forecasts - given to him by Government, namely:-

(a) Unemployed, excluding school leavers, GB, averages 2,850,000 in both 1983-84 and 1984-85, school leavers and others 180,000 in 1983-84 and 170,000 in 1984-85.

(b) Average Earnings in 1984-85 6½ per cent higher than in 1983-84.

(c) Retail prices up 5½ per cent in year to May 1984.

(viii) For further details of changes, see table attached.

Positive

(i) First time since 1979-80 no increase in Class 1 contribution rates. Increase in Upper Earnings Limit in line with assumed increase in earnings. Most employees pay little or no more - only those earning above £235 (well above average earnings) pay noticeably more - and maximum for them only £1.35.

(ii) When account is taken of National Insurance Surcharge, which is assumed to remain at 1 per cent throughout 1984-85, real burden on employers falls. This is because average NIS rate in 1983-84 was about 1¼ per cent (2½ per cent for Local

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Authorities). Most (£830 million) of projected cash increase (£990 million) in employers' and employees' overall payments is attributable to increased earnings. Only very small part (£160 million) attributable to changes in earnings limits.

(iii) Contributions go to pay for benefits. Cost of this month's benefit uprating £1½ billion (not all from Fund). Most benefits worth more than when Government came into office.

Defensive

(i) Why not reduce contributions? Benefit expenditure continues to increase. Although Fund looks heathy for 1984-85, caution needed to avoid frequent unsettling small changes in contribution rates. GA's recommendation was for minimum not target balance.

(ii) So why reduce Treasury Supplement? Treasury Supplement was reduced in earlier years (from 18 per cent to 14.5 per cent in 1981 and to 13 per cent in 1982) to help restore balance of expenditure on social security benefits met by general taxpayer as against contributor. Non-contributory benefit expenditure, and, hence proportion of total benefit expenditure met outside Fund by general taxpayer, continues to rise faster than Fund expenditure. The further reduction in Treasury Supplement will help contain shift to taxpayer of overall burden of benefit expenditure.

(iii) Why increase UEL? Legislation requires UEL to be reviewed each year and to be between 6½ and 7½ times basic pension. Thus UEL could have been left unchanged at £235. But UEL relevant for calculation of state earnings related pension and guaranteed minimum pension. Necessary to increase UEL if value of those pensions not to decline. Also, not unreasonable that earnings limit should be broadly indexed as are most benefits paid from the Fund and as is generally done with specific duties and income tax personal allowances. UEL increased by 6.4 per cent to £250 this is less than 7¾ per cent increase in average earnings in year to September 1983 and in line with assumed increase in average earnings next year. For employers real burden will be lower - because average payment of NIS to 1984-85 will be lower than in 1983-84.

(iv) Cash burden on employers rises by £700 million? £700 million is the increase in payments of NICs. But only £80 million of this arises from change in UEL - rest is effect of higher earnings; emphasises need to contain pay increase. Also, when account taken of NIS, employers cash burden rises by only £330 million - less than 3 per cent - well below assumed increase in both prices and earnings.

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D1 Cont.

ANNEX

MAIN LIMITS AND RATES OF CONTRIBUTIONS 1983-84 and 1984-85

Limits	1983-84 (current year)	1984-85
Class 1 (Employer & Employee)		
Lower earnings limit	£ 32.50	£ 34.00
Upper earnings limit	£ 235.00	£ 250.00
Class 2 (Self Employed)		
Small earnings exception	£ 1,775	£ 1,850
Class 4 (Self Employed)		
Lower profits limit	£ 3,800	£ 3,950
Upper profits limit	£ 12,000	£ 13,000

Rates	1983-84 (current year)	1984-85
Class 1 standard rate		
Primary (Employee)	9.0%	9.0%
Secondary (Employer)*	10.45%	10.45%
Class 1 contracted-out rate up to lower earnings limit		
Primary (Employee)	9.00%	9.00%
Secondary (Employer)*	10.45%	10.45%
Class 1 contracted-out rate above lower earnings limit		
Primary (Employee)	6.85%	6.85%
Secondary (Employer)*	6.35%	6.35%
Class 1 reduced rate for married women and optants (employee)	3.85%	3.85%
Class 2 flat rate self-employed contribution (per week)	£ 4.40	£ 4.60
Class 3 flat rate non-employed contribution (per week)	£ 4.30	£ 4.50
Class 4 earnings-related self-employed rate	6.3%	6.3%

* excluding National Insurance Surcharge

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D2 NATIONAL INSURANCE SURCHARGE

Factual

(i) No change in rate announced in Statement. Remains 1 per cent for 1984-85.

(ii) NIS is levied and collected as a percentage charge on earnings liable to employers' NIC. Increase in NIC Upper Earnings Limits means NIS payments will be about £10 million higher than would otherwise have been the case (but see also Brief D1).

(iii) Rate already reduced by 2½ percentage points. The rates since 1979 are:

Rate up to 1981-82	3½ per cent
Effective average rate during 1982-83	2 per cent
Rate from April to July 1983	1½ per cent
Rate from August 1983	1 per cent

(iv) Local authorities pay at 2½ per cent in 1983-84 only: subsequently at 1 per cent. The reduction to 1½ per cent announced in the 1982 Autumn Statement was not extended to LAs because it was not practicable to recover the benefit through the Rate Support Grant. For the same reason the ½ per cent cut announced in 1983 Budget will not be extended to LAs until 1984.

(v) Expected yields (receipts basis):

1984-85 about £1,300 million (private sector about £850 million)

1985-86 about £1,400 million (private sector about £900 million)

Positive

(i) NIS reductions since 1982 have benefited private sector by about £2 billion per year.

(ii) Government's objective to abolish NIS over the lifetime of this Parliament. [Queen's Speech Debate, Hansard, 22 June 1983, col 56: PM said "We hope during the lifetime of this Parliament finally to abolish Labour's pernicious tax on jobs, the National Insurance Surcharge".]

(iii) Even taking account of NIC increases since 1978-79, the overall effect of NIC and NIS changes is worth about £1½ billion to private sector employers in a full year.

(iv) Overall NIC/NIS rate on contracted-in employers increased from 8½ per cent to 13½ per cent under previous Labour Government. Now down to 11.45 per cent. Contracted-out rate down from 9 per cent to 7.35 per cent.

Defensive

(i) Does NIC UEL increase inevitably mean higher NIS payments?

Yes, because NIS is collected through the NIC system, on the same range of earnings. Impossible to separate them. But this £10 million increase is almost negligible if counted against benefits of NIS cuts in recent years.

(ii) Why not abolish NIS now?

Sympathy with calls for abolition. But obvious difficulties given cost even after recovery from public sector. (1984-85 cost of abolition, if effective from April: £750 million. The revenue cost for 1984-85 differs from the expected receipts because there is a £100 million carryover from 1983-84). No intention of pre-empting overall Budget judgement.

(iii) Abolition in 1984 Budget?

Wait and see. Obvious difficulties given cost even after public sector clawback (1984-85, if effective from August: £450 million. 1985-86: £900 million).

(iv) NIS reductions purely cosmetic, as increases in employers' NIC have offset them?

Not so. Employers were shielded from increases in NIC rates for two consecutive years. 1983-84 increase for the contracted-in was restricted to ¼ per cent; for the contracted-out it was restricted to 0.65 per cent. Even allowing for total increase in employers' NIC since 1979, private sector employers' combined NIC and NIS is about £1½ billion less than it would otherwise have been.

(v) Introduce selective reliefs?

Not practicable, because of links with NIC collection system.

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E1 PUBLIC EXPENDITURE 1983-84

Factual

(i) Supply expenditure outturns for first half of financial year published 17 November along with Winter Supplementary Estimates. [See separate briefing accompanying Financial Secretary's Note on Winter Supplementaries].

(ii) Local authorities budgetting for a significant overspend on current expenditure. But capital expenditure is expected to be slightly below plan. [Note: A lot of this overspend and underspend was anticipated in the Budget FSBR forecast.]

(iii) Latest public expenditure plans for 1983-84, £119.8 billion, are shown in Table 2.1 of Autumn Statement. The new plans incorporate effects of 7 July measures and other known developments since FSBR (for example, additional agricultural support and higher expenditure on the family practitioner services). Estimated outturn against these plans is provisionally put at £120.3 billion: a figure not given in the Autumn Statement itself but which the Chancellor is ready to give in rounded form in reply to questions. Current assessment of outturn on general government expenditure, £120½ billion, is shown in Table 1.7 of Autumn Statement.

[NOT FOR USE: reconciliation of public expenditure plans and estimated outturn on general government expenditure:

Public expenditure in 1983-84

	£ billion
Planning total (plans), Table 2.1	119.8
Forecast shortfall (-)/longfall (+)	+0.5
Planning total (estimated outturn)	120.3
adjustments*	+0.2
General government expenditure (estimated outturn), Table 1.7	120½]

(iv) Percentage of planned public expenditure (including net debt interest, capital consumption and local authority VAT payments) to GDP in 1983-84 is 42½ compared with outturn of 43½ in 1982-83 and 44 in 1981-82. (Even with longfall allowed for in Table 1.7 of the Autumn Statement, 1983-84 percentage is still 42½.) NB. Percentages slightly lower than those previously published, by between ½ and 1 percentage points, because of upward revisions to GDP published by CSO in September.

Defensive

(i) How does latest plan of £119.8 billion in Table 2.1 of Autumn Statement compare with planning total of £119.3 billion in Table 5.5 of FSBR?

Former relates to plans, not estimated outturn, and incorporates effect of 7 July measures as well as other developments since Budget. The latter was an estimated outturn. [IF PRESSED: FSBR estimated outturn incorporated a net allowance for shortfall of £1.2 billion. Developments since then (higher than expected spending in 1982-83 and indications that this was continuing into 1983-84) suggested this

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* Deduct capital expenditure of certain public corporations and public corporations market and overseas borrowing.

shortfall would not arise - 7 July measures therefore taken to bring spending back closer to planned path.]

(ii) What are main differences between latest plan of £119.8 billion in Table 2.1 of Autumn Statement and planning total estimated outturn that surely must underlie Table 1.7 of Autumn Statement?

Latter incorporates latest view of expected spending against plans. Planning total outturn for current year estimated to be about £½ billion above the revised planning total of £119.8 billion shown in Table 2.1. [NOT FOR USE: Main components of overspend are £1¼ billion on local authority current expenditure and around £¾ billion on central government expenditure, offset by £½ billion underspend on nationalised industries EFLs, £¼ billion on l.a. capital and underspent Contingency Reserve of about £¾ billion.]

(iii) Why not publish an estimate of shortfall and/or estimated outturn on the planning total in the current year?

To do this in Table 2.1 would be confusing. Figure for next year is expressed in terms of plans (see E2 Defensive (xiii) and (xiv)). Important to compare plan with plan in comparing this year and next.

[NOTE: Chancellor has indicated his willingness to give the House a rounded estimated outturn of £120 billion if they ask for it. This could be expressed as 'just over £120 billion and about £1 billion more than was envisaged at Budget time, but still within the White Paper plans'. NB 1983-84 outturn forecast not to be revealed until given to House.]

(iv) Reasons for 7 July measures?

1983 PEWP and Budget FSBR incorporated net allowances for shortfall against plans of £1.2 billion. As a result of the higher than expected spending in 1982-83 and strong indications that this was continuing into 1983-84 it became clear that measures were needed to bring spending back closer to the planned path.

(v) 7 July measures not enough?

Measures were taken to bring spending back closer to the planned path and this they have done. Remains to be seen how actual expenditure will compare with those plans - substantial margins of error in any forecast of estimated outturn at this stage. [See also C1 Defensive (iv)].

(vi) Cash limit breaches?

Monitoring information published 17 November in Financial Secretary's Note on Winter Supplementary Estimates suggests cash-limited expenditure overall is on course. Those cash limits in any danger of being breached being monitored carefully with relevant Departments. [See separate briefing on Winter Supplementaries.]

(vii) Local authorities' overspending?

Local authorities' budgets show more current overspending than expected at time of Budget. Overspending authorities have again lost grant. Outline of 1984-85 RSG settlement announced recently by Secretary of State for Environment explained penalties for overspending next year will be even more severe.

(viii) Local authorities' capital expenditure?

Past years have seen heavy underspending but latest returns suggest problem much less in 1983-84. First quarter returns for 1983-84 suggest that, overall, net capital expenditure is likely to be quite close to planned level.

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E1 Cont.

(ix) Latest estimated outturn for 1982-83 planning total, £113.4 billion (AS Table 2.2); earlier estimate published in Supplementary Table S21 of October Financial Statistics. (Figure of £113.4 consistent with figure of £114 billion for general government expenditure shown in Table 1.7.) The overshoot on the estimated outturn shown in Budget FSBR (£112.5 billion) was due mainly to lower than expected underspending against plans.

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E2 PUBLIC EXPENDITURE 1984-85

[NB Detailed questions on programmes should be addressed to Departments concerned.]

Factual

(i) Plans for 1984-85 (Cmnd 8789) were £126.4bn. The planning total based on the revised plans in the Autumn Statement has been maintained at this level.

(ii) The Reserve for 1984-85 stays at the level set in the White Paper (£3 billion). This compares with £1.5 billion in 1983-84.

(iii) Major increases in plans compared with the post Budget plans are:-

Intervention Board for Agricultural Produce	£422 million
Local authority current expenditure	£595 million
Social Security	£163 million

(iii) Major reductions are:-

Nationalised Industries	£666 million
Housing	£497 million
Special Sales of Assets (higher estimated receipts)	£400 million
Defence	£260 million

The 3 per cent pay factor announced on 15 September 1983 represents a saving on all programmes of £400 million.

(iv) On latest forecasts of GDP, revised plans for 1984-85 represent a fall in percentage of public expenditure to GDP, from 42½ in 1983-84 to 42 in 1984-85.

(v) In 'real' (cost) terms, planning total shows a small increase from £114,100 million in 1983-84 to £114,600 in 1984-85 (on 1982-83 base year). Since the difference is only 0.4% on present forecast of GDP deflator, the Statement describes the figures as "broadly constant".

(vi) Plans now announced are firm. Precise figures may change slightly between now and White Paper in the light of more detailed recalculation. Reserve will also be reviewed before the White Paper is finalised.

(vii) White Paper will be published in the early part of 1984. Will contain figures for 1985-86 and 1986-87.

Positive

(i) Outcome of the annual review of expenditure plans has been to hold planning total at the level announced in previous plans. Repeats the Government's similar achievement last year.

(ii) The fall of ½ percentage point in the GDP ratio continues Government's progress in reducing public expenditure as ratio to GDP. Now 1½ points below level of 1982-83.

Defensive

(i) The Reserve is unchanged but Special Sales of Assets have increased. A Treasury conjuring trick to get back to the planning total? The Special Sales of Assets total is made up of a number of components. It is not our practice to disclose details of its composition because the timing of sales is dependent on market conditions and the price information is commercially sensitive.

The increase of £400 million in the figure for asset sales in 1984-85 results from a number of changes and reassessments. Among the more important changes is the slippage of the sale of Enterprise Oil into 1984-85. We are not saying that we expect £400 million from this sale. But it is a real change which among other things has led Ministers to take a different view of the prospects for sales in 1984-85.

(ii) Why is the Contingency Reserve so big? The Reserve for 1984-85 has been set at a level (£3bn) which will, for the first time, accommodate both discretionary increases and all other contingencies, including estimating changes. At this stage the estimates of expenditure on some demand-led services are inevitably still uncertain. Other possible calls on the reserve might arise in the areas of European expenditure, agricultural and other industrial support and from the introduction of a degree of end-year flexibility, both for central government and for local authority capital expenditure.

In its comments on this year's Budget the Treasury and Civil Service Committee argued that the proposed Reserve of £1.5 billion for 1983-84 was too low. We do not accept that, but the retention of a bigger Reserve should help to avoid some of the difficulties of control which arose earlier this year.

(iii) Decision to contain expenditure has inevitably meant reductions in some programmes to compensate for increases in others. But Government's success in controlling inflation makes it easier to accommodate such changes without major cuts in services.

(iv) Why not major increase in public expenditure to boost economy? Way to get sustainable growth is by expanding production in private sector without adding to inflation. Higher public spending would require higher taxation and/or higher interest rates, which would hold growth back.

(v) Hasn't Government gone too far in reducing public expenditure? Government is planning for an increase (£6½ bn) between plans for 1983-84 and 1984-85.

(vi) Capital/Current split? Too early to give figures. No breakdown for the nationalised industries is yet available, and the split for some other programmes will depend upon decisions still to be taken about the allocation of the programme totals. A full analysis will be given in the White Paper.

(vii) Did Ministers take decisions without proper capital/current assessment? True that final figures not yet available. But decisions were qualitative as well as quantative. The need to consider the level of capital spending was in Ministers' minds throughout the public expenditure discussions. n.b. the cut in Housing is much less than it appears. About £300 million of the apparent reduction is additional receipts from the sale of council houses, which are scored as negative public expenditure.

(v ii) Effects on industry? Main effect will be through staying within expenditure plans. Public sector will not be pre-empting resources, raising interest rates or rekindling inflation.

(ix) Local authority current expenditure Government obliged to recognise excessive levels of past and present spending in formulating plans for future which are realistic. But cannot condone failure to meet targets and abide by guidelines which has become a persistent feature of local government current spending. Plans for relevant current expenditure in 1984-85 make provision which is realistic in relation to levels of overspending in 1983-84. But also indicate lower level of expenditure which Government considers desirable and which could have been achieved had authorities complied with previous plans.

(x) Local Authority Capital. Total net provision for LA capital in 1984-85 likely to be about £3¾ billion or roughly the same in cash terms as the expected outturn in 1983-84. (The figure would be considerably higher but for sales of Council houses which are netted off). Authorities' capital spending in 1983-84 is closer to plan than usual and there is not likely to be the huge underspending of earlier years. The Government hopes that this trend will continue in 1984-85.

Total capital spending for 1984-85 depends on decisions Ministers still have to take about allocation of their programmes. A measure of end-year flexibility is being introduced on the overall cash limits which will permit some carry forward of underspending. The Secretary of State for the Environment is announcing details.

(xi) Nationalised Industry planned expenditure for 1984-85 is about £666 million lower than previous plans. A tight financial framework concentrates the industries' minds on increasing efficiency and minimising costs. Individual EFLs are the responsibility of the appropriate sponsor Minister. They are set after careful consideration of an industry's likely performance in 1984-85 and take account of a wide range of factors. Overall, we expect changes in nationalised industry prices in 1984-85 to be at or below the rate of inflation. (These are the only changes in the review which are likely to have any effect on prices.)

(xii) Government's commitment to the NHS? The Government's plans for 1984-85 are to increase spending on health in Great Britian by £800 million over the level this year, just as promised by the Prime Minister in her election speech in Edinburgh. The further real growth planned in NHS services will be in addition to the growth of about 7½ per cent already planned for since the Government came into office. This is a further demonstration of the Government's commitment to the NHS. It is also taking a number of measures designed to increase efficiency in order to make the available cash go even further towards providing better services for patients.

(xiii) Why no net shortfall allowance? It is too early to give a precise figure. Wait for the White Paper.

(xiv) What are the main differences between the plan of £126.4 billion in Table 2.1 of the Autumn Statement and the estimated outturn for the planning total which must surely underlie Table 1.7? On present estimates the net shortfall this year is close to zero; the position needs to be monitored further before deciding on a figure for next year. [NOT FOR USE: AS estimate is a long-fall of about £¼ billion; consists of £1½ billion on central government expenditure and £1¾ billion on local authority current, offset by availability of the £3 billion Contingency Reserve.]

(xv) Long-term public expenditure? This review has been concerned with the period 1984-85 to 1986-87 and the detailed information in the AS relates to 1984-85 only. The Government has said it would welcome a wider public debate and the factors affecting the level of public expenditure in the longer term are under continuous review. But do not expect specific early announcements.

(xvi) Realism of 3% public service pay factor if earnings in economy to rise 6½% (GAD assumption)? These figures are not forecasts, and they cover different things. 6½ per cent refers to increase in total average earnings (including overtime etc) in whole economy between 1983-84 and 1984-85. 3 per cent factor is provision made for increase in pay rates for central government employees from due settlement dates in 1984-85. The 6½ per cent assumption takes account of the 3 per cent factor. Gap between them is not unusual - was 3 points last year and 3½ points in year before.

(xvii) You claim to have kept to the White paper plans. But has there not been an increase in what you expect those plans to buy because of changed expectations about inflation? True. But we plan in cash. The fact that the same cash plans will now buy more is one of the benefits of reducing inflation. Control of public expenditure has played an important part in this.

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F1 DEFENCE (Detailed questions to MOD)

	£m cash
Defence programme	17,008
ROFs net financing	(-2)
Defence Budget	17,010
of which Falklands	684

Factual

(i) Cash provision is nearly £1,300 million (8.2 per cent) higher than the current year.

(ii) In real terms there is provision for growth of some 3 per cent over 1983-84, with an addition for Falklands costs. 1984-85 Falklands provision is £684 million.

(iii) The provision is £280 million (1.6 per cent) lower than envisaged in Cmnd 8789. It is £260 million (1.5 per cent) lower than the survey baseline (the Budget National Insurance Surcharge reduction accounts for the £20 million difference).

(iv) The civilian manpower target for 1 April 1988 is 170,000.

Positive

(i) Defence continues to be the second largest programme.

(ii) Defence expenditure has increased in real terms every year since 1978-79. The 1984-85 provision is the sixth successive year of increased defence spending.

(iii) In absolute terms, the level of UK defence spending is the highest in Western Europe. As a proportion of GDP and per capita, UK defence budget is second only to the US amongst our major allies.

Defensive

(i) In fixing 1984-85 provision, account was taken of the 1983-84 cash limit cut, along with the NATO aim and all other relevant factors. The 1983-84 non-Falklands defence budget (even after the July cut) provides for more than 3 per cent real growth over 1982-83 expenditure.

(ii) Provision for later years will be announced in the PEWP.

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F2 AGRICULTURE AND IBAP (Detailed questions to MAFF)

Factual

(i) The "Agriculture" totals include agriculture, fisheries and food expenditure in the UK. A territorial allocation will be given in the White Paper. The 1984-85 provision is £1009 million, compared with £994 million provided in Cmnd 8789 as amended by the Budget. The increase of £15 million amounts to about 1.5 per cent. Details of adjustments within the total will be announced by Minister of Agriculture in an arranged PQ on 17 November.

(ii) The "IBAP" programme represents expenditure by the Intervention Board for Agricultural Produce on agricultural support under the CAP. 1984-85 provision is increased by £422 million (51 per cent) to £1247 million. About one third of increase reflects expenditure pre-funded from Community Budget. Two-thirds reflects assumed extra intervention purchases particularly for milk products; these costs fall initially on the Exchequer but are re-couped from the market and by Community reimbursement for losses when intervention stocks are sold.

Defensive

(i) Overall net increase in "Agriculture" mainly accounted for by 100 per cent EC funded expenditure. Remaining small increase in domestic expenditure more than covered by savings on arterial drainage and flood protection, within the MAFF programme but shown as part of nationalised industry (water authorities) EFLs.

(ii) Increase for IBAP reflects latest estimates of costs of implementing CAP. Forecasts are highly uncertain and dependent on weather, harvests, market conditions etc.

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F3 ENERGY INDUSTRIES EFLs AND PRICES (Detailed questions to DEn)

Factual

(i) The increase in expected external financing requirement for the National Coal Board is some £180 million. There are reductions for the Electricity Supply Industry, British Gas Corporation and BNOC which go towards an overall £670 million decrease for the nationalised industries overall.

(ii) NCB's projected trading position has deteriorated due mainly to weak markets. Coal price increases this Autumn have averaged about 3 per cent - well below the RPI.

(iii) Gas and electricity tariffs are a matter for the industries. Discussions are taking place <u>within</u> the industries on increases for 1984-85.

(iv) Expect the increases now under discussion to be below the rate of inflation.

Positive

(i) Decrease for Electricity partly reflects expected achievement of the efficiency aim set by Government that unit costs should be 4.25 per cent lower in real terms by 1984-85 than in 1982-83.

(ii) It is right to charge energy prices which reflect the cost of meeting additional demand ("economic pricing"). This is a well established principle endorsed by successive Governments. It is no more than what happens with private sector companies competing with each other. It involves no subsidisation and no taxation.

(iii) Charging prices below these levels leads to wasteful investment. For example it would result in building power stations which made losses in the same way that subsidising, say, TV sales would result in factories being built and equipped to produce loss making TV sets.

(iv) The electricity industry was investigated by Coopers and Lybrand in 1982. In the light of these findings electricity prices are now close to the economic level, but certainly not above them.

(v) BGC was investigated by Deloittes in 1983. This showed most gas prices to be well below economic levels. The freeze on gas prices in 1983-84 has increased that gap and a 5 per cent increase in 1984-85 will not prevent the gap getting wider still.

(vi) Gas and electricity profits large in terms of £ million (see Annex). But these are huge industries. Capital invested is some £32 billion in electricity and £12 billion in gas. The return on these assets is not high. Few private sector businessmen would be satisfied with these returns.

(vii) A policy of holding down energy prices was tried in the mid 1970s and was generally regarded as unsatisfactory - including by the last Labour Government who set about reversing this policy.

Defensive

(i) <u>Price increases</u> for gas and electricity have yet to be settled by the Industries but are expected to be <u>below</u> the rate of inflation.

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F3

(ii) Using prices to cut public expenditure - the EFLs for 1984-85 will reflect efficiency savings the Government considers the industries should make. It is for the industries to determine detailed tariffs but the Government does not want prices to rise above economic levels.

(iii) Price increases will cause electricity to exceeds its financial target - there is no prospect of price increases in excess of those envisaged when the financial target (which covers both 1983-84 and 1984-85) was set - ie a standstill in 1983-84 and an increase below the rate of inflation in 1984-85.

(iv) Effect on industry - gas and electricity prices for industrial consumers are generally in line with continental competitors, except for electricity in France. Special measures were taken in the 1981 and 1982 budgets to help large consumers of electricity - costing £100 million. The right approach is not to sell energy at a loss to industry, but to get down the cost of the gas and electricity industries.

(v) Effect on poor consumers - action has been taken to relieve standing charges for small consumers of gas and electricity. Some £350 million a year of assistance with fuel costs is provided by social security.

(vi) It is backdoor taxation - No. Prices are not above economic levels - so there is no taxation.

(vii) When will increases be announced - that is for the industries.

(viii) Investment by NCB next year should be about the same as the £800 million this year. The level for later years has yet to be determined.

(ix) Sizewell PWR station is still included in the ESI programme but extension of the public enquiry has resulted in reduced provision being needed in 1984-85.

(x) Special Sales of Assets/Privatisation Apart from Enterprise Oil, the energy industries will not be a significant contributor next year.

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A. USEFUL QUOTES

(a) On gas, Deloittes Report (1983)

"In 1982-83 sales of gas in all markets, apart from the interruptible market, were taking place at prices which were insufficient to meet marginal costs and then the costs of maintaining supply".

(b) On electricity, Coopers Report (1982) was not published but on 12 November 1982 the then Energy Secretary said prices would be frozen in 1983-84 as :

"the cost to the industry of meeting marginal increases in demand is likely to be lower than expected."

(c) On last Labour Government's policy. Green Paper on Energy (1978) said :

"The principle that prices should reflect the costs of supply on a continuing basis while providing an adequate return on capital is now firmly established"

"Prices are important above all because they are all pervasive, affecting millions of decisions over which the Government can have no direct control"

"Since the object is to guide investment and other decisions that will affect future events, the relevant cost is the cost incurred or saved in expanding or contracting supplies at present or in the future, rather than an average of past costs. Energy prices should therefore at least cover the cost at which supplies can be provided on a continuing basis, while yielding an adequate return on investment.".

B. PROFITS AND PRICES

(a) Electricity (England and Wales)

	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85
Turnover (£m)	6,171	7,511	8,471	9,187	8,971*	9,300*
Price increase (%)						
- Domestic	13	30	11	9	0	(3)
- Industrial	14	24	12	11	0	(3)
- RPI	16	17	11	7	5	
Pre-tax profit/loss after interest (CCA) (£m)	-499	-272	470 -85	868 332	663 200* 186	469 100-200* 25
Return on assets (CCA) (%)	0.5	1.7	2.0	3.2	1.9*	~~1.7-1.9*~~ 1.3-1.4

*estimated

(b) British Gas Corporation

	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85
Turnover (£m)	3,513	4,295	5,235	5,958	6,495*	7,265*
Pre-tax profit (CCA) (£m)	466	381	311 144	663 188	600 564* 380	592*
Return on assets (CCA) (%)	5.0	4.0	3.0	5.7	4.3* 4-4½	4.0*

*estimated

3/12.7

4.0%

Price Increases for gas :

Domestic

April 1980	17%
October 1980	10%
April 1981	15%
October 1981	10%
April 1982	12%
October 1982	10%
January 1984	5% (proposed)

ANNEX TO F3

Industrial

		Percentage increase on previous quarter of average firm/interruptible industrial contract price
1979	Q1	0.7
	Q2	2.6
	Q3	19.0
	Q4	13.3
1980	Q1	3.2
	Q2	8.2
	Q3	12.6
	Q4	1.9
1981	Q1	-
	Q2	0.2
	Q3	-
	Q4	-
1982	Q1	-
	Q2	3.4
1982	Q3 -1984 Q1	-
1984	Q2	about 3

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F4 HOUSING (Detailed questions to DOE)

Factual

(i) The existing net provision for housing in 1984-85 is some £3 billion comprising some £4.3 billion gross spending less £1.3 billion receipts.

(ii) The revised net provision involves a reduction of £0.5 billion (ie - 17 per cent). This comprises an increase of £0.3 billion in assumed receipts, which come mainly from sales of public sector dwellings, and a reduction of £0.2 billion in the gross provision.

(iii) The reduction in the gross capital provision is about £170 million of which some £124 million is a reduction in the provision for local authorities.

(iv) The local authority capital provision covers expenditure on new dwellings, improvements to existing dwellings and home improvement grants. It is for each local authority to determine its priorities within the capital allocation made by the DOE.

(v) The temporary arrangements under which local authorities receive additional allocations to cover expenditure on home improvement grants during 1983-84 in excess of an agreed figure will not be repeated in 1984-85. The temporary higher rates of home improvement grant will not continue beyond the announced closing date of 31 March 1984.

Defensive

(i) Effect on construction industry. The revised provision for gross capital expenditure in 1984-85 is the same in cash terms as the provision for 1983-84. Effect of measures on the construction industry, if any, is therefore likely to be minimal.

(ii) No figures for individual authorities' planning of capital expenditure. The 1984-85 capital allocations for individual local authorities will be announced shortly, taking account of the government's decision on gross spending and each authorities' expected receipts from sales of public housing. Authorities have been promised that no authority's allocation will be less than 80 per cent of that for 1983-84. Government considering whether arrangements can be made to give local authorities greater certainty about future capital allocations. [See also brief E2.]

(iii) Ending of temporary Home Improvement Grant measures. These measures, introduced in the 1982 Budget, were temporary measures designed to take up immediate capacity and not to add to longer terms demands on the industry. The deadline for expiry, originally 31 December 1982, was twice extended, ultimately to 31 March 1984. That date has now been confirmed.

(iv) 1983-84 capital underspending by local authorities. The outturn for gross capital expenditure, which determines the level of output, is expected to be slightly above plan. However excess receipts expected to lead to modest net underspend overall.

Positive

The Government's housing policy is focussed on encouraging provision by the private sector. The small reduction in gross public expenditure on housing is consistent with that policy. MTFS fosters economic conditions in which the private sector can flourish. The fruits of this are now becoming evident. For example, private sector housing starts in 1983 likely to be highest for 10 years.

Contact point: P J Stredder (LG2) 233-3364

F5 HEALTH (Detailed questions to DHSS)

Factual

(i) The agreed provision for health in England in 1984-85 is £13,130 million, which is the same figure as in the 1983 Public Expenditure White Paper.

(ii) The new plan represents an increase of more than 5 per cent over spending this year.

(iii) Discussions are in progress with the industry on the scope for further savings in the drugs bill next year.

Positive Points:

(i) The outcome honours the Election and other pledges on the NHS: total health spending in Great Britain is planned to increase by £800 million over this year's level, just as the Prime Minister said in her Election speech in Edinburgh.

(ii) Provision is being made in full for costs of demographic change - a bit under 1 per cent more resources in real terms.

(iii) Full provision is being made for the Family Practitioner Services to avoid the risks of an over-run as happened this year.

(iv) The NHS is being expected to bring forward major efficiency savings to provide for improvements in services and to reduce waiting lists. The Griffiths report recommends ways of transforming the management of the NHS and will make it much easier to secure such savings.

Defensive Points:

(i) Exemptions from charges will remain but no responsible Government could rule out increases in charges to patients. IF PRESSED: The level of charges is a matter for my right hon Friend the Social Services Secretary. [SENSITIVE];

(ii) The Government announced on 15 September that it was making provision of 3 per cent (in its cash plans) for pay increases within central government, but that this did not predetermine any individual settlement. Fruitless to speculate on what action might be taken if NHS settlements next year turn out at a different figure.

(iii) Reasonable to look to improved efficiency and cost reductions to offset the costs which can arise from advances in medical science. Many medical advances actually reduce costs (eg drugs which allow the mentally ill to be treated at home rather than in long-stay institutions).

(iv) Nonsense to suggest that this year's manpower cuts of about ½ per cent will damage an organisation as big as the NHS.

Contact point: J G Colman (ST2) 233-3997

F6 SOCIAL SECURITY (Detailed questions to DHSS)

Factual

(i) Social Security programme rises by £163 million (+0.4 per cent) in 1984-85 in comparison with the last White Paper after Budget changes: Budget changes themselves added £748 million to the White Paper totals.

(ii) Benefits will be uprated later this month (21 November), mostly by 3.7 per cent but Supplementary Benefit rises by 4.3 per cent and Child and One Parent Benefits by 11 per cent.

(iii) This month's benefit increases based on new method for calculating uprated announced in the Budget; relevant RPI change is historic movement in prices between May 1982 and May 1983 ie 3.7 per cent. November 1984 increase will be based on movement in prices between May 1983 and May 1984 - currently assumed to be 5½ per cent.

(iv) Main policy change in Budget was 11 per cent real increase implemented November 1983 in level of Child Benefit.

(v) £163 million increase since Budget is net effect of substantial demand determined increases, partly offset by policy changes.

Main demand determined increases arise on Supplementary Benefit and Housing Benefit. Main policy changes are also on Housing Benefit. Further detail to be given by Secretary of State for Social Services on 17 November.

Positive

(i) When benefits are uprated later this month - at a cost of around £1½ billion - nearly all will have more than maintained their value since Government took office - some such as Mobility Allowance have risen substantially in real terms.

(ii) New uprating method ensures greater accuracy in maintaining value of benefits. Old forecast method was inaccurate 5 times out of 7.

(iii) Manifesto renews undertaking, given for period of last Parliament to "continue to protect retirement pension and other linked long-term benefits against rising prices". That pledge more than fulfilled. [Note: pledge does not cover other benefits such as supplementary allowance, unemployment benefit, housing benefit etc.]

Defensive

(i) Housing benefit changes hit at poor?

Housing benefit now goes to around 7 million (about 1 in 3) households of which some will have incomes above average earnings. Changes designed primarily to reduce benefit to this better off group.

(ii) Unemployment benefit as percentage of earnings lowest in Western world?

[Study in Economic Bulletin for Europe, published by UN, says that UK proportion of benefits for unemployed to earnings ('replacement ratio') lowest in West; have fallen between 1972 and 1982 from 75 to 47 per cent; but 'cost of unemployment', as percentage of Government spending, higher than elsewhere - 11-17 per cent.]

Valid international comparisons extremely difficult. Study claims all benefits included, but rent and rate rebate payments have not been taken into account. Including these, for 'average workers' as used in study, gives ratio of around 70 per cent in 1982. Similar problems in making comparisons over time. Calculations of overall costs to Government meaningless because included hypothetical figures for lost tax revenue.

(iii) Long term supplementary benefit for unemployed?

[Social Security Advisory Committee recommended long term rate to be payable to unemployed after 12 months 'as matter of necessary justice and highest priority'.]

Proposed extension of eligibility for long term rate of supplementary benefit would add about £0.4 billion to cost of social security - now standing at £35 billion. Many unemployed will also be receiving help with housing costs through housing benefit. Extension would mean giving long-term scale rate to people still in the labour market, which would have wider economic repercussions, for instance on work incentives. Cannot afford to do more.

(iv) Government plans for pensions?

[Government Actuary's Quinquennial Review of NI Fund published last July analysed possible future cost of contributory benefits and levels of contributions required. Most important factor expenditure on earnings-related pensions. Social Services Secretary told interviewer 27 October (New Society) 'we will be announcing a major inquiry into pensions soon'.]

Government Actuary's conclusions last July not firm predictions but illustrative of possible burden on future generations. Social Services Secretary will shortly announce comprehensive review of provision for retirement, covering adequacy of pensions in both State and private sectors, emerging costs, role of occupationsl pension schemes and other issues, including pension age, flexible retirement etc. Government Actuary's Report and recent ideas on 'portable pensions' will be included in the review.

Contact point: A J White (ST1) 233-3169

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F7 CIVIL SERVICE MANPOWER

Factual

(i) Government plans to reduce the Civil Service from 732,000 in 1979 to 630,000 by 1 April 1984 (14 per cent) should be achieved.

(ii) Manpower requirements up to 1988 have been reviewed and are set out in a written PQ reply to be given on 17 November. The plans provide for a reduction to about 593,000 by 1 April 1988, a fall of 6 per cent from 1 April 1984 target of 630,000: a written reply to be given on 17 November.

	1984	1985	1986	1987	1988
1 April targets (thou)	630	608	605	601	593

(iii) Aim has been to improve efficiency and match staff numbers more closely to departmental functions.

(iv) Proposed change in status of the Royal Ordnance Factories (to a Companies Act company) accounts for some 18,500 of the overall reduction of 37,000 by 1 April 1988.

Positive

(i) The figures make allowance for improved productivity during the period, including the introduction of new technology, where appropriate. They also reflect plans for privatisation and contracting-out where this offers better value for money and is consistent with sound management.

(ii) A contingency margin has been included in the figures to provide a reasonable amount of flexibility in our forward planning to cope with unexpected but essential new tasks or increases in workload.

(iii) The figures will be reviewed annually to take account of changing workload and other developments. Subject to that the presumption will be that they will be adhered to, or reduced further where possible.

Defensive

(i) Why are figures so very different for various departments?

Aim has been to match staff numbers as closely as possible to the essential work each department has to carry out. Not an arbitrary exercise to cut across the board by a fixed percentage. Sensible reductions are planned on account of increased efficiency and privatisation. But increases have also been allowed (eg Home Office) where the needs of the work dictate.

(ii) Contingency margin now only 7,500, previously 15,000. Realistic?

When 630,000 target was set, unemployment was rising substantially and contingency had to be allowed for Department of Employment. Problem should not arise this time [NB no forecasts or expectations on unemployment to be given].

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F7 Cont.

(iii) Criteria for drawing on the contingency margin?

Inescapable new commitment or an increase in workload arising from an existing commitment. Treasury to be satisfied that they could not find compensating reductions from elsewhere within their existing manpower allocation. Each case would be considered on its merits.

(iv) What if a contracting-out proposal not feasible?

If particular plans turn out to be not feasible, then it will be a matter for consideration whether alternative savings should be found from within the departmental target, or whether an adjustment to target should be made from the contingency margin.

(v) How can you fix manpower figures up to 1988, when no plans have been published for so far ahead on public expenditure?

The manpower figures for later years reflect the broad spending plans to 1986-87, which are to be published in the PEWP once details are finalised. The manpower figures are, of course, subject to review in forthcoming public expenditure surveys when manpower and expenditure plans will, again, be considered together.

(vi) Why are proposed reductions so much smaller than between 1979 and 1984; falling-off in the Government determination?

(a) The 1984 target of 630,000, which should be achieved, represented a very large reduction of 102,000 or 14 per cent over the period 1979-84. That has been done, and credit is due to the Civil Service for its major contribution to bringing it about.

(b) The Government is not aiming to do the same thing again. Staffing is now more closely aligned to the essential work that has to be done.

(c) What the Government is aiming to do is to maintain a steady pressure on numbers in order to take maximum advantage of all opportunities to improve efficiency, by the further streamlining of functions, the application of new technology and privatisation or contracting out where these make good sense. The figures are what the Government thinks it sensible to aim for over the next period in the light of this objective.

Contact point: B Brader (GEP4) 233-8260

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F8 EDUCATION (Detailed questions to DES)

Factual

(i) Main element in overall programme increase of £175 million (1.4 per cent) is for local authority current expenditure. Most important changes in Vote-borne spending relate to Student Grants. Any queries on relatively small adjustments to other elements of education programme entirely for DES.

(ii) Higher than expected numbers of students have necessitated increased provision for grants.

(iii) Changes in terms and conditions of awards will produce some offsetting savings. These include:

- halving minimum awards from £410 to £205 a year;

- steepening income-related scale of parental contributions;

Those on higher incomes will thus be expected to pay rather more towards maintenance of their student children than now.

(iv) Value of grants increased by 4 per cent as part of the package.

(v) Fees of all students on mandatory grants will still be met in full.

Positive

(i) Access on demand of suitably qualified young people to higher education is being maintained.

(ii) New parental contribution scale will better reflect ability to pay.

Defensive

(i) Unfair to cut real value of award again? Only a modest reduction. Bulk of savings will come from other changes.

(ii) Halving minimum award unfair to parents? Students on minimum grant will continue to get tuition free of charge, with all fees paid. Reasonable to ask better off parents to pay more towards maintenance.

Contact point: M J C Faulkner (HE2) 233-8481

F9 NATIONALISED INDUSTRIES EXTERNAL FINANCING LIMITS (SEE F3 FOR MORE ON ENERGY INDUSTRIES)

Factual

(i) Nationalised industry expected external finance is decreased from £2548 million to £1882 million (reduction of £666 million or 26 per cent). Increases for National Coal Board, British Steel Corporation, British Shipbuilders, and Civil Aviation Authority. All other industries have decreased requirements.

Positive

(i) Decrease shows that Government attempts to encourage industries to reduce current costs and increase efficiency are proving successful.

(ii) The decrease for Electricity partly reflects expected achievement of the efficiency aim set by Government that unit costs should be 4.25 per cent lower in real terms by 1984-85 than they were in 1982-83.

Defensive

(i) Nationalised industry price rises in 1984-85 are still to be settled by the industries but are expected to be at or below the rate of inflation.

(ii) Too soon to say exact effect decreased financial requirements will have on industries' investment programmes. Investment increased in real terms in 1982-83 and is expected to do so again this year. Hope is that investment will be maintained in 1984-85 but this requires industries to restrain current costs in the way that private sector companies have to do.

Contact points:		
	Individual industries	Relevant Sponsor Departments
	Overall programme	G E Grimstone (PE2) 233-3980

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F10 SPECIAL SALES OF ASSETS

Factual

(i) The target for special sales of assets is increased from £1500 million to £1900 million (eg by 27 per cent).

Positive

(i) Momentum of privatisation programme being maintained.

Defensive

(i) Although the sale receipts are clearly beneficial, the main objective of the privatisation programme is to promote competition and improve efficency.

(ii) Are receipts being used to fudge the figures?

Special sales of assets have customarily been treated as negative expenditure within the Planning Total. Labour Government did so in 1977-78 with sale of BP shares and we have followed this practice since 1979-80. Forecast represents our present best estimate of likely receipts.

(iii) Forecast too low?

Always genuine uncertainty about level of likely receipts. Dependent on market conditions at time of sale and on decisions yet to be taken, for example, about phasing of receipts. Right that Government should take a cautious view when setting targets.

(iv) How is £400 million increase made up?

Asset sales programme always has a number of components (ie nine sales 1982-83, thirteen sales 1981-82). Because details and timing of sales are commercially sensitive, not our practice to breakdown target figures into detailed components. The Government has however made clear that it plans to sell British Telecom in Autumn 1984. The revised 1984-85 target also takes account of the fact that the disposal of Enterprise Oil has regrettably slipped from 1983-84.

(v) 1983-84 target?

The 1983-84 asset sales target is £1250 million. Despite the slippage of Enterprise Oil to 1984-85, the asset sales programme is still broadly on course.

Contact points:	Individual privatisations	Relevant Sponsor Departments
	Overall programme	G E Grimstone (PE2) 233-3980

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G

G TAX READY RECKONER

Factual:

(i) Part 4 of the Autumn Statement contains a 'ready reckoner' for changes in income-tax, corporation tax and indirect taxes at 1984-85 price and income levels.

(ii) It also gives the 1984-85 levels of allowances, thresholds and bands following indexation by an illustrative 5%, the 'cost' of this indexation and the revalorisation of the excise duties.

Limitations and Pitfalls

(i) Changes to income tax are over and above the indexed levels of allowances etc; those for excise duties are from the current (unrevalorised) level of duties.

(ii) The income tax changes are costed in isolation, and this should be recognised in estimating the costs on yields of intereacting changes and packages. For example, revenue effects of a change in an income tax rate depends on the level of allowances, thresholds etc assumed.

(iii) Revenue effects of income tax changes are generally linear over a range and can be pro-rated.

(iv) Within limits, revenue effects of changes to indrect taxes can also be scaled up or down, and unit changes can be combined with revalorisation changes. Large increases, though, may result in last unit of duty raising less than previous ones.

Positive

(i) This ready-reckoner gives estimates for the direct effect on revenue in the next financial year, (prior to Autumn Statements estimates were given for current year only).

(ii) Helpful to those making budget representations, or who wish to cost tax packages.

(iii) More information than last year - cost and RPI impact of revalorisation package for indirect taxes given.

Defensive

(i) Why no PSBR costs? The total effect of a tax change on the PSBR will depend on how the economy responds - which is highly uncertain and on what is assumed about monetary policy. Direct revenue effects do not require such assumptions. [If pressed: PSBR costs in 1984-85 are generally close to first year costs (usually a bit lower).]

(ii) Why are some increases in allowances etc more than 5%? Because the rules for rounding up in 1980 and 1982 Finance Acts (which have been applied here) mean that some increases are rounded up by quite large amounts.

(iii) Why are first-year revenues less than full-year revenue for some taxes? This happens when duties are deferred (beer, tobacco). It also applies to VAT and NIS because these taxes are collected in arrears. There are also lags in collecting income taxes, especially higher rate tax.

(iv) Indexation percentage likely to be wrong (as last year)? 5% is a round number broadly consistent with the annual rise in the RPI towards the end of the year.

Contact point: Ms B Holman (DEU4) 233-4188

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* Last published ready-reckoner was in Treasury Supplement to Economic Progress Report, July 1983

H THE AUTUMN STATEMENT AND TCSC REACTIONS TO THE 1982 PUBLICATION

Factual

(i) In June last year the Treasury and Civil Service Committee published a report on Budgetary Reform. It made a number of recommendations designed to help towards greater public and Parliamentary discussion of budget options and generally to improve the presentation of information. The Government in its reply said that it would each year publish an Autumn Statement (AS). Last year's was the first such Statement.

(ii) The Statement brings together the announcements usually made in the Autumn: outline public expenditure plans for 1984-85 and proposed changes in national insurance contributions from April 1984. It has in addition an economic forecast giving the information required in the 1975 Industry Act and a more complete statement of the fiscal position: expenditure, revenue and borrowing figures for both the current year and next year.

(iii) There is also a section giving ready reckoners of the direct revenue effects of illustrative changes in major taxes, based on assumed income levels of the coming year.

(iv) The TCSC sought improvements in the AS after last year's publication: -

(a) more detail on the forecast and extension to the medium term;

(b) on public expenditure estimates of net debt interest payments; information on proportion indexed-linked and more information at programme level;

(c) on taxation, more information on provisional plans.

Positive

(i) This is the second Autumn Statement. Have sought to improve clarity of presentation this year.

(ii) With figures now given for public finances this year and next, and with the revenue ready reckoners, AS now goes some way towards indicating kinds of choices Chancellor may face in preparing his next Budget.

(iii) Have this year included for first time statistical table showing effect of NIC and NIS changes on total payments by employees and employers, previously published, rather inconveniently, as a separate press notice.

Defensive

(i) Why no draft Budget proposals? Government explained in its original reply to TCSC that detailed tax proposals would not be given: November is too early for this. But AS sets out economic background now available to Government itself and should help people in putting together their Budget representations.

(ii) Why no figures for later years? This is partly a matter of practicalities: wish to make information about 1984-85 available as quickly as possible means that something has to give. But in any case, as Government's reply said, right time to consider prospects for later years is after Budget. Extending forecast to medium term, not desirable, given increasing uncertainty.

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(iii) Why no ready reckoners for economic effects of tax changes? We do publish model simulations from time to time, including effects of tax changes.

(iv) Were tax and expenditure decisions in fact taken together to a greater degree than previously? To take public spending decisions at precisely the same time as tax decisions is not practically possible. But public spending decisions are taken in the context of the MTFS and against the background of a full assessment of the economic prospects, including those for revenue, borrowing, money and interest rates. That is a real sense in which expenditure and finance are taken together. Detailed tax decisions are best taken at time of Budget; and detailed expenditure plans will be published in PEWP.

Contact Point: D Norgrove (CU) 233-8737

Public expenditure file

SPEECH BY THE CHIEF SECRETARY TO THE TIMES/COOPERS & LYBRAND CONFERENCE ON PUBLIC INVESTMENT AND ECONOMIC RECOVERY, LONDON NOVEMBER 15

I welcome this opportunity to participate in the debate about public investment and economic recovery. The subject was considered in some detail in the course of the last Parliament and several parties examined the problems at that time including the Treasury, the Treasury and Civil Service Select Committee, the NEDC and the industries themselves. Now is a timely moment, following the Government's re-election in June, to look at this cluster of issues again. They range from the central questions of macroeconomic policy addressed this morning by Christopher Foster and Patrick Minford to examination of particular projects - for example prisons and the Channel Tunnel, which you will be looking at later. I do not intend to speak today on the macroeconomic issues. These will be the focus of debate following the publication of our Autumn Statement shortly. I will concentrate rather on some other important aspects of the issue.

Public capital expenditure, as the conference programme rightly observes, has fallen as a proportion of GDP during recent years. What public capital spending means in this context I shall come to in a moment but I will start with the basic figures. Between 1973-74 and 1982-83 public sector capital expenditure increased in cash terms from £6.4 billion to £11.1 billion which was equivalent in cost terms to a reduction of about 50 per cent. It fell also as a proportion of the public expenditure planning total.

This fall occurred of course during a time of severe shocks to the world economy which resulted in a rapid surge in inflation and two recessionary troughs in activity. Over the same period private sector investment in Britain also declined in relation to GDP, although I recognise that much the larger fall was in the public sector. Naturally if the rate of growth declines the need for many forms of public investment also declines, for example in transport or electricity generation. At the same time the growth in public programmes to deal with the effects of the recession has put pressure on all the other parts of the public sector given the need to constrain public expenditure as a whole.

But the numbers I am talking about when I refer to public capital expenditure have to be understood for what they are. And what they are is not altogether what they may seem. First of all what is meant by "capital" spending in the public sector differs from capital spending as it is understood in commercial accounting. Ignoring these differences can be misleading both about the amount of public sector investment which is actually going on and about the merits and demerits of different types of spending. For example, virtually all expenditure on defence is classified, by United Nations convention, as current expenditure. The tanker built in one berth for BP scores as capital expenditure; its neighbour in the next berth built for the Navy counts as current. With a defence equipment programme running at about £7 billion a year this makes quite a lot of difference to the figures; and it even makes a difference to the trend, because defence has been increasing as a proportion of public expenditure since 1979.

We must also remember that the figures for public sector capital expenditure are expressed net of certain asset sales. Sales of council houses, for instance, reduced the overall capital spending figure last year by over £2 billion. Some of the published aggregates are reduced also by the proceeds of the privatisation programme.

An even more potent source of misunderstanding is that public sector capital expenditure as defined in the White Paper does not include capital spending by the nationalised industries. Borrowing by the industries counts as public expenditure, but capital spending financed by own resources does not. So when you hear the statement that capital spending has fallen in relation to current in the public sector this tells you nothing about the fate of railway electrification plans, investment in water and sewerage facilities or power station building.

Ian MacGregor

In fact nationalised industry investment, adjusted for privatisation and certain changes in accounting treatment, has increased by around 43 per cent since 1979-80 which means that it has been broadly maintained in real terms. If this year's plans are fulfilled investment will increase by a further 12 per cent over last year's outturn, an increase in real terms. In the past, nationalised industries have underspent their investment allocation - by about £900m in 1981-82 and by over £1 bn. last year - but the prospect this year is that they will spend closer to target.

I think I have already said enough to demonstrate that public capital expenditure is not all of a piece, and that when we speak of the trend in capital spending in relation to current we need to be very careful about the definition of the totals we are talking about. We also need to be aware of the very different character of different investment programmes within the public sector. An investment programme such as the present one on prison building has no easily measurable return. That does not make it any the less important but it does make it different in kind from an investment in, say, new aircraft by British Airways where fairly precise calculations can be made about the expected rate of return.

Public investment in hospitals and schools also produces a social return which cannot easily be measured, but here the notion of an economic return - in terms of fitness for work or of training - is more realistic. Investment in infrastructure such as roads and sewers produces a very clear economic return. But still it is not simple to measure since the goods are provided free at the point of use and the return cannot be measured directly in terms of what consumers are prepared to pay. Finally there is investment by the public trading sector where the returns on investment in a new telephone exchange or the exploitation of a new coalfield can be measured in terms of what people pay for the goods or services produced as a result. So there is a range of different types of investment, stretching if you like from prisons to post vans, which are very different.

In assessing investment plans over this wide range of different types of capital project can we simply operate on the formula: capital spending good; current spending bad? Of course we cannot. Capital investment is only desirable if it produces a worthwhile return. Post Office chairman Ron Dearing made that point at the CBI Conference in Glasgow last week. But with a sizeable part of public sector capital spending the worthwhileness of the investment is not easy to measure. The choices to be made are more political than economic. In these cases the economic virtue of productive investment, the belief that a sensible Government should hoard the seed corn rather than spend it, is rather difficult to establish.

Not / support [illegible]

Where we can measure the return the history of past investment decisions in the public sector is far from reassuring. We all know of striking examples: Power stations are built but not used, oil rig facilities constructed which never build oil rigs. In

- and I stress in aggregate -

aggregate the nationalised industries have not earned an adequate rate of return for many years. Given the lamentable outcome of so may plausible investment proposals over the years the Government is right to examine new proposals rigorously and with healthy scepticism.

That scepticism is properly reinforced by the discipline of having to finance the expenditure once decisions are made. Under any government extra capital spending can only be financed in three ways by extra taxation, by savings on current spending, or by higher borrowing.

I need not emphasise how unattractive the first route is to this Government. We are determined to reduce taxes during this Parliament in order to foster the enterprise and initiative in the private sector which is vital to the nation's future.

The second route - cuts in current spending - has more appeal at least in principle. But the Government cannot rest on the principle; it has to look at each programme in detail and decide where economies are to be made. In certain areas we have made great progress for example in reducing the size of the Civil Service to its lowest total since the War. We will certainly keep up the pressure. But don't let us fool ourselves - there are no easy options. Education, health, social security, defence, law and order - just to list the main areas of spending is enough to bring home the difficulties involved in retrenchment. And don't think that these are merely 'political' in a pejorative sense and that a strong government should sweep them aside. It is by no means clear, for example, that spending on hospital building is always a better use of money than spending directly on staff and services. Moreover in many fields higher capital spending brings higher current expenditure in its train.

But, say the protagonists of more public investment, companies borrow to invest, why should not the Government? The answer is that it can and does do so but in deciding how much it must take account of the effects of its borrowing on the private sector. Under a policy designed to prevent a resurgence of inflation, every extra £100m. borrowed by the Government is liable to raise the cost of borrowing for the private sector. And, as I have said, the record is not reassuring that the Government and the nationalised industries are better at picking winners than the private sector. Exactly by how much extra Government borrowing drives up the cost of all borrowing is a matter for ~~discussion~~. debate As I said at the start, I do not propose to discuss this central issue of macroeconomic policy here. I would say only that in the end the Government has to make a judgement on the appropriate level of borrowing. Our judgements on this are clearly set out in the Medium Term Financial Strategy.

I wish to deal finally with another suggestion which will doubtless be made today. Cannot, public sector investment projects compete on equal terms for finance with the private sector, funding their requirements direct from the market outside the PSBR? Ingenious minds have looked at many possible ways of doing this, but I am afraid that no-one has yet solved the fundamental problems. The NEDO Working Party which examined joint financing during the last Parliament identified two important conditions of fair competition with the private sector: Investors should not be offered a greater degree of security than that available on private sector projects. Secondly, such schemes should yield benefits in terms of improved efficiency. and profit from additional investment commensurate with the extra costs of raising risk capital from financial markets. But with the taxpayer standing behind them - whether explicitly or not - it is difficult to see how the Government or the nationalised industries can borrow on level terms with the private sector. What we do not want to see is bureaucratic investment decisions funded at the expense of market investment decisions. Nor, on the other hand, do we want public investment financed unnecessarily expensively.

By far the best solution is to transfer so far as possible these investment decisions from public sector to private sector by privatising the industries concerned. Capital spending decisions can then be taken under the same disciplines as the private sector where there are penalties for failure and rewards for success. This, I suspect, is not the solution which many of those urging the virtues of higher public sector investment envisage. It is, however, the solution, where it can be applied, which will produce the most efficient allocation of resources for investment in the economy as a whole and will do this at the lowest level of interest rates consistent with the Government's objectives for inflation. For one thing is clear: this Government will not finance an investment programme at the expense of its policies for sound money.